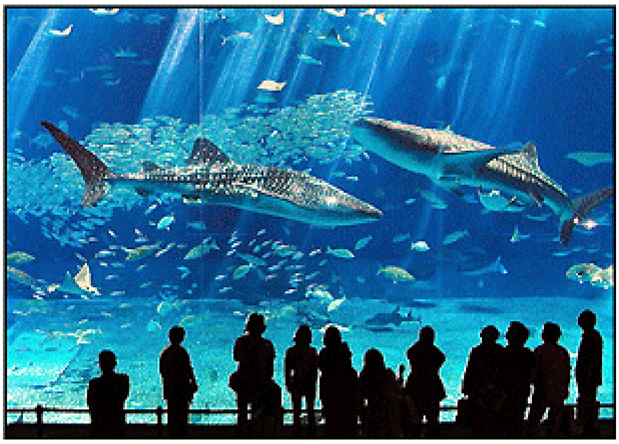

HEDGE FUNDS :

NEW LBO PLAYERS ?

The emergence of hedge funds in the European Leverage Buy Out market

Conservatoire National des Arts et Métiers

Master Stratégie & Expertise Financière

2004-2006

Responsable mémoire : Mathieu Antonini

Dealing with this subject was very interesting and quite complex as hedge funds world is still private and secret and the information about these "cash animals" very hard to find.

Our work has consisted in:

(1) studying general information about hedge funds and private equity through internet, newspapers, databases

(2) conducting a survey among syndication & sales teams of European Banks

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- Julia Hunt, European Loan Syndicate, Loan Markets, The Royal Bank of Scotland London
- Sucheet C. Gupte, Standard & Poor's Leveraged Commentary & Data

Contact list:

Christophe Cerisier, Calyon Hong Kong - Philippe Lefelle, Natexis Banques Populaires - Tim Reason, CFO Europe - Janet Kersnar, CFO Europe – Prudential - Liesl Fields, Bain & Cie - Sarah Bowles, Simmons & Simmons - Antony Bryceson, Simmons & Simmons – M. Abibi, Amaranth - Monique Suter, Alpstar - Jan Lernout, Cheyne Capital - Bruce Ivory, Citadel Group - Noel Amenc, Edhec - Gary Charalambides, Hedge Fund Intelligence - Amina.Hamman, Hedge Fund Intelligence – Hedgeworld - N Motelay, Oaktree Capital - Ryan Kuhn , Kuhn Capital - Reservoir Capital - Tammy Harris, Brevanhoward - Canyon Partners - Myriam Frileux-Gaussier, BNP Paribas - Rémi Tawalama, Bossard Group AM - Simon Richards, Rab Capital - Man Financial - S. Smith, M. Cutler, Covington & Burling - Paul Watkins, The Royal Bank of Scotland London - Axel WEYTENS, Natexis Asset Square/Alternative Investments - Vijay Rajguru, Barclays Capital – JP Morgan

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Dealing with this subject was very interesting and quite complex as hedge funds world is still private and secret and the information about these “cash animals” very hard to find.
This topic is one of the burning issues of the LBO market and has met therefore a lot of interest and enthusiasm among many of the professionals we’ve had the chance to meet.

Our work has consisted in:

(1) studying general information about hedge funds and private equity through internet, newspapers, databases
(2) conducting a survey among syndication & sales teams of European Banks

AUTHORS

- Florence DELBOR

31 years’ old, Manager Middle Office on LBO deals, The Royal Bank of Scotland Paris branch

Florence has been working for 2 ½ years at RBS. She previously worked at the Corporate& Investment Bank of Calyon (ex Crédit Lyonnais) for 5 years, in Correspondent Banking and Aircraft Financing Business Support.
She has a master degree in foreign languages, International trade& export at the Lille Private University.

Contact :
Email: flodelbor@yahoo.fr
Phone: 33(6) 67 92 45 44

- Marc DAUMAS

30 years’ old, CEO of Solefim, a Public-Private Partnership player.

Marc has been managing the birth and growth to 25M€ of Solefim for 2 years. He previously created PRAGMA f.m., a 2M€ facility management company, and worked a year for L’Oreal Australia.
He is graduated from French engineer high school ENSAM and from European business school ESCP-EAP.

Contact :
Email: marc_daumas@yahoo.fr
Phone: 33(6) 74 51 72 78

1 INTRODUCTION

The LBO European market recently discovered a new player: hedge funds. At first look, it could be understood as a casting error. But then, the increase of their presence in different deals, at different stages made the first thought wrong.

Who are the funds playing in the LBO market?
Can we draw a profile on these funds?
Of the deals they're in?
Why are they here?
Simply opportunistically?
2005 bad results?
Do they have a long term strategy?
How are they investing: senior, mezzanine, equity?
Do they have competitive advantages: leverage, mandates …?
Where are they going?
What are they bringing to the market?

Are some of the questions quickly coming to minds, and this study aims at answering them.

2 HEDGE FUNDS

2.1 HISTORIC

A quite recent industry...

In 1949, Alfred Winslow Jones creates the first hedge fund. It is a long/short US fund which principle is based on creating profit from bullish and bearish market. In the 80's, the hedge fund industry grows very fast and new strategies are developed. It is also the gold age of big funds like Quantum and Tiger, which will make that type of investment famous.

… part of the following industry

ALTERNATIVE INVESTMENT TOOLS

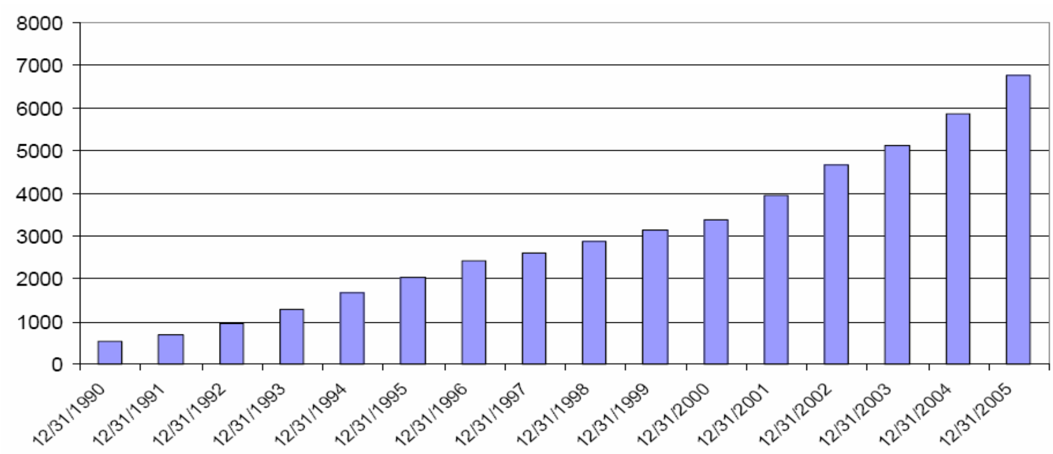
1. PRIVATE EQUITY
- LEVERAGE BUY OUTS
- VENTURE CAPITAL
- DISTRESSED DEBT
- MEZZANINE DEBT

2. HEDGE FUNDS
- DISTRESSED DEBT
- EQUITY LONG/SHORT
- EQUITY MARKET NEUTRAL
- EVENT DRIVEN
- FIXED INCOME ARBITRAGE
- MACRO
- MBS ARBITRAGE
- RISK ARBITRAGE

3. COMMODITY FUNDS
- DIRECT INVESTMENT
- MANAGED FUTURES
- INDEX-LINKED
- CTA

4. OTHERS
- PHYSICAL ASSETS
- ASSET-BACK SECURITIES
- INSURANCE-LINKED SECURITIES
- ARTS

Numbers of Hedge Funds 1990 – 2005 in the world



2.2 DEFINITION

Hedge funds have been a frequent press topic the last decade and have often been misunderstood. Hedge funds' definitions became numerous.

"High risk / high return, unlinked to the market, mainly institutional investors"

Definitions

Private investment association using a large spread of financial techniques as arbitrage, leverage, long/short, derivatives…The management has a large liberty of using the strategy he wants and is highly interested in the result he is delivering. **These funds are speculative and have high risk / high return profile.**
Hedge funds are often registered in tax haven for tax reasons and ease of fund raising, are lightly regulated and their lack of transparency is often criticized.

In the US, according to Hedge Fund Association (august 2006):
"Today, 'Hedge Fund' applies less to the hedging process and more to how hedge funds are structured and managed for the various types of strategies the use. Hedge funds are a private investment pool formed under a limited partnership agreement. The investors are 'limited' partners; they do not participate in the fund's operations, and **their liability is limited to the amount of capital invested.** The fund manager is the 'general' partner, who is responsible for operating the fund and is liable for any potential misconduct under Federal Securities Laws.
Unlike mutual funds, not everyone is eligible to invest in a hedge fund. For an individual to be an 'accredited investor', they must have a minimum of one million dollars of liquid net worth. Institutions (pensions funds, endowments, investment banks) can also invest in hedge funds as 'qualified purchasers' if they have at least five million dollars in assets. Hedge funds have a minimum investment amount which is usually 250'000 $.
Hedge funds also have an incentive to outperform traditional investments. As part of their compensation, **hedge funds charge a performance fee**, commonly 20% of profits.
One of the biggest misconceptions about hedge funds is that **they must take excessive risks in order to gain higher returns**. The best hedge funds are specialists at minimizing risk and make it an integral part of their investment plan."

Alternative investment strategies are so named because they allow the investment manager or advisor to seek to **achieve a given investment objective via any of a number of routes**. Those strategies - and the structure of the investment vehicle itself - encompass an exceptionally broad spectrum of possibilities.

A "hedge fund", as that term is typically used, is not necessarily a hedge fund - it does not need to balance the potential upside gain against downside protection by simultaneous taking long and short positions. **A hedge fund can operate with a long investment bias, a short investment bias, or a variable or fixed**

neutral stance in respect of either the specific portfolio assets, the market in general, or the denomination of portfolio assets relative to the currency denomination of the fund's shares.

A hedge fund could be an incorporated business entity, a limited partnership, a managed account or a private pool. **It could be organized in any of a number of jurisdictions** - indeed, it could effectively be organized in several jurisdictions simultaneously by employing a master/feeder cascading structure with a common investment portfolio.

Investors

The minimum entrance ticket is often high so their access is limited to institutional and high net worth individuals. Originally dedicated to fortunate people looking for better performance than the market, **the hedge funds' investors are today a majority of institutional**.

Strategy

Their performances are not linked to the market and are qualified as "**alternative investments**".
Looking for absolute performance : hedge funds don't follow the market. **They invest in high risk products and deliver performance** unrelated to the market's performance. They often use leverage to realise their performance.

Investments could range from a set of public or private equity or debt placements (which could include other "hedge fund" entities), contracts on various types of financial or physical commodities, or buy or sell options on any of them.

2.3 INVESTMENT STRATEGIES

Hedge funds are using many different technical strategies. Some of them are described here in order to understand their way of investing. Flipping through these different strategies, we will confront them with the LBO world.

- **Relative value:** arbitrage's long and short positions on similar assets. For example, this strategy uses the undervaluation of Peugeot in the automotive industry.
  vs LBO: unrelated
- **CTA commodity trading advisors:** the managers are using technical analysis of market's trends and bet on market's future.
  vs LBO: unrelated
- **Managed futures:** strategy using the market of futures.
  vs LBO: unrelated

- **Event Driven:** managers are looking for events in the enterprise's life able to modify the valuation.
  vs LBO: related. This LBO is an event in itself, and is even happening of public company now.
- **Distressed securities:** arbitrage on enterprise with difficulties. A type of event driven strategies.
  vs LBO: could be related. If companies under LBO's structure are having some difficulties, hedge funds may be interested in buying some participation at a lower cost because they expect a return.
- **Global macro**: anticipation of market's directions (stocks, bonds, money, commodities, derivatives)
  vs LBO: unrelated
- **Convertible arbitrage**: buying the convertible bond of a firm while selling the stock.
  vs LBO: unrelated
- **Risk or Merger arbitrage**: in case of M&A, arbitrage between the market's price and the buyer's price.
  vs LBO: related. The LBO is an event in itself, and is even happening on public companies now.
- **Fixed-income arbitrage:** arbitrage on bonds' markets, playing with yield curve's movements and relative's movements of government bonds.
  vs LBO: unrelated
- **Long/short equity:** associating buying and selling positions in order to reveal some under- or over-evaluation on specific criteria (geographic, sector…). Some managers can have long-only, short-only or market neutral strategies.
  vs LBO: unrelated
- **Multitstrategy**
  vs LBO: related

2.4 HEDGE FUNDS RECENT BUT FAST DEVELOPMENT IN EUROPE

**"The number of European hedge funds launched
in the first half of the year 2006 grew of 15%
from the corresponding period a year earlier"**

Some 172 new funds collectively raised $11.4 billion, compared with 150 funds raising $13 billion in the first six months of 2005. Last year's assets were boosted by five new hedge funds that started with $1 billion (or more).

The most popular type of fund continued to be those that take long and short positions in European stocks, with 41 of these funds attracting $2.28 billion in assets. Last year, 36 European long/short equity funds raised $2.66 billion.

Next in number is **global equity**, with 32 funds launching with $1.6 billion in all, compared with 24 global equity funds started in the first half of 2005 with $575 million.
Meanwhile, **credit hedge funds fell out of favour**, with just 7 funds raising $358 million. In the first half of 2005, 13 credit funds launched with $1.2 billion in collective assets. **Many credit hedge funds suffered losses and investor redemptions last year after May ratings downgrades at U.S. automakers caused a rise in corporate bond yields**.

Nick Evans, editor of EuroHedge, said

"**The record pace of new fund launches**
demonstrates growing demand from all types of investors
for alternative investments and the success of
established hedge fund managers
in expanding their businesses"

Assets under management (AUM) in a tracked group of more than 1,800 European hedge funds are expected to jump better than 25% to around $390 billion by the end of 2006, compared with just over $300 billion at the beginning of the year, according to new research from the European hedge funds database Eurekahedge.

The growth in Assets, according to the report by hedge fund analyst Rajeev Baddepudi, is accompanied by a **proliferation of smaller funds** at the lower end of the asset size spectrum. Funds between $20 million and $200 million now account for almost half of all funds, up from 38% a year earlier.

