SVCA

Private Equity Performance Study 2015

A STUDY OF SWEDISH PRIVATE EQUITY OWNED PORTFOLIO COMPANIES (2005-2014) WITH A FOCUS ON MOST RECENT TRENDS (2012-2013)

A detailed analysis of growth trend in the Swedish Private Equity Portfolio Firms

Outline:

Key Questions and Methodology

- Construction of the sample and of the benchmarks
- Purpose of the study: an assessment of the Swedish PE portfolio firms

Relative size of the Swedish Private Equity Market

- Private Equity in comparison with total GDP and employment in Sweden

Comparison of CAGR trends

- Portfolio companies
- Listed companies of different size
- The Swedish economy

Growth trends after a PE investment

- The impact of a PE investment on number of employmees, revenues and value added over a five-year period

A detailed analysis of growth trend in the Swedish Private Equity Portfolio Firms

Key Questions:

1. How relevant is Private Equity investment in Sweden?
2. Do PE-backed companies grow at a faster pace than other firms of comparable size?
3. How does a Private Equity investment impact the subsequent growth in number of employees, revenues and value added?
4. In which way do the growth trends differ between Buyout and Venture portfolio companies?

A detailed analysis of growth trend in the Swedish Private Equity Portfolio Firms

Main Findings:

1. Private Equity backed companies represent a sizable part of the Swedish economy, with 318 billion SEK in turnover, comparable to 8 % of GDP and 190 000 employees, 4 % of the employment
2. PE-backed companies grow at a faster pace than the economy as a whole and than other firms of comparable size
3. Both Buyout and Venture portfolio companies show higher growth in terms of number of employees, revenues and value added in the years after the investment
4. PE-owned firms outperform especially at the earliest stages of the investment, with Venture portfolio companies growing faster in the very first years and Buyout portfolio companies keeping pace over a longer horizon

A unique sample of portfolio companies, including exited investments

Methodology for sample construction

- The sample of companies is constructed by looking at the **SVCA** and **EVCA databases** of PE-owned firms in Sweden
  - The **investment year** and investment **company** are **double-checked** through PE-firms websites, media sources and Retriever
  - We also **include Swedish companies** owned by **foreign PE** firms and companies in **liquidation, bankruptcy** and **restructuring**
  - Companies **without** any **reliable** financial data are **excluded**
- **Financial data** are collected from Retriever, based on the firms' organization number
  - We investigate the **corporate structures** to include data from the individual entity that represents the **Swedish operations** in the most **accurate** way
- **Growth** numbers and **CAGRs** are calculated only within the **investment period**, i.e. when the company has been PE-owned
- **Outliers** in the top and bottom **5%** of the sample are **excluded** from the analysis

Methodology for benchmark construction

- **Macroeconomic** data from **SCB**
- **Financial data** on listed companies from **Retriever**
  - We include **Large-cap** (OMXS30), **Mid-caps** (OMXSMC) and **Small-caps*** (OMXSSC)
- The benchmark is constructed by **matching** each **portfolio company** with the **index** of comparables
  - The matching is **based on**:
    - The **historical year**
    - The number of **years after investment**
  - The indices are **weighted** based on the **investment** and **divestment patterns** in portfolio companies
- The benchmark **tracks** what would have been the **development** for **listed** firms over the **same holding period** as for portfolio companies
  - We consider the first **5 years** after the investment because most **PE** investments are **realized** within 5 years
- **Outliers** in the top and bottom **5%** of the sample are **excluded** from the analysis

* VC portfolio companies lack an appropriate benchmark because of their peculiar nature of start-ups, their size at the time of the investment, etc. (SVCA and PwC 2012). In this study, small-cap listed firms are used as benchmark, based on previous literature.

A unique sample of portfolio companies, including exited investments

Definitions

Portfolio company: Company whose majority of the equity capital is owned by a Private Equity firm. In this study, groups of companies are considered as one entity

Venture Capital: PE firm that invests in companies in early development stages. In this study the definition includes private funds as well as state-backed institutions

Buyout firm: PE firm that invests in companies in later stages of development. In this study buyout includes also growth capital

Value Added: The term Value Added is a measure of the additional value created for society by a company's employees and capital. It is directly comparable to GDP and defined as EBITDA + wage costs

EBITDA: Earnings before interest, taxes, depreciation and amortization. Can be considered a good proxy of the operating cash flow generated by the firm

