

Overview

The last three months have seen a continued pick up in both transaction activity in the sector as a whole and in our own deal flow.

In this edition we provide details of the recent realisations of Thermocoax and MPS and an update on a selection of our portfolio companies. Our guest article is a spotlight on motor and home insurer, esure, by Chairman and CEO Peter Wood.

Interim Management Statement

In July our major client Electra Private Equity PLC ("Electra") released its Q3 Interim Management Statement (IMS) to 30 June 2010.

Electra's unaudited net asset value at 30 June 2010 was 1,873p per share compared to 1,900p at 31 March 2010, a decrease of 1.4%. This however was not a true reflection of the entire portfolio as only purchases and sales of investments, currency movements and bid values in respect of quoted investments are revalued for IMS purposes.

At 30 June 2010, Electra had cash and liquidity funds of £203 million and had drawn down £159 million of borrowings under its £185 million banking facility. Inclusive of this facility Electra had available investment capacity of £229 million. At 30 June 2010 Electra's quoted portfolio was valued at £116 million and commitments to third party funds amounted to £78 million.

Colette Bowe, Electra's Chairman said:

"Prospects for Electra's portfolio, which comprises mainly non-cyclical and defensively positioned investments, have improved despite the uncertain economic environment. With Electra's broad investment mandate, Electra Partners has a pipeline of investment opportunities which is likely to result in an increase in new investment."

If you would prefer to receive this newsletter electronically please email Nick Board at nboard@electrapartners.com.

Realisations

MPS meat processing systems

In August 2010 we announced the sale of our interest in MPS. Electra received net proceeds of £34 million generating an IRR of 48%, a return of 2.0x original cost in under two years and an uplift from the value in Electra's holding in MPS at 31 March 2010.

Based in the Netherlands and employing some 500 people worldwide, MPS is the global leader in the development, production and installation of abattoir equipment. Since Electra's investment, profits have grown by over 35% on the back of continued geographic expansion into emerging economies, increased food safety concerns and the global industrialisation of agriculture.

In October 2008, Electra invested €21 million in MPS as part of its €36 million acquisition of a 51% limited partnership interest in a fund managed by Steadfast Capital. Steadfast Capital are a mid-market private equity house based in Frankfurt who invest in Germany and German speaking countries.



The investment was made during the peak of the recent financial crisis and underlines Electra Partners' ability to extract value throughout the economic cycle as a result of its flexible investment strategy.

Through the sale of MPS, Electra's purchase price of the fund has been returned.

THERMOCOAX *from vision to reality*

In August 2010 we also announced the sale of our interest in Thermocoax, a leading manufacturer of customised thermal solutions and temperature measurement systems. Electra received proceeds of £12.3 million, generating a return of 2.8x original cost in just under four years.

Based on mineral insulated cable technology, Thermocoax's products serve a large number of sectors including nuclear energy, civil and defence aviation, solar energy, electronics and semi conductors, medical and scientific instrumentation, industrial and petrochemical. The company is headquartered in France and has a presence in the USA, China, Germany, UK and Holland.

Electra's interest in Thermocoax was held as part of its €28 million secondary purchase in 2006 of a majority interest in TCR Capital's second fund.

Over TCR Capital and Electra's ownership, Thermocoax successfully grew revenues from €21 million to €35 million and EBIT from around €4.4 million to around €10 million (2005-10E CAGR 11% and 18% respectively).



Electra Partners' relationship with TCR Capital, the Paris-based mid-market buyout firm, dates back to 2006 when we identified the French country-specific private equity house as a possible investment partner.

TCR Capital was founded in 1989 as the Paris-based direct investment arm of Quilvest – the wealth manager of the Bemberg family. Having backed TCR's first and second funds, Quilvest sold its stake in the second fund, TCR Capital II, to Electra.

Portfolio progress

Management Teams Strengthened



Capital Safety Group, one of the world's leading manufacturers of fall protection equipment, announced the appointment of Anders Pettersson as its new CEO in April. For the last eight years, Anders has served as President and CEO of Sweden-based Thule AB, a global manufacturer of sports and utility transportation products.