In a comparison of funds launched between 1995 and 2005, Eurekahedge found that **funds in operation five years or more had outperformed their more recent peers, even though the latter had turned in an average of 20% annual returns**. The research also shows that data since 2003 indicates a clear trend of diminishing marginal returns for funds with $1 billion or above.

"There is an implicit cap on a fund's size in order to ensure optimal returns,
and every additional million that a $1 billion fund increases its AUM
by only pulls down its average returns," *Mr. Baddepudi wrote*.

What's more, the $1 billion-plus funds also exhibited greater volatility.

Over the past nine years, **European funds were outperformed by their North American and emerging market counterparts, such as those in India.** However, European funds were the more stable performers, with more consistent returns than even funds of funds in those markets. The data also showed that hedge funds allocating to the developed markets proved much more resilient to tough markets than their emerging market peers.

Broken down by strategy, **long/short equity is far and away the leader in Europe**. But its relative share is slipping as long/short accounts for 47% of the number of funds, but only 38% of assets. More esoteric strategies are gaining in assets.

**"Event-driven may only account for 4% of the number of funds,
but it holds 10% of total assets"**

Other funds with relatively high average fund size are arbitrage, macro and multi-strategy funds.
For fund managers setting up shop in Europe, the United Kingdom, where funds are primarily based in London, has a 77% share, which Mr. Baddepudi says is "arguably to do with the talent available in one of the world's biggest financial capitals." **France is a distant second with 6% of fund managers** and Ireland third with 5%, leaving Sweden and Switzerland tied for fourth with 3% of managers. Germany, in comparison, with 1% of fund managers even manages to trail Russia, which has 2%, the report said.

During 1997-2000, funds with shorter lock-ups, ranging from two weeks to three months, turned in the best performance. **Overall, about 84% of European hedge funds have lock-ups of one to three months.**

Mr. Baddepudi said:

**"Current trends, including rising European fund allocations
to emerging markets in central Europe and beyond, are positive"**

He also cited the benign economic outlook in Europe as likely to be supportive of further merger and acquisition activity, so creating new opportunities for hedge funds to exploit.

3 LEVERAGE BUY OUT

3.1 THE PLAYGROUND: PRESENTATION

3.1.1 DEFINITION

A Leverage Buy Out is specific takeover mechanism that consists **in financing the acquisition of a company through debt** in order to exploit a **leverage effect**. A holding company is set up to carry the long-term debt.

A LBO takeover comprises four major stages:

(1) finding an investment fund with the capability of engineering the takeover;
(2) developing a five-year business plan;
(3) leverage calculation and financial engineering;
(4) negotiation with seller and closing of deal.

The LBO principle consists in borrowing as much as possible and investing the minimum capital in the acquisition price. The development of a **Business Plan** is required to define the value and risk of the Target. In order to determine the debt leverage, different parameters are taken into account such as the company **cash flows and EBIT/EBITDA forecasts**. The debt represents about 70% of the purchase price of the company ("the Target"), the 30% left are financed by equity, brought by private equity investors & managers, interested in the new structure.

3.1.2 LBO CLASSICAL STRUCTURE

(1) Capitalisation (debt/equity)

	2000/2002	2002/2004	2005
Equity and quasi equity	35%	30%	27%
Mezzanine debt	15%	15%	15%
Senior debt	50%	55%	58%
Total	100%	100%	100%

(2) Financial Leverage

	2002-2004	2005
Mezzanine Debt	4.5x	5.5x
Senior Debt	3.75x	4.25x

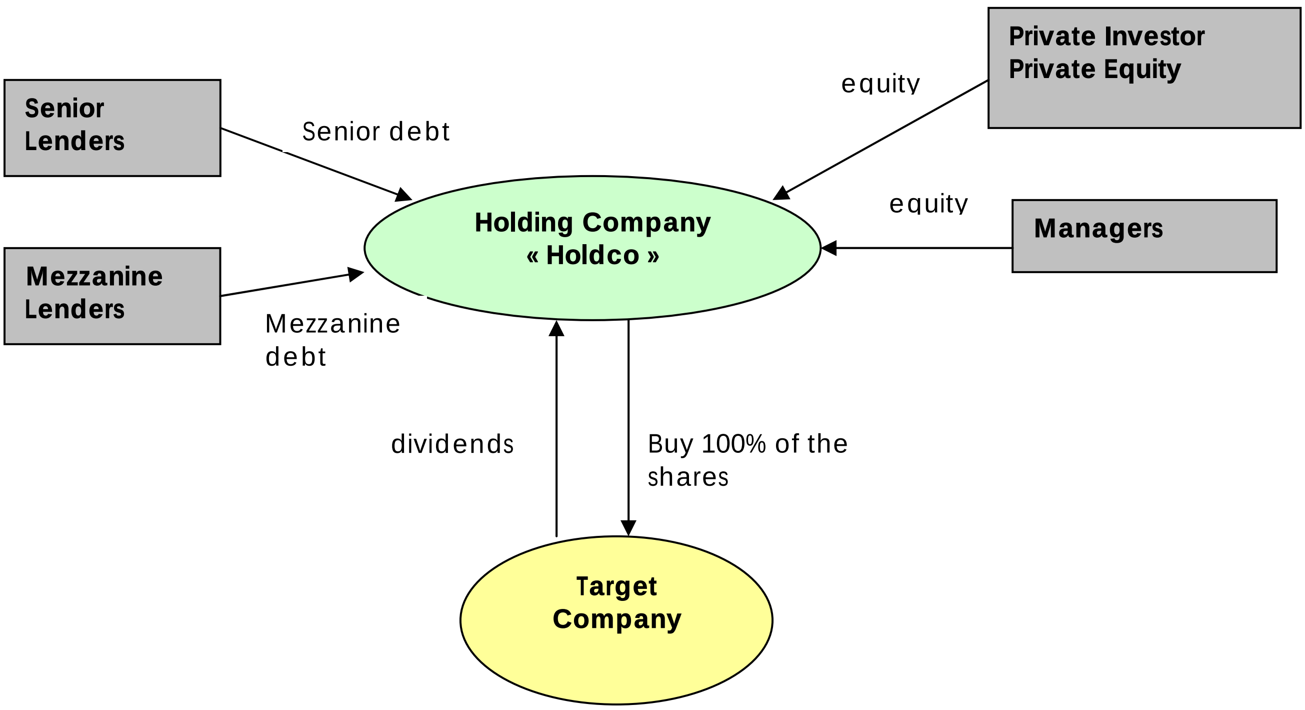
Debt is structured into senior debt and mezzanine debt. Senior debt is the bank debt raised to finance an acquisition through a leverage effect. The senior banker has guarantees on the assets of the takeover holding company. Mezzanine debt is hybrid financing between senior debt and equity. It is repaid after senior debt, but usually offers in return higher revenue.

(3) Classical Debt structure

Tranches	Margin	Maturity	Type of repayment
Senior A	2 - 2.25%	7 years	Amortization
Senior B	3%	8 years	Bullet (in fine)
Senior C	3.25%	9 years	Bullet (in fine)
Revolving	2 – 2.25%	7 years	Revolving : repaid & redrawn
Acquisition/Capex	2.25%	7 years	Amortization
Mezzanine	4% cash + 5% capitalized	10 years	Bullet (in fine)

3.1.3 SCHEME

The holding company “acquisition holding” borrows the debt to pay the purchase price and repay the debt & bank interest by the cash flows generated by the Target and paid to the holding through dividend distribution.



3.1.4 ECONOMIC VALUE ADDED FOR INVESTORS

Three sources:

(1) Banking Debt reduction (Leverage)

(2) EBIT/EBITDA increase, which may come from :

- the organic growth of the turnover
- the margin increase
- the cost decrease
- the external growth operations

(3) Valorisation of the multiple at exit

3.1.5 TARGETS

To be of any interest in a LBO operation, the "target" company shall respect the following criteria:

- To be in a sector having good visibility and few risk of change
- 1st rank in terms of notoriety, product quality & innovation
- Regular cash flows
- Business not having too much capital needs (investment, working capital)
- Acquisition opportunities and identified growth sources
- To offer a reasonable price

3.2 PLAYERS

3.2.1 INVESTORS

Private Equity companies: PE managers request their investors to fund once they found the target/investment

Hedge funds: HF managers are entrusted with the investors' funds and have to find high return investment

3.2.2 SELLERS

Shareholders: could be private individuals (family business for example), private equity funds (in case of 2ndary LBO for example), managers, hedge funds, insurance companies …

3.2.3 MANAGERS

Existing Shareholders - Managers

3.2.4 DEBT LENDERS

Agent Bank mandated to handle the pool

Underwriter: usually a few banks that are sharing the debt before syndication

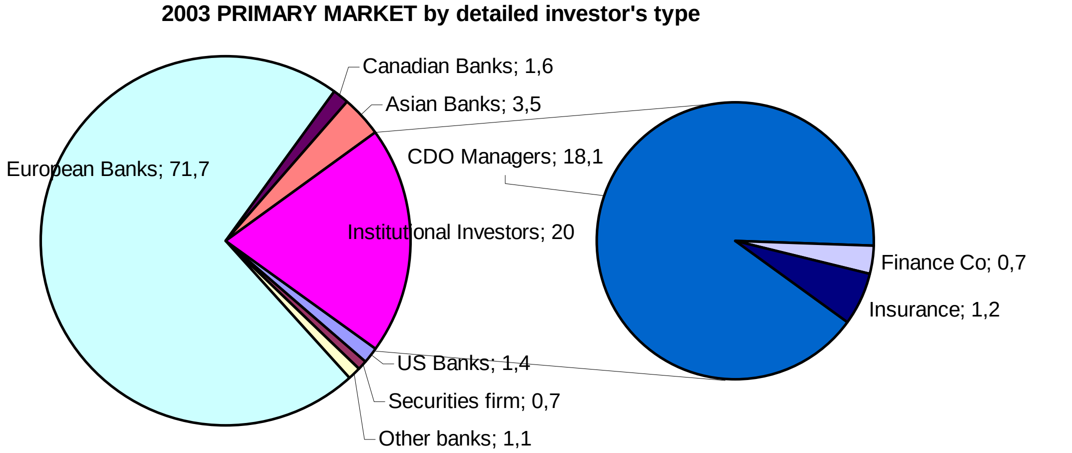
Mandated Lead Arranger mandated to arrange the facility, handle the syndication and sell the debt to the new participants

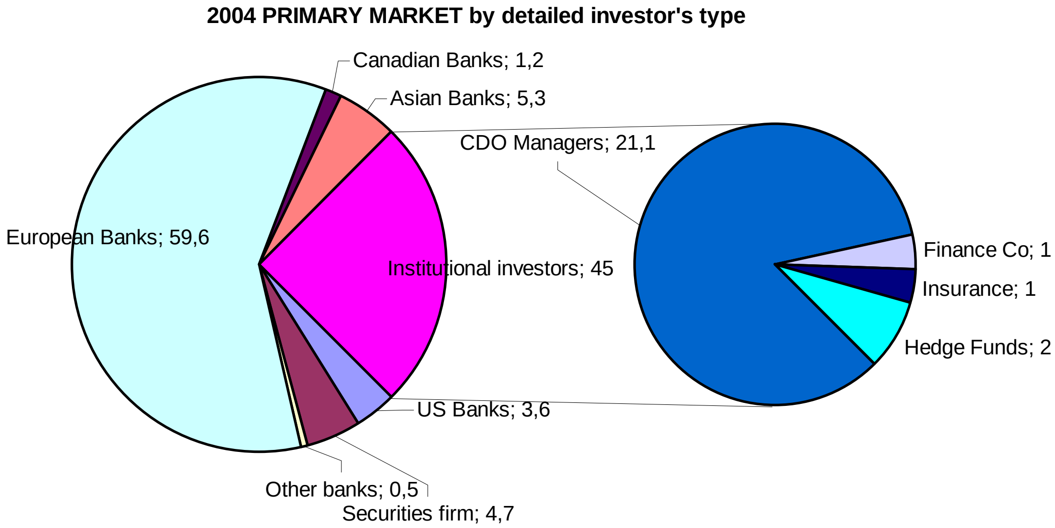
Pool (banks, mezzanine funds, CDOs & hedge funds)

3.2.5 LAWYERS & ADVISORS

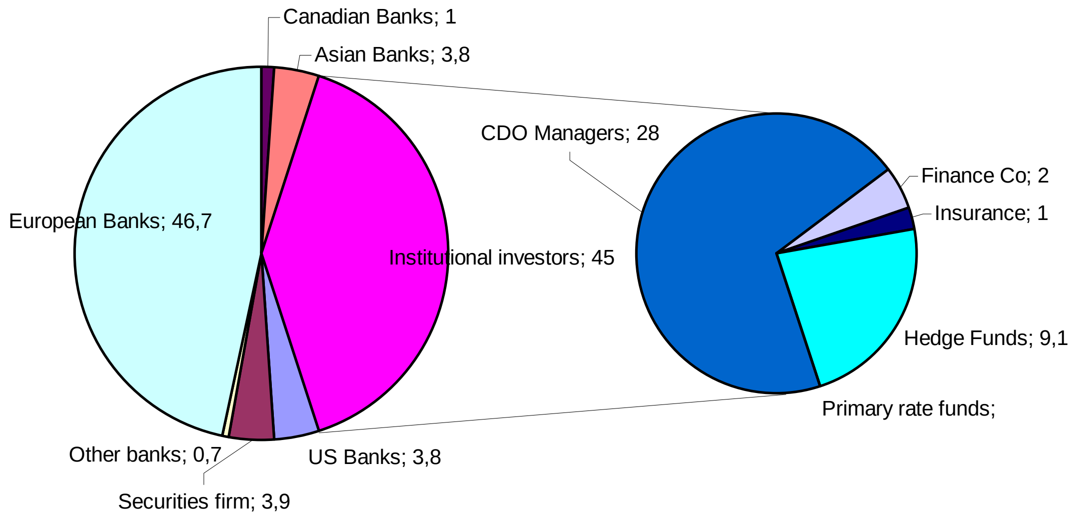
Have a major role as they are working with the different parts during the set-up of the LBO for legal, tax and structure aspects. There are usually different lawyers: the Agent Bank's one, the Buyer's one, the Seller's one, and/or the managers' one. Same lawyer firm could even work for the different parties (with different lawyers within the same firm respecting the "Chinese wall").