CAGR: Compound annual growth rate. Tells the annual growth rate of an investment by assuming a linear growth trajectory

Micro-firms: Firms with 0-9 employees

Large-cap*: Companies with a market value above € 1 billion

Mid-cap*: Companies with market value between € 150 million and € 1 billion

Small-cap*: Companies with market value below € 150 million

ICT: Information and Communication Technologies, used in this study as a near synonym of Technology

Life Sciences: Sector centering on Biology and related fields. Represents a better specification than the broader term ”health care”

Trade sale: An exit path in which the owner of the firm sells it to another financial or strategic counterparty

Listing (IPO): An exit path in which the shares of the portfolio company start to be traded on pubilc markets and are gradually sold by the PE owner

State-backed VC fund: VC fund that is used by the responsible ministries as a tool to boost entrepreneurship. The definition excludes university backed funds, even though the universities themselves migh be public.

* Source: NASDAQ OMX Nordics, https://indexes.nasdaqomx.com/docs/Methodology_NORDIC.pdf

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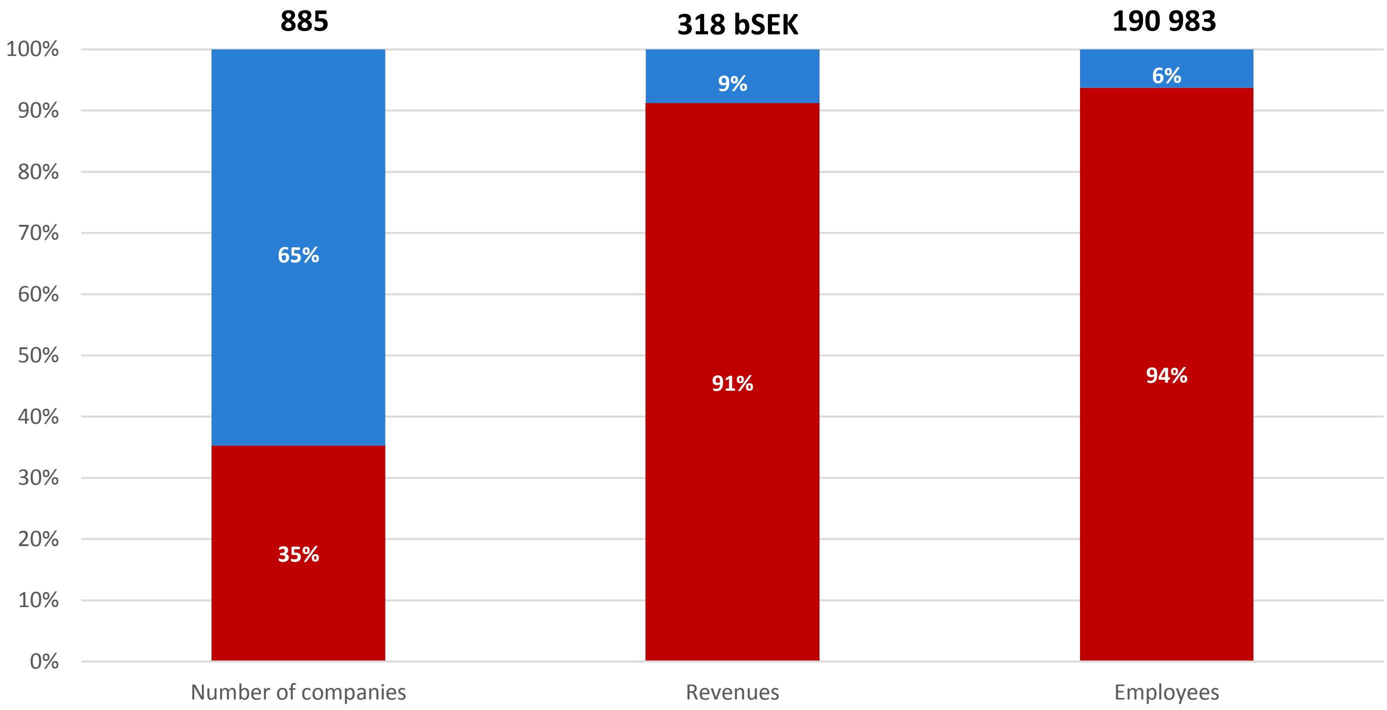
Private Equity represents a substantial part of the Swedish economy