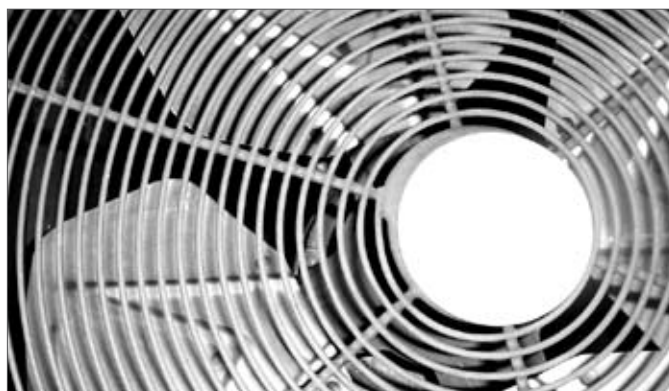


Provider of specialist credit cards, SAV Credit appointed Sir Malcolm Williamson as its new Chairman in June. Sir Malcolm, the former Group Chief Executive of Standard Chartered Bank and President and CEO of Visa International, brings with him extensive industry experience and expertise.

Carbon Trust Standard



Nuair has become the first UK ventilation manufacturer to achieve the Carbon Trust Standard for reducing its carbon footprint. Nuair has been working closely with the Carbon Trust for the past five years to significantly reduce its environmental impact and has successfully reduced its energy consumption by more than 16% since 2007. The company has also committed to regular environmental audits to ensure it continues to achieve the highest possible standards.



Unipart, the automotive and logistical services company, has also been awarded the Carbon Trust Standard for successfully reducing its carbon footprint over the past three years. Energy saving projects included lighting, heating and ventilation reductions coupled with improved fleet logistics enabling Unipart's automotive division to reduce its van fleet by more than 100 vehicles.

Other News



Treetops Nurseries is now in the top 10 largest nursery school providers in the UK with over 2,250 childcare places following two recent acquisitions in Derbyshire. The new additions take the number of nurseries in PINE's portfolio to over 50.



In October, property investment fund London & Stamford moved from AIM to the Main Market and converted to a real estate investment trust (REIT). The conversion will generate a number of tax advantages which are likely to increase cash returns for shareholders.

Outlook

Despite evidence of a limited recovery, we continue to operate in a challenging market. The availability of debt for mid-market buyouts is still restricted to a small number of lenders, and only at relatively low levels. However raising bank finance is definitely possible albeit a more complicated and protracted process.

Our portfolio remains in good health, being largely non-cyclical in nature, and we are optimistic that our deal flow will continue to strengthen. However with evidence of the overhang of private equity funding in the market leading to increased competition, we remain cautious in our pricing decisions for the sake of the long term health of the portfolio and shareholder value.

Spotlight on esure and Sheila's Wheels

Peter Wood, CEO and Chairman



It was the best of times, it was the worst of times. Charles Dickens' opening line for 'A Tale of Two Cities' set the scene for an honest look at the contrasting fortunes for the inhabitants of the cities of London and Paris during the 18th century. If I were writing the story of the period surrounding esure's management buy-out from Lloyds Banking Group in February this year, the same line in reverse would be appropriate.

For the motor insurance industry, 2009 was perhaps the worst that any of us 'old timers' had ever seen. There were three root causes; combined they caused a slump which wiped away some of the major players' previously huge profits alongside seismic reserve adjustments and pricing increases that would hike car insurance premiums for most Britons by 20 – 30% in a single year.

First, a surge in low level personal injury claims in the UK spurred by aggressive claim farming and a step-change in the public's awareness of the personal benefits to be gained within a burgeoning compensation culture. Second, a slump in the investment returns that had always been relied on to turn loss-making motor underwriting results back into healthy profits. And finally, the dawning realisation of the future cost in financial and human resource terms that would be required to implement Solvency II by 2013.



I suspect that the last 18 months have seen more tears shed into more bowls of cornflakes by insurance chief executives than at any time in the previous ten years.

For esure, however, it has also been the best of times. In February 2010, with the help of a team of like-minded external investors including Electra, we gained independence from a bank joint venture partner that had effectively become state-owned. What's more we gained it at a price that reflected both Lloyds' desire to focus on its in-house insurance strengths and the poor market conditions that were dragging most motor insurers into uncharted territory.