3.3 LEVERAGE LOAN MARKET'S EVOLUTION IN EUROPE

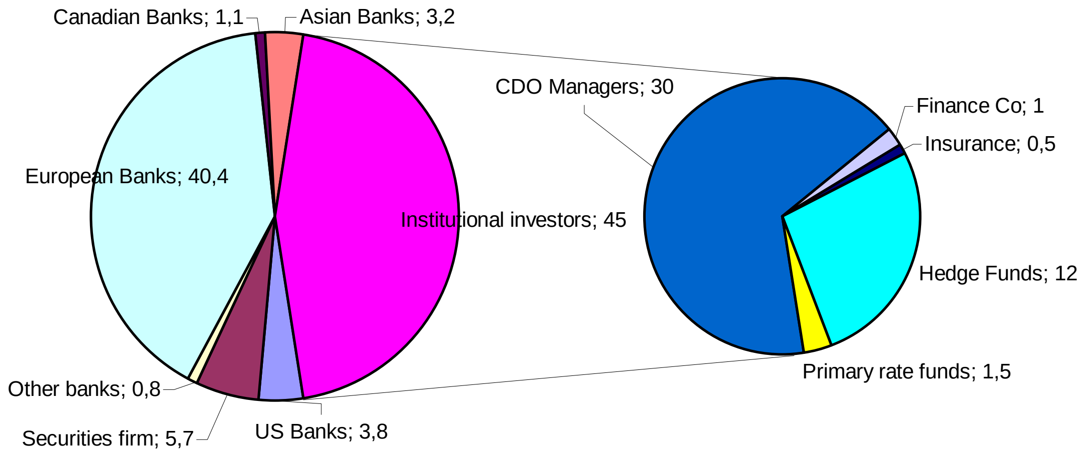




2005 PRIMARY MARKET by detailed investor's type



1st S - 2006 PRIMARY MARKET by detailed investor's type



These charts show how the market has seen **a big evolution in the investors** interested in the leverage loans. As the market grew and the liquidity improved (see next graphic), Hedge Funds took an increasingly share of the market, where institutional investors became the biggest group in the industry.

"The leverage loan market is now diverse, liquid and very active".

France is currently enjoying huge investor liquidity across all assets classes including equity, subordinated debt and senior debt, and attracts therefore a lot of investors.

4 HEDGE FUNDS ON THE PITCH

Hedge funds are increasingly looking to **vary their strategies** not only to capture lucrative new trades, but to **appeal to institutional investors**, according to a report recently released by Greenwich-based research firm Greenwich Associates.
In the United States, the percent of hedge fund managers who classified their firm as single-strategy dropped from 56 percent last year to 48 percent this year. **The number of funds calling themselves multi-strategy jumped from 44 percent to 52 percent**.

4.1 PROFILE

In the US, most of the hedge funds playing in the PE market are multi-strategy. They are often going into private equity. Some hedge funds have two different teams: one for public companies, and another one for private companies. Almost all of the big funds are acting on the PE market, but the smaller ones are also considered as players.

American hedge funds are very interested in EU, considering that the financial markets are now well developed and liquid. They are entering Europe by different ways: opening desks, buying European funds, partnering with European, acting as a fund of fund…

In EU, a few hedge funds are acting on the PE market, but it is growing fast. They're either pure **European players or American desks**. Most of them are **big funds** (means > 1b€ managed).

US hedge funds with EU entrance point	EU hedge funds	Private Equity firms creating their hedge funds
Amaranth Black ant Cerberus Citadel Fore Research High Bridge Och Ziff Paloma Black Diamond Satellite Silverpoint	Blue Bay Brevan Howard Cognis Capital GLG RAB Capital Vega	Wendel Investissement PAI KKR Bain Capital Carlyle Blackstone

4.2 EXAMPLES OF HEDGE FUNDS IN LBOS

4.2.1 US

- Highfields Capital Management (Boston) : 15/02/2005 : buy out equity of Circuit City for 3,2B$
- Cerberus Capital Management (NY) : 1st Q 2005 : buy out equity of MeadWestvaco for 2,3B$
- Edward Lampert via ESL with Kmart: 4th Q 2004 : buy out equity of Sears
- Pay by Touch Solutions : executive vice president & CEO wanted to refinance their balance sheet and raised capital among five hedge funds (75M$ out of 130M$ raised)

4.2.2 EUROPE

- Citadel : Feb 2005 : ticket of 150M€ debt in Rexel
- Fore : Feb 2005 : ticket of 75M€ debt in Rexel
- Och Ziff : 2004&2005 :

  - 1.2B£ auction for Yellow Brick Road

  - equity in the UK football team Manchester United with the family Glazer and two other hedge funds (Citadel & Perry)

  - currently negotiating for public-to-private deal Whitehead Mann: GE commercial finance is providing debt finance for the buyout. The senior employees will own up to 30% of the company and the rest will be owned by Och Ziff.
- Consortium of 6 hedge funds, including Och Ziff, Perry Capital and Citadel, entered talks to take over discount retailer Peacock Group
- Hedge funds sole providers of equity in the reverse takeover of insurer Britannic Life by Resolution Life

In the US in 2004, 23 private equity deals totalling 30BN$ were conducted by hedge funds. In Europe, hedge funds conducting a deal are still very marginal but hedge fund involvement in private equity as a whole is growing.

4.3 REASONS

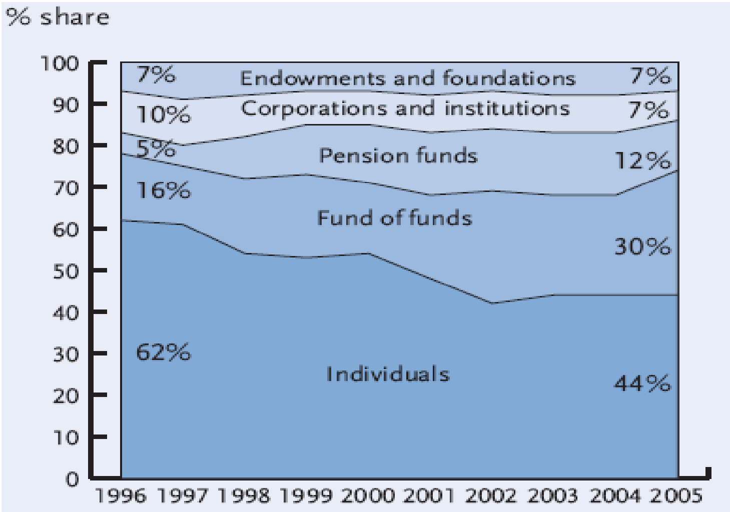
4.3.1 PERFORMANCE OF HEDGE FUNDS AND PRIVATE EQUITY

4.3.1.1 Hedge funds

Dollar, Federal Reserve, oil had negative impact on different assets such as bonds and stocks. American Treasure has published that **hedge funds have sold almost $ 20 billion between January & February 2006**.

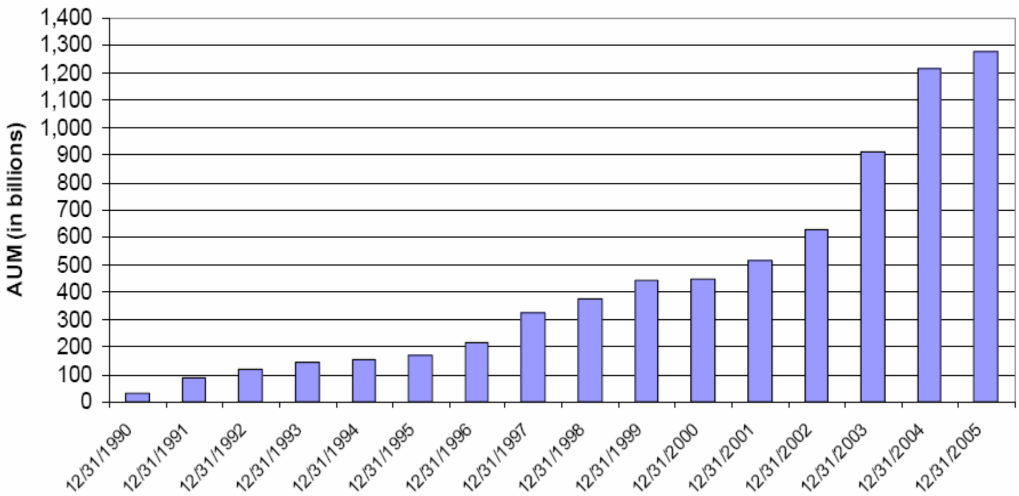
Despite low performance, French financial institutions still rely on alternative funds. A 2005 survey of *Les Echos* shows that **42% of institutional have increased their share of hedge funds in their allocation, mainly banks & insurances companies**. This for multiple reasons: performance seeking, allocation diversification, by taking strategies not linked to the market. Multi strategy hedge funds are the most sought after.

Hedge Fund Sources of Capital 1996 – 2005



While some moderation in profits and questions about the value proposition exist, the industry continues to grow

Hedge Fund Assets Under Management 1990 – 2005(global)



Performance figures North America / Europe (*Eurekahedge* figures)

Performance by Strategy – EurekaHedge **North America**

Strategy	Jul-061	Jun-06	'06 YTD	2005	2004
Arbitrage	0.47%	0.69%	6.55%	2.87%	5.35%
CTA/Managed Futures	-3.22%	-1.01%	2.61%	1.23%	4.97%
Distressed Debt	-0.11%	0.15%	8.24%	11.80%	23.01%
Event Driven	-0.05%	-0.12%	8.76%	7.40%	16.46%
Fixed Income	0.48%	-0.28%	2.99%	4.38%	8.97%
Long/Short Equities	-0.21%	-0.19%	5.34%	7.87%	9.30%
Macro	-1.82%	0.25%	5.32%	13.56%	7.35%
Multi Strategy	0.20%	1.27%	8.58%	5.52%	12.97%
Relative Value	0.30%	0.27%	6.17%	6.04%	11.13%
Eurekahedge North American Hedge Fund Index	-0.42%	-0.06%	5.60%	6.88%	9.87%

Performance by Strategy – EurekaHedge **Europe**

Strategy	Jul-061	Jun-06	'06 YTD	2005	2004
Arbitrage	0.56%	1.40%	3.72%	0.69%	-1.32%
CTA/Managed Futures	0.23%	0.29%	2.50%	0.98%	-6.76%
Distressed Debt	2.30%	-0.89%	7.21%	9.12%	17.26%
Event Driven	0.75%	0.25%	8.60%	9.81%	7.97%
Fixed Income	1.36%	0.26%	1.90%	4.62%	9.17%
Long/Short Equities	-0.19%	-0.73%	5.56%	14.46%	10.06%
Multi Strategy	-0.18%	-0.37%	8.25%	15.21%	13.12%
Relative Value	1.57%	-0.23%	7.55%	9.81%	5.76%
Eurekahedge European Hedge Fund Index	0.27%	-0.53%	5.75%	12.77%	8.71%

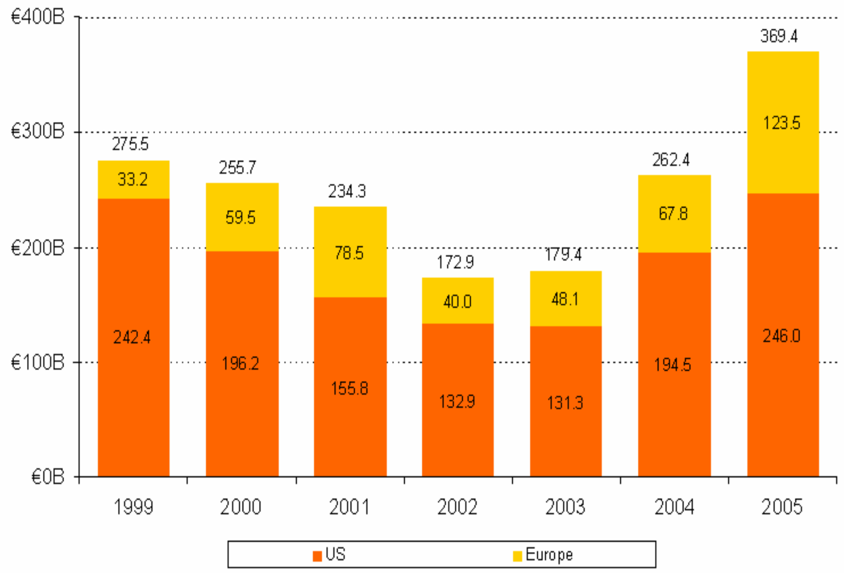
Source: Eurekahedge

Figures show that 2005 was a very bad year for American funds, this could explain the reasons of their interest for European market, which is in a far better position.

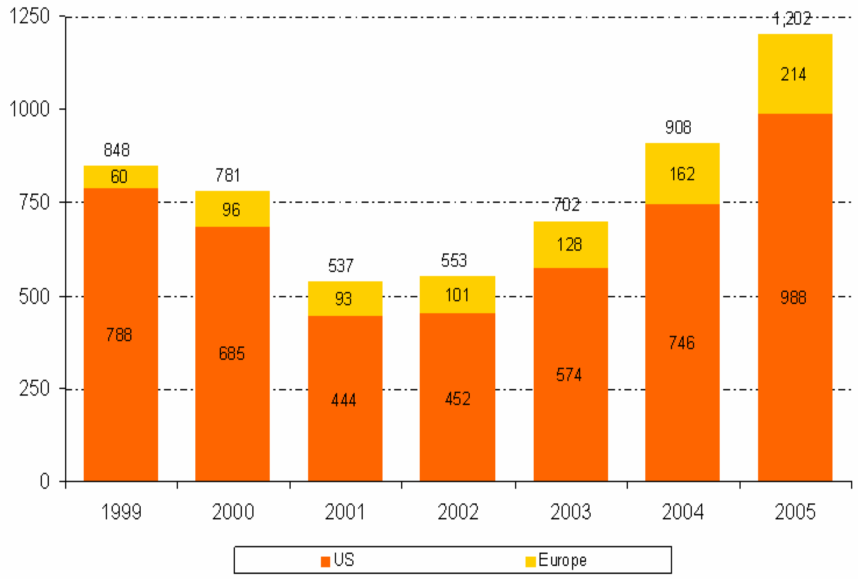
4.3.1.2 Private Equity

The US market remains very important with 988 loans in 2005 against 214 for Europe. Nevertheless, Europe operations have tripled in value between 2003 and 2005.