- **318 billion** SEK in **revenue** by PE portfolio companies is comparable to **8.4%** of Swedish **GDP**
- **190 983** employees in PE portfolio companies is comparable to **4.1%** of the **Swedish** employed **workforce**
- **Buyout** portfolio companies represent **91%** of the **revenues** and **94%** of the **employees** in PE portfolio companies, despite making up only for **35%** of the **firms**
  - **VC-backed** firms start very often from a much **smaller size** and **expand** thereafter



	Number of companies	%	Revenues 2013 (bSEK)	%	Employees (2013)	%
Total	885	100%	318	100%	190 983	100%
Buyout	312	35%	290	91%	179 026	94%
Venture	573	65%	28	9%	11 957	6%

[*] Despite the fact that GDP is not directly comparable to revenues, it can be an intuitive benchmark measure to gauge the size of the industry. GDP is also the standard benchmark in similar studies on PE, see SVCA (2012), EVCA (2014)

More divestments than new investments
Venture on the rise again

The relative reduction in the relevance of PE portfolio companies can be explained by:

- Relatively **low deal flow** for new buyout investments
  - Over the years 2013-2014, divestments have exceeded new investments by around 404 mSEK[1]
- The **low deal flow** has been driven mainly by the different **phase in the investment cycle**
  - Especially for **buyout**, the years **preceding 2013-2014** have seen most of the **investments**, implying that the **current** phase is one of **development** and **realization** of previous investments
- The **welfare sector**, which in Sweden has a sizeable importance in terms of people employed and turnover, is **not** attracting new capital from Private Equity firms[2]
  - Although several large players in the welfare sectors are still PE-owned, there has been a clear slowdown in new investment in the sector

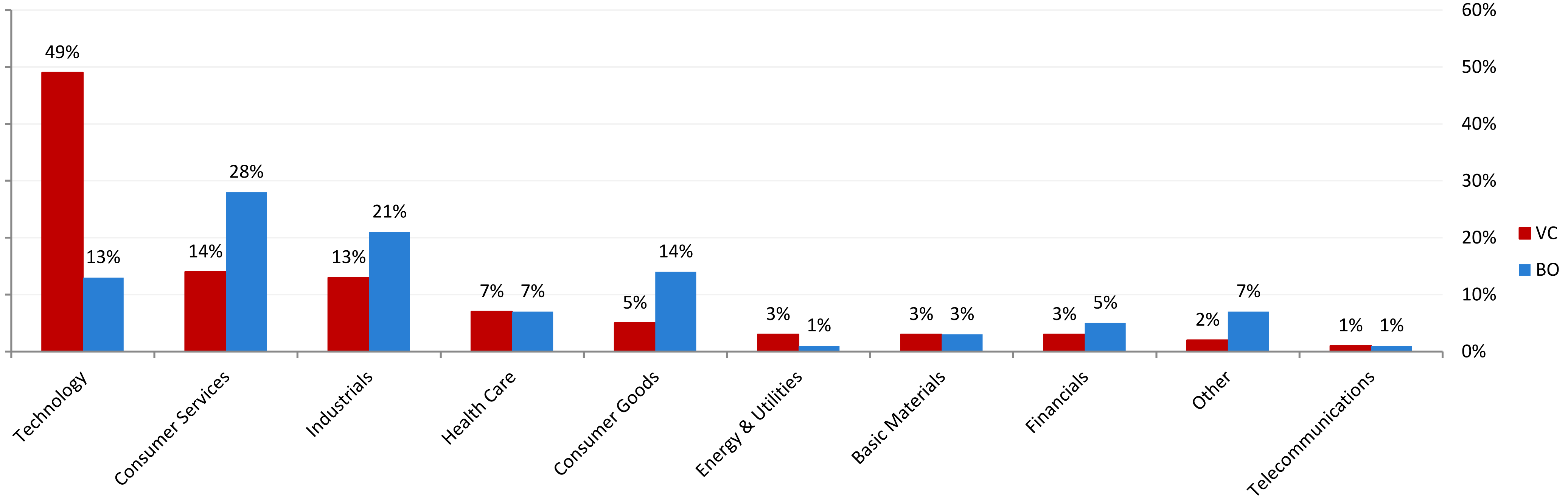
Venture Capital investment has gained traction starting from 2013[3]