The insurance market does not suffer fools gladly but it can also give short shrift to the wise on occasion. Had the recession simply hit investment returns it would have been hard but the pips would not have squeaked. The blow that did the major damage to so many insurers writing motor business was the personal injury phenomenon. It is worth a few moments to describe just how the punch was landed.

They used to be called Ambulance Chasers. Today, they are called Claims Management Companies or more accurately, claims farmers. They buy tens of millions of pounds worth of day-time TV and Radio advertising space. They send text messages, emails and personal representatives to seek out those who may have 'forgotten' to make a personal injury claim from any accident they have been party to in the last three years. I am not in a position to attribute blame for a phenomenon that has wreaked social as well as financial havoc but if I were, I know where I would start.

A friend in the retail estate world recently told me that until 2009 UK shopping mall landlords routinely sold lucrative temporary floor space to such companies who would set up stalls on a Saturday morning and offer to help shoppers gain access to justice for the neck ache that they had never claimed for after a car or work accident. This practice continued until the same landlords realised that the cost of claims for people having 'slipped or tripped' in the very same precincts had gone through the roof. A problem had been created by placing opportunity and incentive side-by-side.

The blow that did the major damage to so many insurers writing motor business was the personal injury phenomenon.

In effect, claims farming has generated a market in low level injury claims: a revenue stream of referral fees by encouraging potentially injured folk to claim for what is 'rightfully theirs'. The problem is that free money is hard for anyone to refuse and the requirements for accessing this money are apparently simple. When was the last time your doctor challenged your reported symptoms?

The problem is compounded because such claims give the acting solicitors access to fees that match the compensation they expect to win for clients almost pound for pound. The majority of their clients may still be genuine claimants who have suffered genuine injuries in genuine accidents but an increasing proportion are accident 'victims' who might previously have taken a few Aspirin and a day off work. Now many have realised that they stand to pocket around £2,500 by adding a few embellishments – and who loses out? Unfortunately, it is every honest driver who loses.

The issue for the honest car insurance buyer is that each personal injury claimant/solicitor/farmer combination taking £5,000 out of the system requires a lot of drivers making no claims at all to balance the books and keep premiums steady – at least 16 per low impact claim. Yet, despite driver numbers remaining relatively static, the number who drive uninsured is rising and the number claiming for personal injuries caused by other drivers has gone through the roof. The only remedy is a blunt instrument – serious hikes in insurance premiums to restore the balance over time. This is exactly what we are seeing today.

For the industry, the correction will normally take a minimum of three years if it has to be done through rates alone. We would all love a culture shift that reverses the compensation culture but I believe the genie is now out of the bottle.

Thankfully, at esure, we maintained prudent reserves at times when others were 'releasing the fat' in their cupboards to bolster flagging P&Ls. We also acted quickly and forcefully when the personal injury problem became clear. We have shrunk in size but we have protected profitability and held onto a core of honest, risk averse drivers while boosting fraud detection and investigation. In short, we suffered... but we suffered in style.

Moving forwards, I expect that having made our stitch in time, esure will emerge in 2011 in a competitively strong position. Our brands – including Sheilas' Wheels whose success still takes my breath away after five years – give us a headstart but it is our willingness to tackle fraud head-on and adopt realistic pricing - while others get to grips with an unpalatable problem - that will benefit us most.

Could esure have done all of this with a state-owned bank as a partner? I don't know – but I do know that my buy-out partners are all blessed with the right combination of vision, tolerance and patience to ensure that the worst of times are past. And the best? They are still ahead.

In February 2010 Electra invested £29.7 million in esure.

ELECTRA PARTNERS LLP

Electra Partners is an independent private equity fund manager with over 25 years experience in the mid-market buyout sector.

Our flexible investment approach allows us to invest across a broad range of sectors and financial instruments including equity, senior equity, convertibles and mezzanine debt.

Concentrating principally on Western Europe and with the majority of investments expected to be made in the United Kingdom, we seek to invest in the region of £20 million to £75 million per transaction.

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