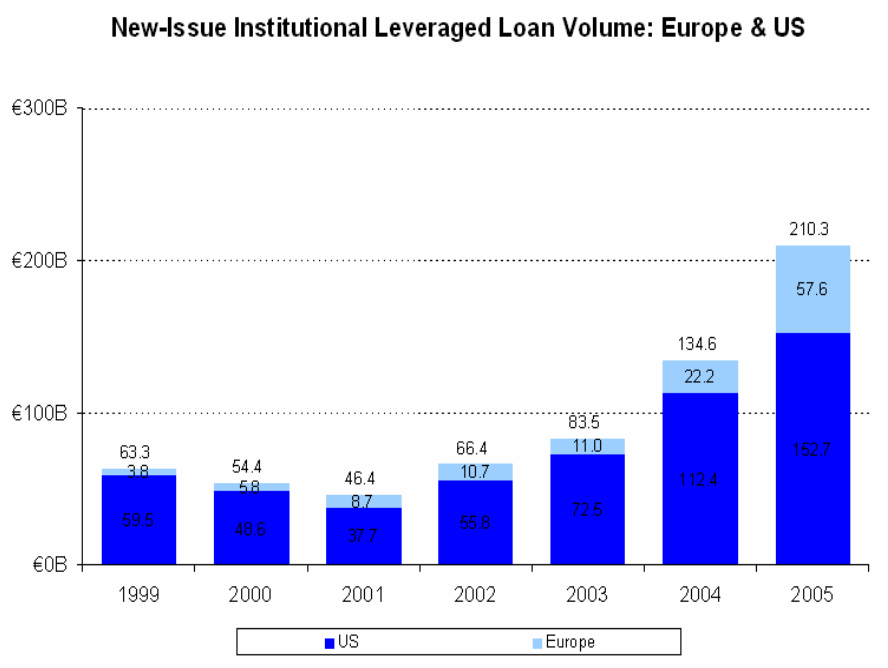
New-Issue Leveraged Loan Volume: Europe & US



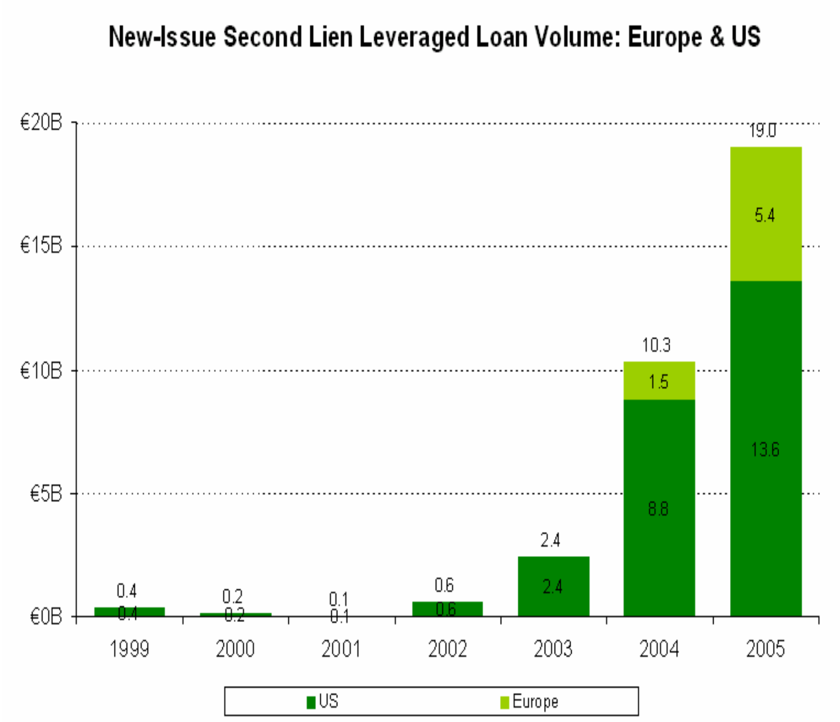
New-Issue Leveraged Loan Count: Europe & US



The institutional share now represents 45% of European loan market, while their share in the US represents over 62% of the market. They are the biggest investors on the global market.



Debt structure becomes more and more sophisticated with new products appearing

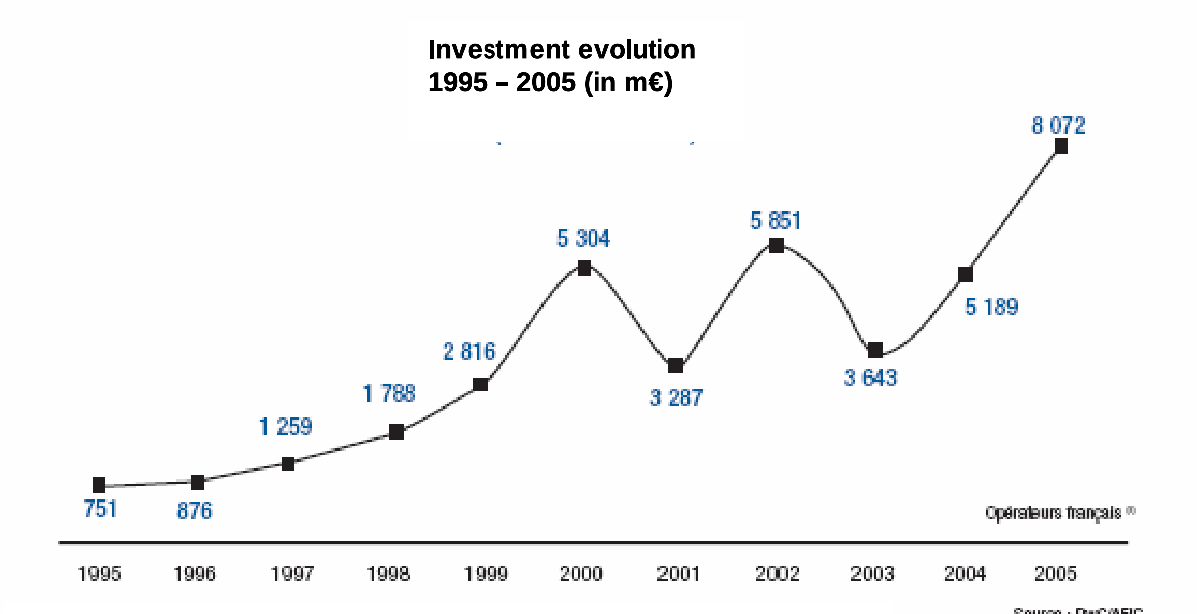


"Leveraged loan market's boom
The boost in leverage loan market has two main causes:
the big increase in private equity and the big development of M&A's"

This boom made the market highly attractive for all the lenders: by the volume needed first and of course by the performance delivered. Hedge funds are part of the game. Actually, S&P hedge fund index returned 2,4% in 2005, while senior and second-lien are delivering 8 to 10% and mezzanine 12 to 15%.

4.3.1.3 Private Equity in France

"Law default rates on leveraged loans mean that more and more investors see leveraged finance as an attractive business. Ultra low default rate and stability still delivering high yields »

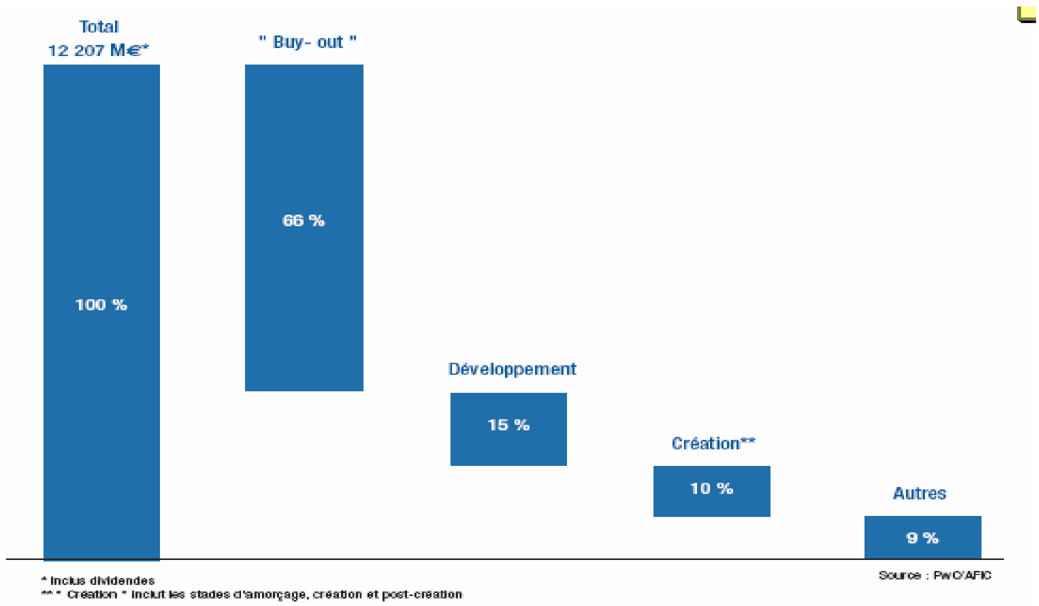


Operations in France and abroad by French Private Equity firms

French Private Equity has been strongly developed since 1995, with an **annual growth of 27% for 10 years.**

"2005 has registered a 56% growth versus 2004, thanks to the LBO operations growth"

Share of LBO operations has increased and reached 78% of the investments in 2005, which represents € 6,3 billion (€ 3,7 billion in 2004).



Development Capital has increased (in value) of 37% between 2004 & 2005. Investment represents € 954 billion in 2005 versus € 695 billion in 2004. This segment is the most important with 425 firms financed and 730 investments realised.

Investments in venture capital reach € 481 billion in 2005 against € 396 billion in 2004.

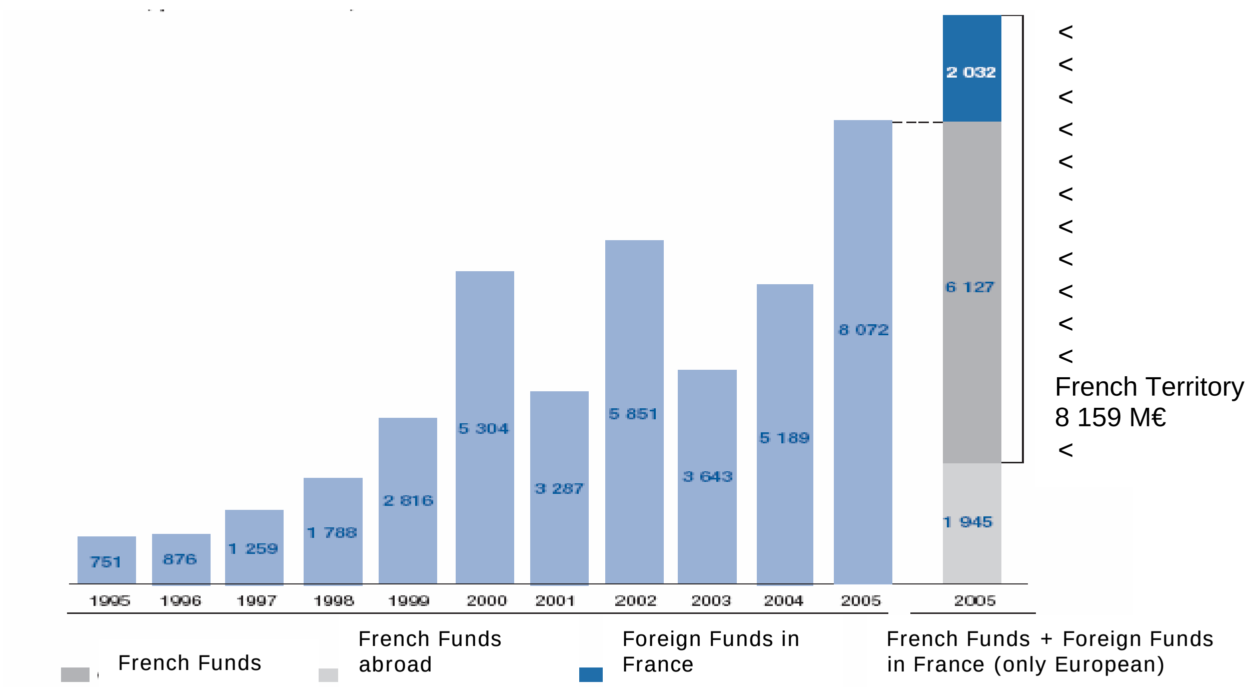
"Small and middle French Capitalisations below 500 employees have represented 88% of private equity operations and 47% of capital brought in 2005"

Investments in IT and industry are the highest, respectively 24% and 18% of the total investment of the year.

The 2005 year has registered a record of investment with 12 € billion versus € 2,2 billion in 2004.