- The **balance** of Private Equity investments has **shifted more towards Venture**, as shown by the large number of VC-backed firms in the sample
- The large number of Swedish **start-ups** backed by VC firms represent a **great growth potential** going forward
  - In 2011 Q4 there were only 464 VC-backed firms compared to 537 in 2013 Q4
- A substantial deal of the new Venture investments has been made by **state-backed VC firms**
  - Out of 537 VC-backed firms in 2013, 236 were portfolio companies of state-sponsored VC funds
- **Most** of the **VC**-backed firms are **micro-firms**, i.e. firms with less than 9 employees

[1] EVCA, 2014 Yearbook
[2] SVCA, Private Equity har flytt välfärdssektorn på grund av den politiska osäkerheten (2014-03-12)
[3] Tillväxtanalys: Riskkapitalstatistik 2013: Venture Capital (2014-11-28)

Venture Capital investments focus on ICT
Buyout firms show a more diversified industry focus

Distribution by Industry of Portfolio Companies*



Sources: SVCA, Retriever

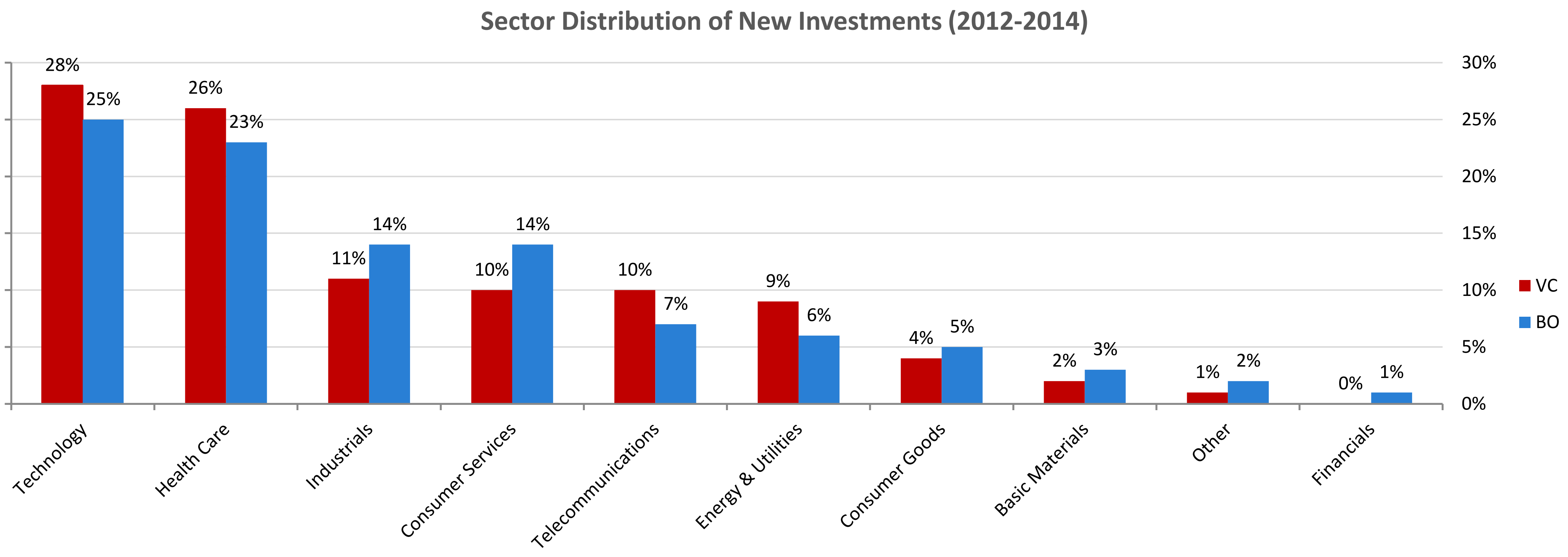
- **About half** of the VC-backed firms operate within **Technology**. Most of these work on **Software** development
- **Services** and **Industrials** capture a **substantial share** of the remaining firms

Sources: SVCA, Retriever

- Buyout firms show a **diversified** sector distribution, dominated by **Services** and **Industrials**
- A **sizeable** amount of firms operates also in **less traditional** sectors such as **Technology** and **Health Care**

* To constructs these graphs, the BVCA industry classification was used to simplify the broader sector framework provided by Retriever.

