

Legrand: A Chance LBO

Nightfall had brought a light drizzle to the Parisian suburb of Rueil-Malmaison, covering the tree-lined boulevard housing the head office of Schneider Electric in a hazy yellow light. It was a late evening in May, 2002. Inside, the future of Legrand, global leader in the low-voltage electricity market with sales of €3 billion and present in 60 countries worldwide, hung in the balance. Just a year before, in 2001, Legrand had been bought by Schneider Electric in a €17 billion merger that would have created one of the world's largest electrical solutions companies. The European Commission's anti-trust office forbid the merger citing unsolvable competition concerns and gave Schneider one year to find a buyer. A consortium made up of the French investment office Wendel Investissement and private equity firm Kohlberg Kravis Robert & Co (KKR) offered to purchase Legrand in a €4.8 billion leveraged buyout (LBO). However Schneider was only willing to sell on its own terms.

That night, in the large Schneider board room, the two sides tried to iron out their differences. Henri Lachmann, CEO of Schneider, supported by his legal and financial team, listened to the case made by Ernest-Antoine Sellière and Jean-Bernard Lafonta, Chairman and CEO of Wendel Investissement, respectively, and Henry Kravis, founder of KKR, seconded by Ned Gilhully, head of KKR's European operations. If the deal went ahead, Legrand would be the largest LBO in Europe to date. It would also be a spectacular entrance for KKR in the French market and a remarkable first large foray into private equity for Wendel.

The deal was clouded in uncertainty. Legrand's management had indicated their determination to remain independent. However, Schneider was hopeful that the Commission's decision could still be reversed and needed time. In addition, the financial structure of the deal itself was highly complex due to its sheer size. The buyers needed to reassure Schneider of their capacity to fund the deal in the context of a difficult economic and financial environment.

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As the night ebbed away, Jean-Bernard Lafonta noticed that Henri Lachmann seemed to sit more often on the side of the table where Wendel and KKR were sitting, and less often on the side of his own advisers. “This”, he thought, “might be a sign that a deal is still possible”.

The Low-Voltage Electrical Equipment Market

The world market for low-voltage electrical equipment in 2002 was worth €48 billion with the main markets in Europe and North America (Exhibit 1). The market consisted of a wide variety of sockets, light switches, circuit breakers, alarm systems, and other items designed for homes, commercial buildings and industrial premises. Although manufacturers tailored their offering to electricity professionals as well as consumers, products were usually distributed through a large network of specialized wholesalers. The typical product life cycle varied between 5 and 12 years.

Throughout the late 1990s, the market had grown at rates of around 5% per year. Roughly 50% of sales depended on new construction which had been growing at rates faster than the overall economy. The other 50% depended on replacement, renovation and various other market niches, which typically grew in line with global GDP (2-3%). In addition, the growth rate of a geographical market could sharply increase following regulatory changes, such as when the Italian government introduced new safety requirements for offices and residential buildings in 1995. After 2000, however, the global slowdown led the industry into negative growth territory, especially in North America. The industry was also notoriously cyclical (see Exhibit 2 for growth rates of Legrand and Schneider Electric during the period).

Major players

There were two main types of players in the low voltage industry: large players, which included global groups and mid-size companies; and small, specialized local companies. Included in the first category were well-known brand names like ABB, Siemens, Schneider Electric, Legrand, General Electric, and Matsushita. These firms sold products that could be easily modified and adapted according to each country’s standards and requirements. The mid-size player category was composed of specialized firms including Cooper Industries, Hubell and Gewiss (see Exhibit 3 for revenue information on selected industry players). Generally, all large suppliers had other products in their portfolios in addition to the low voltage items (Exhibit 4). Legrand was the exception to this rule as it was the only large, global company that offered a “pure play” on the low voltage business. Another important aspect of Legrand’s positioning relative to competitors was that it was one of the companies with the broadest product portfolio in the sector (Exhibit 5).

In contrast to these large players, there were many national, local players in the industry with estimated turnovers of less than €75 million. The low voltage industry was heavily fragmented, with 50% of net sales made by local manufacturers each having less than a 1% market share. These companies usually supplied products for just one geographical market with only a small proportion of sales outside their home country. This fact, along with their flexible organizational structures, meant that they could react quickly to changes in demand due to their knowledge of the local marketplace. However, small players lacked the financial resources required for sustained investment in R&D. This