"Banks, Pension Funds and Insurance companies are the most important funds providers, with respectively 24, 22 and 18% of allocated funds"

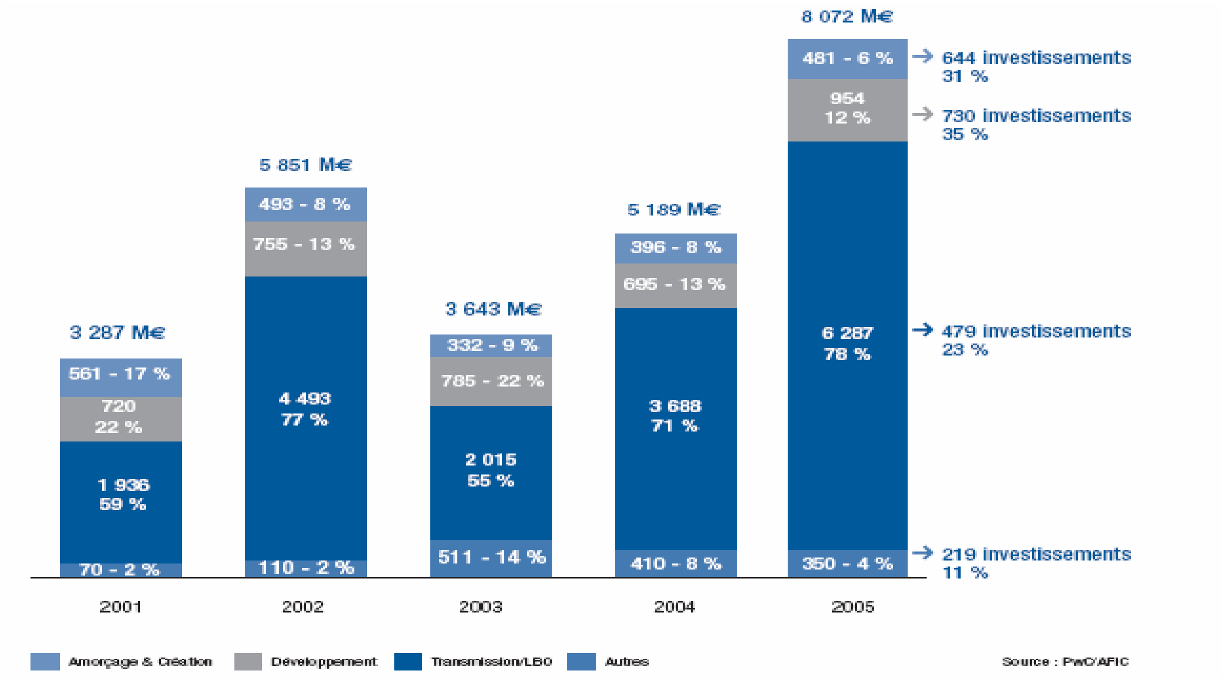
Investors that have been interviewed have a **preference for LBO operations which represent 66% of investment intentions against 45% in 2004**. Nevertheless, they intent to invest € 1,2 billion to Venture Capital (against € 365 millions in 2004) and € 1,8 billion to their development (against € 771 millions in 2004).



"France has confirmed its major position in Europe,
being in 2nd rank just behind Great Britain
and at the first rank in Continental Europe"

The French activity is at the highest level for the decade and reaches € 8,1 billion invested in France and foreign countries in 2005.

Private Equity growth in 2005 has been significant thanks to LBOs operations.



"LBO operations have increased of 70% with € 6,3 billion,
78% of investment in 2005 against 71% in 2004"

Average ticket investment for LBOs has increased from € 6,6 millions in 2001 to € 13,1 millions in 2005, which represents an average growth of 18,7% per year, while average tickets in development have increased by 9,6% and the ones for venture capital have been stable on the same period.

The average ticket for LBOs has increased by 53% between 2004 & 2005 (€ 19,7 millions in 2005 compared to € 12,9 millions in 2004) while average tickets for venture capital and development have increased by 44% and 37% on the period.

Investment distribution by type

Investment type	2003	%	2004	%	2005	%
Equity	2 653 851	72,86%	4 168 947	80,34%	5 784 056	71,65%
Quasi equity	676 062	18,56%	750 500	14,46%	1 733 551	21,48%
Mezzanine	140 600	3,86%	150 553	2,90%	463 474	5,74%
unwarranted debt	134 823	3,70%	84 410	1,63%	81 963	1,02%
warranted debt	37 252	1,02%	34 808	0,67%	9 187	0,11%
Total	3 642 588	100,00%	5 189 218	100,00%	8 072 231	100,00%

Historic investment figures (in € million)

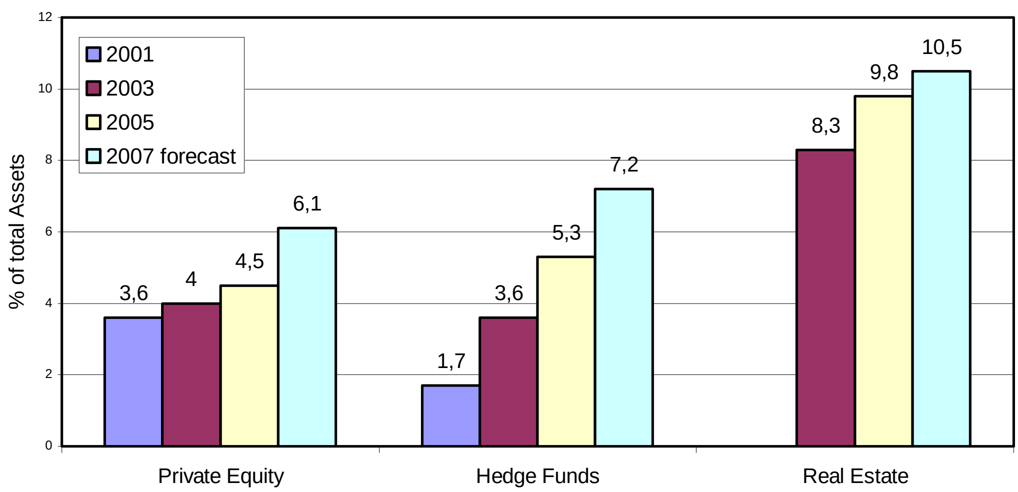
Development stages	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Seed stage	2	2	1	3	52	70	30	50	25	31	45
Venture Cap	80	148	166	257	467	1085	531	443	307	365	436
Development	258	358	382	587	1071	1884	720	755	785	695	954
Transmission/Succession	253	257	613	821	1073	2020	1936	4493	2015	3688	6287
Minority position buyout	158	111	96	120	153	245	70	110	375	166	273
Others	0	0	0	0	0	0	0	0	136	244	77
Total	**751**	**876**	**1258**	**1788**	**2816**	**5304**	**3287**	**5851**	**3643**	**5189**	**8072**

4.3.2 THE ALTERNATIVE INVESTMENT MARKET'S GROWTH

Starting in the early 80's in North America with real estate and private equity, alternative investment have seen a robust growth all over the world. Developing in the 90's, Hedge funds rapidly became strong players in this growing market.

The Russell's survey shows us that Hedge Funds are the main beneficiaries of this growth, will probably raise more fund and will take a bigger place in the institutional's portfolio.

Allocations to Alternative Investment



source : Russell Survey

4.3.3 SOPHISTICATION

4.3.3.1 A context in favour of more aggressive structures

- Maturation of the French market
- Quality of the assets
- Specialisation & development of LBO teams
- Low interest rates
- Important liquidity
- High competition (between funds, between banks)
- Multiplication of successive LBOs

4.3.3.2 Increase of Debt Leverage

- development of Collateralized Debt Obligations vehicle
- institutional debt tranches
- life length increase of senior tranches
- increase of price targets
- high pressure of strong debt leverage
- mezzanine high pricing nearer hedge funds traditional return requirements, paper more attractive

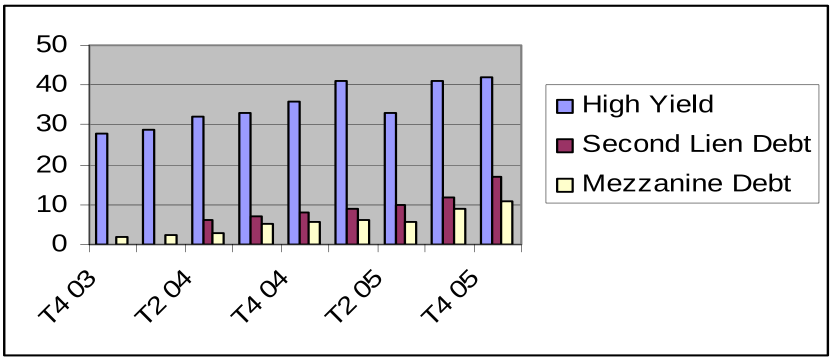
4.3.3.3 Reduction of Equity

- high competition between investor funds which :
- Increase the acquisition multiple
- To maintain an acceptable IRR, obligation to optimise the equity level

4.3.3.4 Development of new products

- D tranche senior (9,5 years maturity).
- Second Secured term “Second Lien” which is an alternative between senior and mezzanine. Second lien term is well remunerated for the bank but with a higher risk. Bullet tranche with a 5% margin. Second Lien prominence in the Europe market continues in 2006, with 36% of all transactions including a 2^{nd} Lien term, up from 25% last year and from only 7% in 2004. The total amount of second lien deals is so far 49% higher than amounts seen during the comparable period in 2005.

- Sophistication of Mezzanine (warranted, Junior PIK, Mezzanine notes...). Mezzanine volume for the 1st half of 2006 has registered an increase of 74% compared to the volume seen in the first half of 2005, and is already higher than 2004's total volume.
- Equity Kickers : unwarranted mezzanine
- High Yield Bonds due to the bonds market liquidity. From the client's point of view, the main advantage is the higher leverage they afford. High Yield issuance have almost doubled in 2006 (1st semester 15bn€ borrowing against 17,2m€ for the whole year 2005) mainly thanks to the LBO market.
- PIK, 2nd lien & notes strongly bought by Hedge Funds
- Increase size of the mezzanine

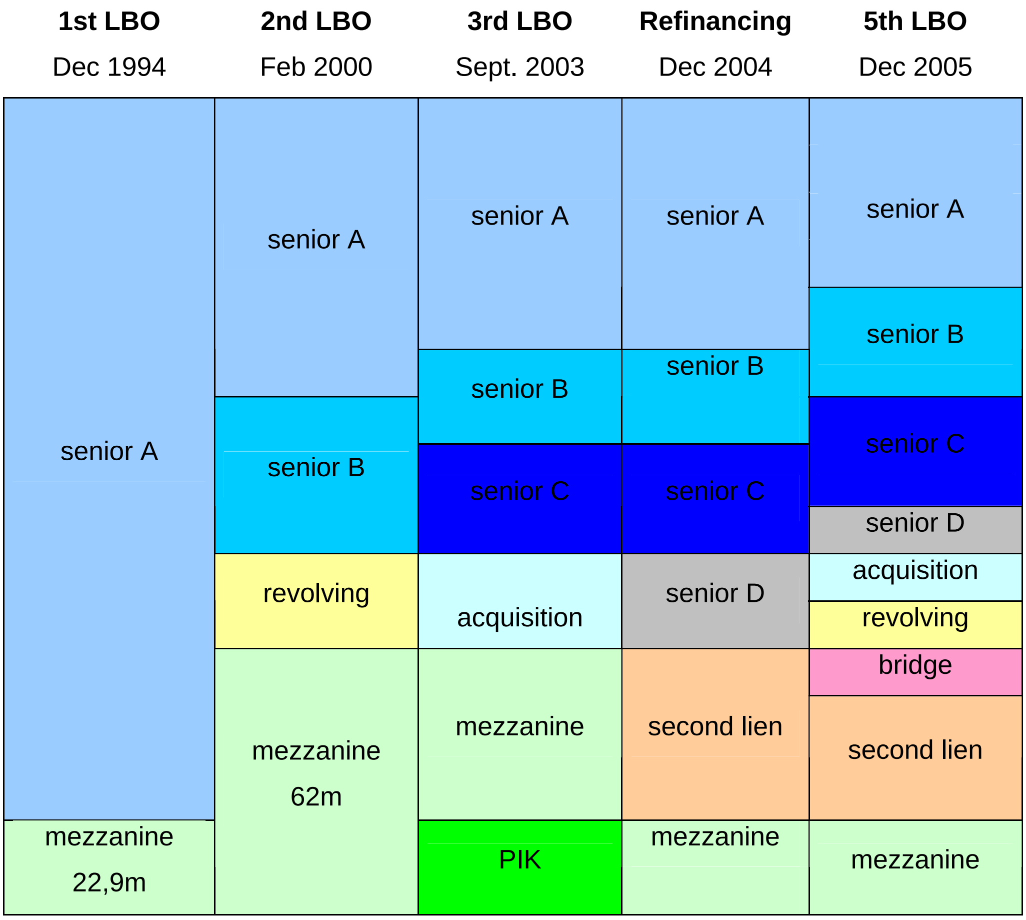


Source : *Les Echos March 2006*

High return at low risk:

Hedge funds invest in all type of debts: senior B and C (8 to 10% return), second-lien (8 to 10%) and mezzanine loans (12 to 15%). Second-lien, a market that did not exist 4 years ago, is typically one of the products developed with and for hedge funds.

Example of *Frans Bonhomme* firm successive LBO structures



1st LBO	2nd LBO	3rd LBO	Refinancing	5th LBO
Acquisition Price	Acquisition Price	Acquisition Price		Acquisition Price
180m€	388m€	525m€		890m€
42% equity	35% equity	24% equity		27% equity
6,5x EBITDA	9x EBITDA	9x EBITDA		9,9x EBITDA

4.3.4 MANDATES

All depends on the mandate of the fund and its agreement with its investors – **some have to turn the portfolio over five times a year, others can hold paper for over three years**.

Traditionally, hedge funds were mandated with strong conditions on liquidity and the funds could be turned-over 5 times a year.

"Today, the turnover can attain 2 years and mandates are a bit less strict on liquidity"

This evolution has been brought by different factors:

- Institutional: the selection process (due diligence) can be very precise and very long (up to 3 months). Once this selection made, institutional bet on medium to long term strategy with the Hedge Fund they invest in…
- increase of the managed funds
- lot of money to invest

With this liquidity and turnover constraint disappearing, hedge funds rules become compatible with LBO's investments.

Actually, LBO's turnover is about 2 years, as the study made by RBS shows:

	Number of Deals	Loan Volume €B	Time Between Months	Time Between Year	Average Total Leverage	Average Senior Leverage
2002	8	3,6	27,5	2,3	3,7	3,3
2003	14	5,1	26,4	2,2	4,0	3,5
2004	28	9,7	20,6	1,7	4,7	3,7
2005	39	26,1	22,2	1,8	5,1	4,3
2006 (1st Sem)	*25*	*10,8*	*27,4*	*2,3*	*5,8*	*5,0*

source: RBS

4.3.5 FRENCH INVESTMENT DEVELOPMENT

ARIA

In France, the recent development of the OPCVM ARIA class (A Règles d'Investissement Allégés) and the OPCVM ARIA EL (à Effet de Levier) and the OPCVM contractuels allowed Hedge Funds to be registered onshore (in France).