Most current trends (2012-2014) confirm that VC investment tends to concentrate in ICT and health care; Buyout shows broader focus



Sources: SVCA, EVCA

Sources: SVCA, EVCA

- **About half** of the **new investments** in the last few years concentrated in **ICT** and **Life Sciences**
- Investment in **Technology** has **accelerated**, since it accounted only for **24%** of VC investments in **2007-2011**

- **Buyout** investment has focused increasingly on **Industrials** and **Services**
- The largest **difference** with the previous trend is the **drop** in **Health Care** investment (**18%** in **2007-2011**)

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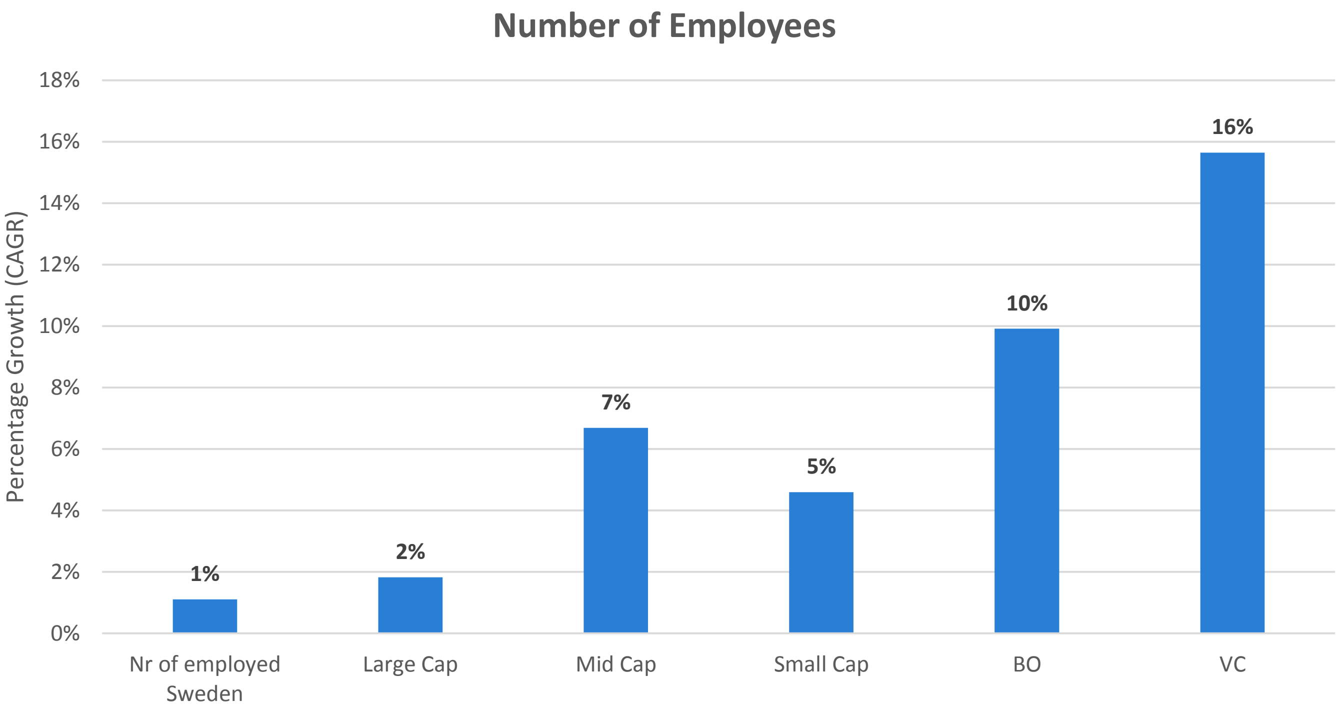
PE-backed Swedish firms outperform public comparables in terms of job creation

- PE-backed companies **outperform** in terms of **growth** in number of employees
- **VC**-backed firms show the **fastest** growth in number of **employees** (~ **16%** p.a.)
- **Buyout** portfolio companies show the **solid** employment growth patterns (~ **10%** p.a.)
- Among public companies, only **mid-cap** firms show **comparable**, albeit **lower**, growth numbers