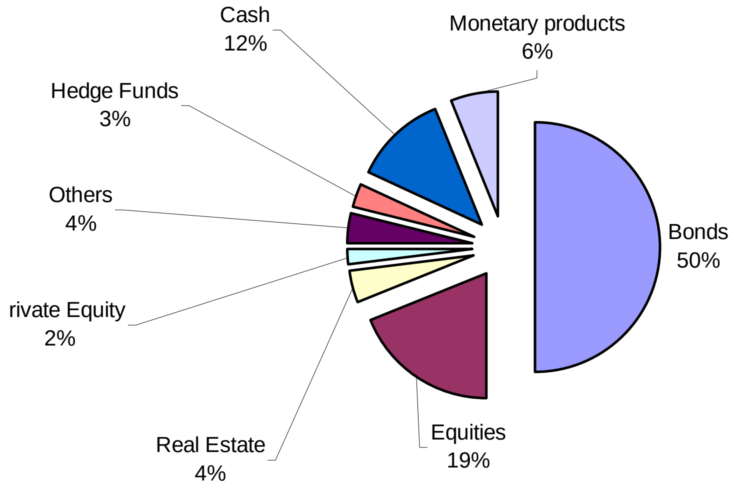
"This new scheme gives good perspectives for French hedge fund development".

The funds raised through these vehicles will be added to the already big amount raised and will push forward hedge fund's development, industrialisation and diversification.

SAVINGS

Due to a strong demographic change, France is facing big problem with its public retirement model. The last decade have seen French governments trying to solve this problem, one of the issue being to offer tax incentives to boost savings. These changes will probably continue and **French institutional will importantly increase their assets.**

French institutional allocation (end of 2003)



French institutional have been affected by 2000 year and the market is looking for more alternative investment, as they are seen as uncorrelated investments able to deliver performance even if the market is down.

4.3.6 INVESTORS

After the e-krach in 2000, when their traditional investments were badly affected, investors began to look at hedge funds differently. Today, they are building their portfolio with hedge funds in order to attain ‘absolute performance’.

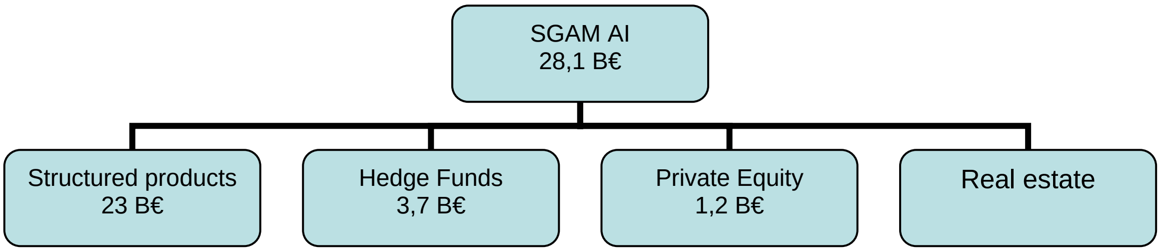
4.3.7 INDUSTRIALISATION

The hedge fund industry has rapidly grown up: **from 116B$ in 1997 to 1200B$ in 2005 managed by more than 8000 funds.**

The time of consolidation has come: boosted by investment flows looking for alternative investment and looking for a more sustainability, **hedge funds are now developing their range of products**. Traditionally, hedge funds have been a specialised team with a strong expertise on a specific subject (for example: long/short equity, arbitrage, derivatives…). They are now looking for more expertise and diversification. **This development allows them to enlarge the range of products offered to their customers, to increase the managed funds and to be less exposed to market’s return.**

This recent development allowed global player in alternative investment to develop. ADI (4B€ managed) is one of them, SGAM AI is another one. In these funds, hedge funds are becoming one of the 'alternative investment' possibilities.

In France, the example of SGAM Alternative Investment is very interesting as they merged 4 alternative investment activities under one entity SGAM AI.



Morgan Stanley is currently developing a team to deliver advises in alternative investments.

4.4 WHAT ARE THEY BRINGING AND DOING

4.4.1 LIQUIDITY

The leveraged loan market is now very liquid for most of the companies, but who build this liquidity?

"It is rather banks and CDOs who made this liquidity but hedge funds are certainly contributing."

Basel II and IFRS impose the banks to identify their assets… In front of their risky assets, banks have to identify a big proportion of equity. These new rules push the risky assets out of banks' portfolios. Therefore, if banks are still weighting 40% of the market, they sell almost all of their risky tickets, including leverage loans, and increase the market's liquidity.

The market attracts a lot of different players and this diversity is also bringing liquidity. CDOs are the biggest institutional players of the industry, weighting 30% of the market, are deep pocketed and are really one of the liquidity animators.

4.4.2 LOWERING THE WACC

Spread tend decrease these past years (please refer to Annexe 5), but hedge funds don't seem to be the ones that make this decrease.

"Big amount of available funds, facing the small number of companies able to be leveraged, is the main factor that makes the spread decrease."

4.5 WHERE ARE THEY GOING ?

4.5.1 SCENARII

Nobody really knows if the hedge funds will stay in the industry or how they will evolve within this industry. We can only imagine different **possible scenarii:**

- Consolidation on this market will continue, alternative investment movement will continue to develop, **hedge funds and private equity funds will merge into alternative investment funds.**

- The **LBO market will burst**. And the **hedge funds will probably stay**: distressed activities are one the strength of hedge funds.

LBO Bubble ?

	2002	2005	
Valuation (EBITDA multiple)	5 x	8.5 x	2005 figures are at a 10 years higher.
Leverage (EBITDA multiple)	3.5 x	5 x	

Source : S&P Leveraged Commentary Data Reports

- The hedge funds will **leave the market**: according to the different interviews we had, this scenario is far from materialisation. If they leave, our guess is that the impact on the market will be more important than anyone think. Not only they are already weighting 12% of primary leverage loan, but they also are bringing liquidity to the market, they ease syndication, they act via CDOs…
  If they leave, it also means that better fields are appearing and their flight could be a warning signal to all the LBO industry.
  We think that if the hedge funds presence is continuing the actual tendency (please refer to chapter 3.3), the LBO leverage loan market will be deeply affected.

4.5.2 USA VERSUS EUROPE HEDGE FUNDS WORLD

Looking at the US market might bring some answers too:

In the US, hedge funds have always played on the PE market. They have always been in equity (considered as ‘activist investors’) and entered loan market 4-5 years ago. They are now deeply rooted in the LBO market, which is one of their playing field. Some of the hedge funds even have two distinctive group of people (one working on the public market, the other one on private’s market).

“In the US, hedge funds have taken quite an aggressive approach and are competing head to head with private equity players. That is raising some eyebrows as some people wonder whether hedge funds know how to run a company. Although sceptics could say the same of private equity houses, there are undeniable

differences in track record, investment philosophy and resources where private equity firms can demonstrate they have created value by actively managing their investments

In Europe, however, hedge funds are taking a more collaborative entry strategy in the private equity arena. They are aiming to participate in consortia working alongside traditional private equity players. They can be very flexible with their mandates and, in large transactions in Europe, hedge funds are currently offering an additional source of capital to complement the debt from the banks and the equity from private equity houses"

Says an investment director of private equity group 3i

In the US, hedge funds are putting pressure on other providers. More than half the private equity professionals interviewed by ACG/Thomson complained about the hedge funds' involvement in their space. With good cause as hedge funds were able to offer a more suitable alternative to private equity in the case of Pay By Touch, elsewhere they are acting as pure private equity houses.

4.5.3 PRIVATE EQUITY AND HEDGE FUNDS CONVERGENCE

	Hedge Fund	*Private Equity*	*Why do they converge ?*
Mandates	. Liquidity offered to investor: monthly/quarterly/annually …	. Invested cash is committed by the investor and called when needed . Non-liquid	>> Fund raised are booming, and liquidity is less a problem for hedge fund investors >> Acceleration in LBO deals gives more and more liquidity to the equity >> the LBO debt market is structuring and the market is OTC now, giving liquidity needed
Investors	. Institutional . High net worth individuals	. Institutional . High net worth individuals	>> Having the same customers, it is easy for one or another to open a new counter
Investments	. Marketable securities	. Private companies	>> Private equity firm tend to look at bigger companies, even if they are public

			>> Market's return is not really good and assets are still in the hedge funds' portfolio
Valuation	. On the market	. Non precisely determined, except at the purchase and the sale	>> Acceleration in LBO's deal, competition and market's structuration help equity valuation >> Structuration of debt OTC market help valuation

4.6 HEDGE FUNDS IN LBOS: PROS AND CONS

4.6.1 PROS

Hedge funds are more flexible than Private Equity; they can put capital to work more quickly with fewer restrictions. They can invest small amounts across a wider cross section of capital structures. Because of their active role as participants in the senior and subordinated debt, IPO and other financial markets, hedge funds have contributed to the enhanced returns private equity firm have been enjoying these past few years. Hedge funds have been big players as lenders in leverage buyout transactions and refinancing, as well as buyers in public market exit.

Companies with healthy balance sheets and good growth prospects are discovering that hedge funds can offer an alternative and perhaps preferable source of financing, be it through private equity type arrangements, private placements, leverage loans, commercial loans or asset-based lending.

"**Not being a long-established company**
with an established cash flow, we knew that
the traditional banks would not provide a loan.
At the same time, we didn't want to use private
equity firms as we didn't want to dilute our share price
and give up control in the company"
said Spanos, executive vice-president of Pay by Touch Solutions

Hedge Funds have a clear competitive advantage over the traditional private equity firms. They have bigger pools of capital, and their return requirements are lower. Hedge funds takes upfront fees and revalue the assets on a continued basis, private equity houses, however, take their fees out on exit.

Also on procedure aspects, hedge funds are more flexible than private equity houses. They enjoy a lack of restrictions over traditional private equity investors. An Och Ziff manager says "**some private equity firms**

need a board seat, all Och Ziff requires is a one-page legal document declaring that it has the same rights as all the other large capital providers."

One of the main advantage of hedge funds is that they are able to turn out things very quickly in the private equity market. They can make decisions faster than traditional finance companies.

4.6.2 CONS

Private equity funds have traditionally been pretty good in supporting management to implement strategic growth, and it is still unknown whether hedge funds can replicate this. If they want to win deal flow, they will have to show they can work with the management team over a long period.

Private Equity firms are quite unhappy to let hedge funds buy their debt. Hedge funds reputation as short term investors and their likely behaviour during the crucial time before a company gets into serious trouble when financial covenants need to be loosened and flexibility is required that is causing problem. Hedge funds are not like bank, they won't work with the company when it is getting into trouble, they sell out at the 1st sign of trouble. Sponsors like to deal with familiar faces they know they can rely on if there is a problem. Sponsors usually say that they don't want them buying the debt because they could be a nightmare in a recap or default situation.

For waivers: 100% consent of the syndicate required. If the company is performing, banks and CDOs are usually happy to give it, in return for a nominal fee and future business from the sponsor. On several occasions in 2005, hedge fund have reported to have demanded huge fees from sponsors for approving a recap. They are less relationship driven.

5 FORECAST – CONCLUSION

Huge increase, liquidity, sophistication, high leverage and new investors have dramatically changed the LBO world over the past few years. The recent development of secondary market is reflecting this evolution by bringing a huge investor turnover. The return on LBO investment is profitable for any kind of investor: EBITDA multiple increase for equity buyers and emergence of high yield tranche for debt buyers.

These changes have made the hedge funds interest possible.

The number of hedge funds acting as debt investor in the LBO market is quite difficult to evaluate since they may act through different structures such as CLOs or CDOs. However, names of some of them are often mentioned and are now rooted in the leverage loans as well as the other investors. They appear to be a relative small part of the loan market so far, but taking into account their secondary activity and most important their appetite for mezzanine and pik, they make up a useful, perhaps vital, tier of investors in today's market.

Some European deals have been recently driven by hedge funds, following the American market, and we could expect that this trend will expand in the future. Another trend is the development of alternative investment structures issued from private equity and hedge fund merger, which shows the appetite of institutional investors for that market. We may wonder whether the limit between private equity and hedge fund will vanish one day, and if their activities will converge as well as their customers : one of the Carlyle group founder thinks that in 10 years private and speculative funds will be managed by the same investors.

LIST OF ANNEXES

ANNEXE 1: INTERVIEW SYNTHESIS

HEDGE FUNDS:
NEW LBO PLAYERS?

INTERVIEW's GUIDE

SYNTHESIS

INTRODUCTION

This study aims at understanding:

Who are the funds playing in the LBO market?
Can we draw a profile on these funds?
Of the deals they're in?

Why and How are they here?
Simply opportunistically?
2005 bad results?
Do they have a long term strategy?
How are they investing: senior, mezzanine, equity?
Do they have competitive advantages: leverage, mandates …?

Where are they going?

What are they bringing to the market?

Having direct information from the hedge funds is almost impossible. We interviewed different persons working with or beside them in order to collect up to date information.
Collecting this indirect information we had to:
ensure coherence ;
ensure comparability ;
make it usefull and meaning full
make it objective.
To match these goals, we prepared an interview guide in order to drive the different discussions we had on the same tracks.

This document is a synthesis of all the interviews we had and reflects the current knowledge and feeling of the LBO market.

WHO ARE THE HEDGE FUND PLAYING IN THE LBO MARKET

We try to draw a profile (if there is one) of the hedge funds currently playing in the market.
What is your opinion on the Hedge Funds playing in the European LBO industry ?
Could you draw a profile of these funds ?

Ideas:
Origins: Americans ?
Strategy: Multistrategies ?
Size: > 1B€ managed ?

Growth: big growth of the managed funds ?
Customers: institutional ?
Mandate: light on liquidity ?
Results: bad results recently ?
Others…..

The hedge fund world is very vast and diverse and it is very hard to map. Hedge funds can be very different in size, in strategy, in the way they're acting and in the assets they're investing in. They are composed of very smart professionals, are very reactive, can change strategy/asset very often and only care about return.

In the US, most of the hedge funds playing in the PE market are multi-strategy. They are going into private equity often. Some hedge funds have two different teams: one for public companies, and another one for private companies. Almost all of the big funds are acting on the PE market, but the smaller ones are also considered as players.

American hedge funds are very interested in EU, considering that the financial markets are now well developed and liquid. They are entering Europe by different ways: opening desks, buying European funds, partnering with European, acting as a fund of fund…

In EU, a few hedge funds are acting on the PE market, but it is growing fast. They're either pure ***European players or American desks***. Most of them are ***big funds*** (means > 1b€ managed).

For either EU or US, it seems that hedge funds' mandates are not specifically designed for private equity investment.
The questions on their main customers and their eventual bad results are estimated "not related" to the subject

Can you list some Hedge Funds playing in the LBO market ?

Here is the aggregate of the funds listed (you will find a detailed list enclosed in the study):

ALPSTAR	Cerberus	GOLDEN Tree	Paloma
Amaranth	Chart Group	GLG	PERRY
Athena	CHEYNE Capital	GSO	RAB Capital
Axone	Citadel	Highfields	Reservoir Capital
Black ant	Cognis Capital	Highbrige	Satellite
Black Diamond	CQS	Lempier Kapital	Sankaty
Blue Bay	DPE Shaw	Millenium Capital	SGAM AI
Blue mountain	Eaton Park	MOORE Capital	Silverpoint
Brevan Howard	ESL (Edward Lampert)	OAK Tree	Texas Pacific Group
Canyon Capital	FORE Advisors	Och Ziff	

A FAVORABLE ENVIRONMENT

Do you see explanations on Hedge funds presence?
Evolutions of LBO markets?
Growth of the fund managed?
Hedge funds evolution?
Legal evolution?
Customer evolution?
Competition?
Other markets evolution?
Others…

In US, hedge funds have always played on the PE market. They have always been in equity (considered as 'activist investors') and entered loan market 4-5 years ago.
In Europe, hedge funds entered PE leverage loan market 2-3 years ago. They became equity buyers 2 years ago, but it is still quite rare.

The reasons why they're on the EU market are diverse:
the European loan market is wide and liquid enough

alternative investment is attracting more and more funds and hedge funds are the main beneficiaries of this trend
risk/return of PE market is considered as very attractive
Baale II and IFRS are imposing banks to reduce their risky assets. More and more banks are even willing to sell their paper 'to zero' in order to make their participation turn, and are by the way increasing the market's liquidity.
The high yield market is much more fragile and sensitive than the LBO market.

The ***recent evolution of the European market is quite bizarre (and maybe dangerous)***. Actually, there is a lot of fund on the market but very few companies to be bought. Mechanically, prices are increasing and WACC is lowering but the problem is that structures are really aggressive and are weighting on the companies. The future evolution of the market will be very interesting and will certainly have a big impact on the hedge funds' strategies: will it burst or will it cool down?

IS THERE A TYPE OF DEAL THEY ARE IN?

Geographic: UK ? France ? Germany ? Italy ? ….
Size: < 200 M€
200 < < 500 M€
500 < < 1 000 M€
1000 M€ <
Private company / Public company going private
Spin Off / minimum 2nd LBO
Distressed situations
Others….

In the US, hedge funds are looking at ***every type of deal,*** whether it is a big or small deal, the only reason why they look at deals is that they think they can get return. They are very reactive and flexible so they will be able to get the return they expect in different situations.
For example:
the big ones BB deals are 2.25% to 2.75% return: it's not the type of return they're looking at. They can go in different ways:
through leverage (through CDO for example),
the loan's market will be wide and liquid so they can play with liquidity, arbitrage…
The small ones is considered as typical high risk / high return profile they like. But on the small to medium deals, private equity funds have their words and sometimes, they don't want hedge funds in equity or in loan syndication. But in this type of situation, secondary market is always free.
If a company is in a distressed situation, hedge funds will probably be the first looking at it and trying to think a winning strategy.
When banks underwrite deals, they are sometimes backed by hedge funds, who are able to liberate funds very quickly.

In Europe, it is different. Most of the hedge funds are only looking at loan market, and they want liquidity. This strategy guides them only on ***medium to large deals.*** This will probably evolve rapidly. Recently, we have seen hedge funds driving deals, and more and more American hedge funds are interested in the EU market. Actually, they are doing it by different ways: opening European desk, buying European funds, partnering.
Compared to CDO, hedge funds are very price oriented. Where CDOs will buy a certain type of company, will try to have a diversified portfolio, hedge funds are able to buy any well priced company.

WAY OF BEING IN

What type of investment are they doing?
Senior debt why?
Bonds why?
Mezzanine why?
Second Lien why?
Via CDO / CLO why?
PIK why?
Equity why?

*Others …	why?*

When are they acting?
*Before the deal)	why?*
(taking advantage of Public to Private operation)
During the deal why?
*Arranging the deal	why?*
*After the deal (syndication)	why?*
*Secondary trade	why?*
*Other	why?*
The first answer to this question is that hedge funds are able to be in deals at every stage/any time. On the other side, hedge funds are very secret, they can act via many different vehicles, and they almost never have only one position. This makes hedge funds' actions very hard to identify precisely.

Looking more closely, we understand that in Europe, hedge funds can be classified in two different groups:

Group A is looking at debt only and is interested in every type of debt.
. Senior A: they need leverage to buy these type of tranche. They can also ask for A only because they want more risky tranches (B, C, mezzanine...).
. Senior B and C: they are able to buy some directly and are interested in bullet type of debt.
. Mezzanine and second lien: this is the type of tranche they like the most. The recent development of this type of tranche has been boosted by hedge funds arrival.

For these papers, liquitidy is key. And syndications appreciate their flexibility and their ability to buy big tickets.

This group is big as ***almost all of the hedge funds*** are able to take debt on an enough liquid market.

The strategies can be diverse, for example:
. Buying the biggest ticket you can on primary, then continuing to buy the ticket above first pricing.

Group B is also able to look at PIK and equity
This group, which is very developped is the US, is still very small in Europe as only ***a dozen of hedge funds are identified***. They are rather deep pocketed, well capitalised funds, and most of them are Americans.

In the US:
They can be sleeping partner or deal-driver. Private equity funds sometimes match with them. They can be very quiet and patient investors, looking at medium to long term return. They can also be very active and nervous. If they get majority, they probably will be very proactive and very smart. If the enterprise is going wrong, hedge funds will probably work as hard as they can to turn the situation to their advantage.

WHAT ARE THEY BRINGING AND DOING

What do you think of hedge fund's arrival?
Opinion
*good / bad for the market ?	why?*

Do they bring
liquidity
competition: lowering the WACC …and the return
competition: price increase
risk
other…

Strategy
What type of strategy are they following in the deal ?
How long do they stay in the deal?
Do they have a long term strategy?

Other …

In Loan
Hedge funds have been on the US market for 4-5 ears, and on the EU market for 3-4 years.
They bring ***liquidity*** and competition on loan market.
They are very ***reactive***: they are able to free funds in 2-3 days, when banks need 1-2 weeks. Actually, decision making process is very short, the managers are brain powered and able to take fast decision.
The other interesting point is that they ***re-price the risk quickly***, and are able to arbitrage the papers' price very fast.
Syndication is often ease by the presence of hedge funds
They are also very ***adaptive on 'margin flex'*** conditions
Hedge funds are also able to have ***medium to long term strategy*** on this market.

In equity or PIK
Hedge funds recently appeared on the EU market, whereas they've always been on the US market.
It is ***rather big funds*** who are looking at equity. They are ***able to drive deals***, to have very ***proactive*** approach, and to have ***medium to long term strategy***.

WHERE ARE THEY GOING ?

What is your opinion on this movement? Where do you think it is going?
How do you think Hedge Fund will deal with their equity and the need of being implied in the companies' day to day activity?

What do you think of the evolution?
- Hedge Funds in PE will last, it is going to be structural YES/NO
- HF will focus on certain type on debt (ie mezzanine)and stay there YES/NO
- HF will take senior, then mezzanine, then equity and then arrange YES/NO
- HF will discover the PE characteristic and leave YES/NO
- The market's characteristics are incompatible with HF one's YES/NO
- HF will leave as soon as they will find a better market YES/NO
-HF will leave with the PE bubble's explosion YES/NO
- HF and PE funds will merge and become 'alternative investment funds' YES/NO
- Other………….
If the HF are leaving the LBO market: consequences?

Today, hedge funds are ***rooted in the leverage loan market*** where they find liquidity and return. They will probably ***continue to stay*** on this market and will probably be more and more aggressive. Actually, they are willing to create value, and will continue to ***bring their ideas and methods*** to the LBO world.

Alternative investment
Hedge funds are part of the 'alternative investment' movement. They are very well positioned because they are very flexible and by this way able to ***raise a lot of money***. They are very reactive, act rapidly, have a few investment constraint.
The HF are getting closer to PE world and the ***'alternative investment' funds***, 'total return' funds are developing a lot on the US market.

Will they leave?
It is ***too early*** to know whether they will leave or not. We don't really know how they will react if confronting a waver, a crash?
Note that ***if the market bursts, hedge funds will probably stay***: distressed activities are one the strength of hedge funds.

What if they leave?
They are still weighting a small percentage of syndication, and liquidity is driven buy CDOs, CLOS, and Banks. So if they leave the leverage loan market, it will generate a ***small impact on the market***… except if the reason why they are leaving is more structural.

ANNEXE 2: LIST OF HEDGE FUNDS (not exhaustive)

Nom du HF	$ Under management		Origine	Equity or PIK	Driving deals	Notes and comments
ALPSTAR			EU			. www.alpstamgmt.com
Amaranth	7 800	M$	US	x		. www.amaranthllc.com . Offices in Europe . In Europe, they are enterring deals from senior B to PIk
Athena			EU			. www.athenafund.com
Axone						
Black ant			US			. Offices in Europe
Black Diamond	8 000	M$	US	x		. Offices in Europe
Blue Bay			EU			. www.bluebayinvest.com
Blue mountain	2 500	M$				
Brevan Howard			EU			. www.brevanhoward.com
Canyon Capital	11 000	M$	US			. www.canyoncapital.com
Cerberus	16 000	M$	US			. Offices in Europe
Chart Group			US			. www.chartgroup.com . Offices in Europe
CHEYNE Capital			EU			. www.cheynecapital.com
Citadel	12 000	M$	US	x	x	. Offices in Europe . www.citadelgroup.com . Ability to drive deals
Cognis Capital			EU	x		
CQS						
DPE Shaw	*17 100*	*M$*	*US*	*x*	*x*	*. Not quoted as a European player* *. Ability to drive deals*
Eaton Park						
ESL (Edward Lampert)						
FORE Advisors			US			. Offices in Europe . Taking high yield to senior B loan.
GOLDEN Tree						. Quite active on European loans
GLG			EU			
GSO			*US*	*x*	*x*	*. Not quoted as a European player* *. Ability to drive deals*
Highfields						
Highbrige			US			. Offices in Europe
Lempier Kapital						
Millenium Capital			US			
MOORE Capital						
OAK Tree						. www.oaktreecap.com
Och Ziff	12 000	M$	US	x	x	. Offices in Europe . Very active on the PE market, in debt and equity . Ability to drive deals . Management with PE background
Paloma			US			. Offices in Europe
PERRY	11 500	M$		x	x	. Offices in Europe . Very active on the PE market, in debt and equity . Ability to drive deal
RAB Capital			EU			. Active in loan
Reservoir Capital	2 800	M$	US	x	x	. www.reservoircap.com . Ability to drive deals
Satellite			US			. Offices in Europe
Sankaty			US			. Difficulties to be classified between PE and HF . Created CDO and CLO
SGAM AI	4 900	M€ (HF+PE)	EU			. Fusion between all the AI activities in Societe Generale
Silverpoint			US			. Offices in Europe
Texas Pacific Group			US			
Vega			EU			

ANNEXE 3: INTERVIEW GUIDE FOR SYNDICATION TEAMS

HEDGE FUNDS:
NEW LBO PLAYERS?

INTERVIEW GUIDE

Interview with:

M………………………………………………………………………………………………..

Company…………………………………………………………………………………….

Place………………………………………………………………………………………….

Role in the company……………………………………………………………………….

Tel…………………………………………………………………………………………….

Email…………………………………………………………………………………………

Agree to be quoted	YES	NO
Willing to receive the study	YES	NO

INTRODUCTION

Florence is working at RBS middle office in Paris and Marc is working in the PPP industry in Paris. We both are studying in a part-time Master of 'strategy and finance expertise' at CNAM school in Paris. This study is part of our Master.

We are studying the emergence of hedge funds in LBO deals in Europe. Our study will be done through 3 steps:

bibliography and press analysis (done)
interviews with professionals (qualitative)
questionnaire to hedge fund's managers (quantitative)

This study aims at understanding:
Who are the funds playing in the LBO market?
Can we draw a profile on these funds?
Of the deals they're in?
Why and How are they here?
Simply opportunistically?
2005 bad results?
Do they have a long term strategy?
How are they investing: senior, mezzanine, equity?
Do they have competitive advantages: leverage, mandates …?

Where are they going?
What are they bringing to the market?

This interview's will be done through this guide in order to ensure coherence and comparability of the different interviews.

WHO ARE THE HEDGE FUND PLAYING IN THE LBO MARKET

We try to draw a profile (if there is one) of the hedge funds currently playing in the market.

What is your opinion on the Hedge Funds playing in the European LBO industry ?
Could you draw a profile of these funds ?

Ideas:
Origins: Americans ?

Strategy: Multistrategies ?

Size: > 1B€ managed ?

Growth: big growth of the managed funds ?

Customers: institutional ?

Mandate: light on liquidity ?

Results: bad results recently ?

Others…..

Can you list some Hedge Funds playing in the LBO market ?

A FAVORABLE ENVIRONMENT

Do you see explanations on Hedge funds presence?

Evolutions of LBO markets?

Growth of the fund managed?

Hedge funds evolution?

Legal evolution?

Customer evolution?

Competition?

Other markets evolution?

Others…

IS THERE A TYPE OF DEAL THEY ARE IN?

Geographic: UK ? France ? Germany ? Italy ? ….

Size: < 200 M€
200 < < 500 M€
500 < < 1 000 M€
100 M€ <

Private company / Public company (going private with the LBO)

Spin Off / minimum 2nd LBO

Others….

WAY OF BEING IN

What type of investment are they doing?

Senior debt why?

Bonds why?

Mezzanine why?

Second Lien why?

CDO / CLO why?

Equity why?

Others … why?

When are they acting?

Before the deal) why?
(taking advantage of Public to Private operation)

During the deal why?

Arranging the deal why?

After the deal (syndication) why?

Secondary trade why?

Other why?