Private Equity portfolio firms are a dynamic part of the Swedish labor market

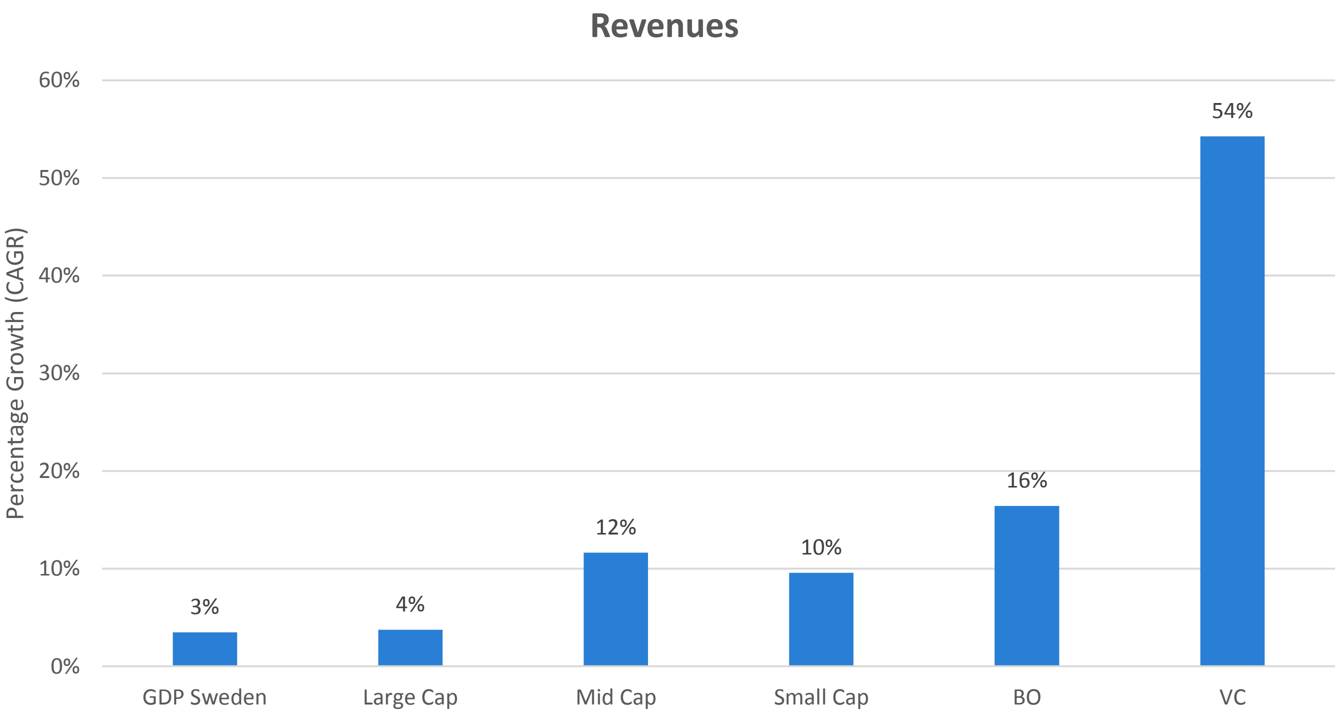


Sources: SVCA, Retriever, EVCA, SCB

Revenue growth is stronger among PE-backed firms than among publicly listed firms

- PE-backed companies **outperform** in terms of **growth** in revenues*
- **VC**-backed firms show the **fastest** growth in **revenues** (**~ 54%** p.a.)
  - This number might seem hard to justify, but one has to think that VC portfolio companies start from a small size, and often manage to double or triple their business in just a few years
- **Buyout** portfolio companies also **outperform** public comparables (**~ 16%** p.a.)
- Among public companies, only **mid-cap** firms show **comparable**, albeit **lower**, growth numbers