WHAT ARE THEY BRINGING AND DOING

What do you think of hedge fund's arrival?

Opinion
good / bad for the market ?   why?

They bring

funds

liquidity

competition: lowering the WACC / the IRR …and the return

competition: price increase

risk

other…

Strategy

What type of strategy are they following in the deal ?

How long do they stay in the deal?

Do they have a long term strategy?

Other …

WHERE ARE THEY GOING ?

What is your opinion on this movement? Where do you think it is going?

How do you think Hedge Fund will deal with their equity and the need of being implied in the companies' day to day activity?

What do you think of the evolution?

- Hedge Funds in PE will last, it is going to be structural   YES/NO

- HF will focus on certain type on debt (ie mezzanine)and stay there   YES/NO

- HF will take senior, then mezzanine, then equity and then arrange   YES/NO

- HF will discover the PE characteristic and leave   YES/NO

- The market's characteristics are incompatible with HF one's   YES/NO

- HF will leave as soon as they will find a better market   YES/NO

-HF will leave with the PE bubble's explosion   YES/NO

- HF and PE funds will merge and become 'alternative investment funds'   YES/NO

- Other………….

CONSEQUENCE OF HEDGE FUNDS STRATEGY

Risk for the LBO market if HFs change strategy and decide to invest in other markets?

CONCLUSION

Other ideas ?

Do you know someone we could have the same discussion ?

Do you know someone working in a Hedge Fund who will be willing to answer a short questionnaire?

Thank you very much…….

ANNEXE 4: QUESTIONNAIRE FOR HEDGE FUNDS

HEDGE FUNDS:
NEW LBO PLAYERS?

QUESTIONNAIRE

Questionnaire answered by:

M……………………………………………………………………………………………………..

Company…………………………………………………………………………………………..

Place………………………………………………………………………………………………

Role in the company……………………………………………………………………………..

Tel…………………………………………………………………………………………………

Email………………………………………………………………………………………………

Agree to be quoted	YES	NO
Willing to receive the study	YES	NO

PLEASE FILL IN THIS QUESTIONNAIRE AND SEND IT TO: hedgefundlbo@yahoo.fr
OR FAX IT TO: +33 (0)1 69 36 17 09

INTRODUCTION

Florence and Marc are both studying in a part-time Master of 'strategy and finance expertise' at CNAM school in Paris. This study is part of our Master.

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This study aims at understanding:

<u>Who</u> are the funds playing in the LBO market?
    Can we draw a profile on these funds?
    Of the deals they're in?
<u>Why and How</u> are they here?
    Simply opportunistically?
    2005 bad results?
    Do they have a long term strategy?
    How are they investing: senior, mezzanine, equity?
    Do they have competitive advantages: leverage, mandates …?
<u>Where</u> are they going?
<u>What</u> are they bringing to the market?

This interview's will be done through this guide in order to ensure coherence and comparability of the different interviews.

LBO'S STRATEGY

LBO's investments		Y/N

Position		
lender in debt (any type)		Y/N
buyer in equity and/or PIK		Y/N

date of first deal		mm/yyyy
number of deal		#

The type of deals you're in	Y/N	
Valuation		<200M€
		200< <500M€
		500< <1000M€
		1000M€<
Public company		
Private company		
1st LBO		
2^{nd}, 3^{rd} ... LBO		
Specific industry ? Pleaseprecise…………………………………………………………….		
Specific geography ? Pleaseprecise…………………………………………………………….		

MIN of investment in EQUITY or PIK		% of total equity
MAX of investment in EQUITY or PIK		
MIN of investment in DEBT (senior, mezz, 2^{nd} lien)		% of total debt
MAX of investment in DEBT (senior, mezz,2^{nd} lien)		

Debt type used / Investment vehicle	Y/N
Bullet	
Amortized	
Mezzanine	
Second lien	
Via CLO/CDO (internal : created by your fund)	
Via CLO/CDO (external)	
Other (please precise……………………………………….)	

Exit strategy	
< 1 year	
< 2 years	
< 5 years	

When are you entering ?	Y/N
Before the LBO (ex : taking advantage of public to private operation)	
During the LBO (close relationship with the arranger)	
Arranging the LBO	
After the LBO (syndication)	
Secondary market	

PERSPECTIVE

Why are you considering LBO market? What are your perspectives?

	Y/N
Multistrategy to leverage the risk of your portfolio	
Opportunistic: The PE market is better than others	
Opportunistic: The operation you're looking at has good risk/return	
You have many funds	
Mandates are less constraining on liquidity	
Turnover is being long enough	
You have a long term strategy on this market	
You plan to launch a specific team	
You want to stay at senior debt level	
You want to stay at mezzanine/2nd lien level	
You want to stay at participative equity	
You want to arrange debt	
You want to arrange deals	
You will leave if a better market reveals	

PROFILE

MANDATES/INVESTORS RELATION

Investors' expected return		%
Investors are looking for absolute performance		Y/N
Liquidity requirements (in months)		M
Turnover of the fund (X times a year)		#

THE FUND

a. number of employees		#
b. location(s)		
c. date of first funding		mm/yyyy
d. number of funds/refunding		#
d. managed outstandings (M€)		2000
		2001
		2002
		2003
		2004
		2005
		2006 (expected)
e. return on investment (%)		2000
		2001
		2002
		2003
		2004
		2005
		2006 (expected)

STRATEGIES
What is the Hedge Fund strategy ?

ASSET

	Y/N	% of fund
a. Rates and derivatives		
b. Commodities		
c. Public companies (Market value > 10B€) : equity & debt		
d. Public companies (Market value < 10B€) : equity & debt		
e. Private companies: equity and PIK		
f. Private companies: senior debt, mezzanine, 2nd lien…		
f. others…………………………………		

GEOGRAPHIC

	% of fund
a. Europe	
b. US	
c. others	

TYPE

	Y/N
a. Event driven	
b. Distressed securities	
c. Risk/merger arbitrage	
d. Macro	
e. commodity trading advisor	
f. long/short	
g. short selling	
h. equity non-hedge	
i. relative value arbitrage	
j. convertible arbitrage	
k. fixed income arbitrage	
l. mortgage backed securities	
m. equity market neutral	
n. emerging markets	
o.fund of funds	
p. sector	
q. multistrategies	
r. others	

OTHERS

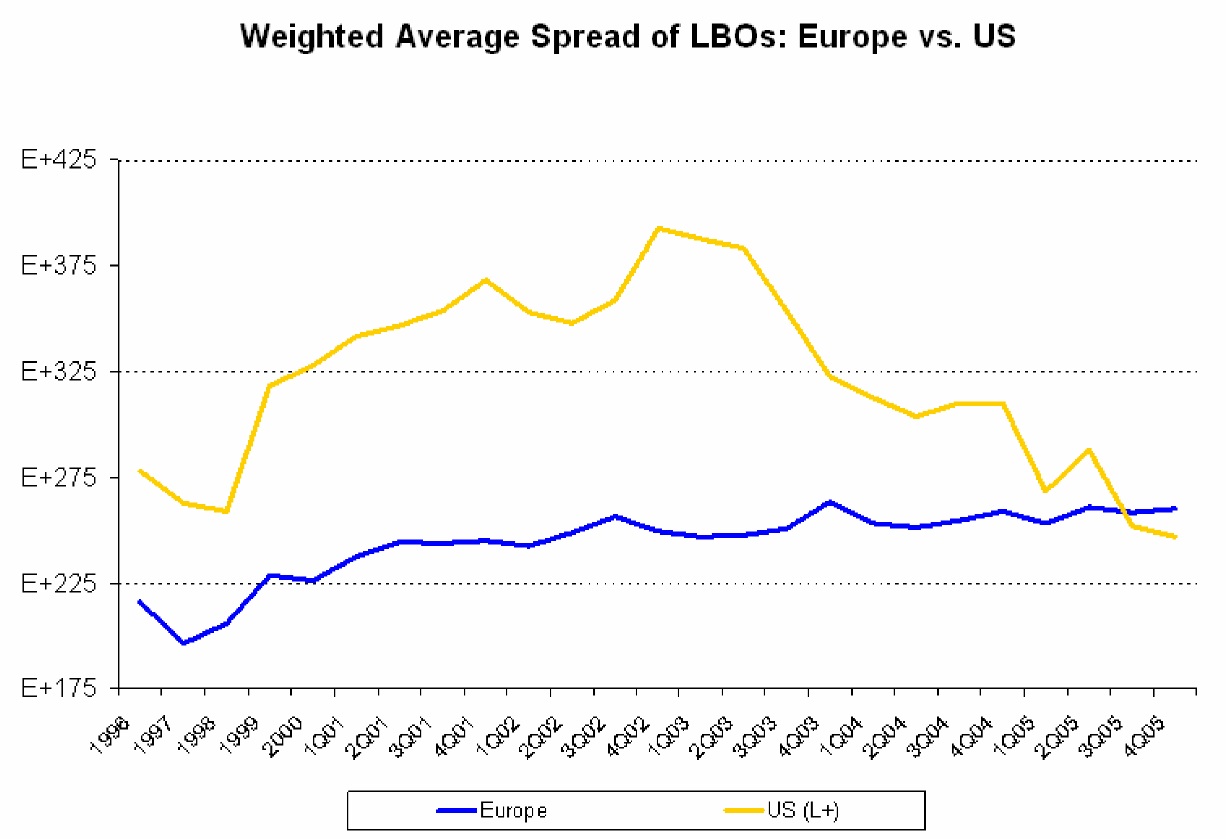
If you have any other information, please, write it down
………
………
………………………………………………

CONTACTS

Do you know anybody who will be willing to answer this questionnaire and to receive our study ?
………
………
………………………………………………………………………………………

THANK YOU

ANNEXE 5


Weighted Average Spread of LBOs: Europe vs. US
E+425
E+375
E+325
E+275
E+225
E+175
1996
1997
1998
1999
2000
1Q01
2Q01
3Q01
4Q01
1Q02
2Q02
3Q02
4Q02
1Q03
2Q03
3Q03
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2Q04
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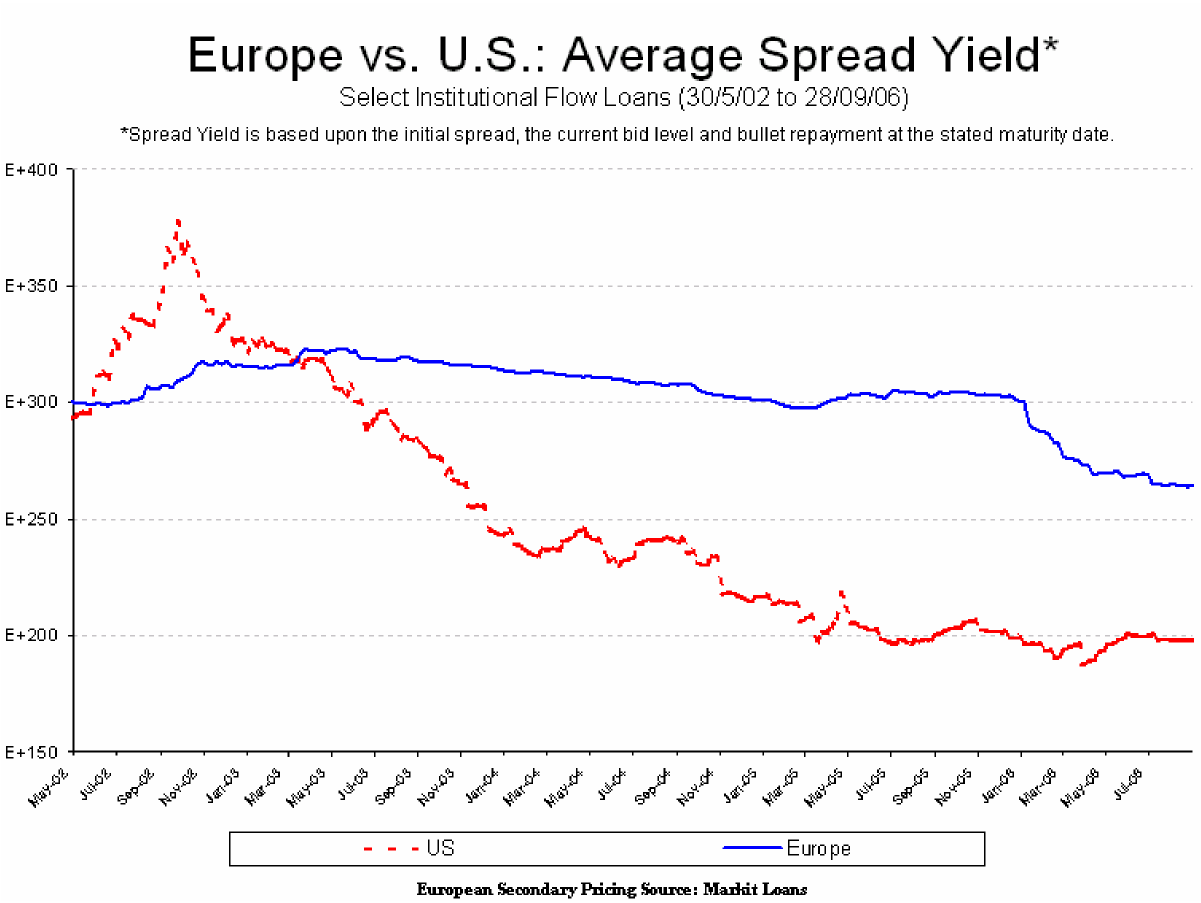
4Q04
1Q05
2Q05
3Q05
4Q05
Europe
US (L+)


Europe vs. U.S.: Average Spread Yield*
Select Institutional Flow Loans (30/5/02 to 28/09/06)
*Spread Yield is based upon the initial spread, the current bid level and bullet repayment at the stated maturity date.
E+400
E+350
E+300
E+250
E+200
E+150
US
Europe
European Secondary Pricing Source: Markit Loans

ANNEXE 6: BIBLIOGRAPHY

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- Wall Street Journal 2005-2006
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- LBO Wire
- AFIC
- Covington & Burling
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- Deloitte
- Hedge Fund Research
- AIMA : Alternative Investment Management Association
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- Cogent
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- Prudential Investment Management
- Standard & Poors
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- Yahoo finance & Google Finance
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- www.simmons-simmons.com
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