Private Equity represents a fast-growing part of the Swedish economy



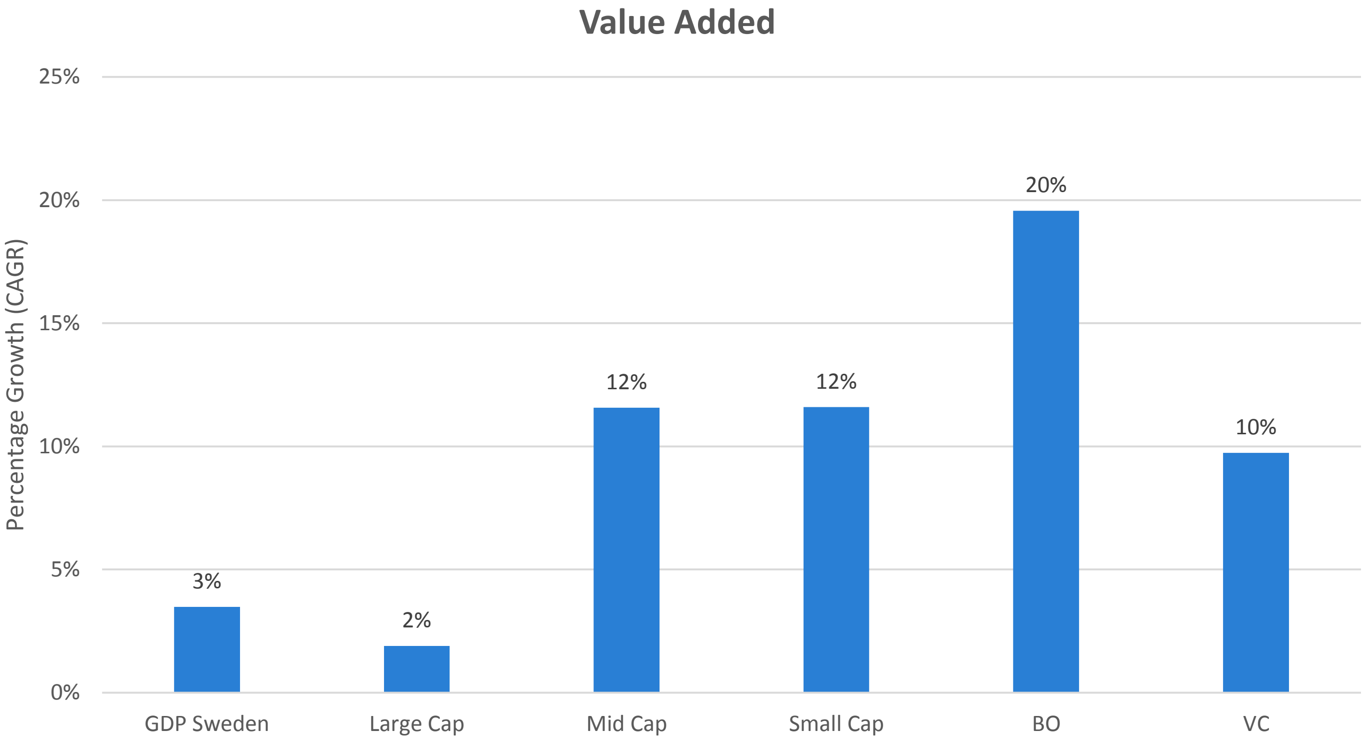
Sources: SVCA, Retriever, EVCA, SCB

* The graph reports a comparison with the Swedish GDP, which is the most intutive macroeconomic benchmark. GDP however cannot be compared directly with revenues and therefore the results have only illustrative purposes.

Buyout portfolio companies are the best performers in terms of growth in value added

- Buyout portfolio companies **outperform** in terms of **growth** in value added* with a **CAGR** of **~ 20%**
  - The strong growth in value added for **buyouts** might be explained by both the hiring of **more employees**, and the effort to **improve operating margins**
- **VC**-backed firms lag slightly behind small- and mid-cap comparables (**~ 10%)**
  - This **slight underperformance** might be due to the fact that **newly established** firms might need to **focus** more on **market penetration** in the first years of existence **rather than** on **margin** improvements

Private Equity growth translates into growth in the value added for society



Sources: SVCA, Retriever, EVCA, SCB

* Value added is defined as the sum of EBITDA and wage costs.

Improvements in operational efficiency and market extension explain strong growth numbers

PE-backed firms manage to grow thanks to streamilining of operations and expansion of products and markets

- VC-backed firms usually **start from low volumes** and a **low number of employees**; this helps explain their rapid revenue and employment growth
  - The **VC investment model**, however, has evolved from the simple injection of funds to the development of a **business network** for portfolio firms; this contributes to **protracted expansion** in later stages
- Buyout portfolio firms usually **start** from sizes **comparable** to those of listed **small- and mid-cap** firms
  - The **Private Equity governance model**, however, provides more **flexibility** in making the **key strategic changes** that drive the expansion of the business
  - **PE-ownership** also allows companies to have an **easier access** to different sources of **funding** at a **lower cost than** the one the individual company would face **on its own**

The strong growth in value added shows that growth in volumes is most often also translated into value created for the society as a whole

- **Value added** is a **good measure** for the value created by a firm as it captures the **benefit received by both capital and labor providers**
- Value added is a **comparable measure to GDP** as it can approximate income for both firms and individuals
- The fact that portfolio companies manage to **grow not only in size** (revenues and employees), but also in terms of **added-value** highlights the **strength of the Private Equity model** in managing operations

Sources: SVCA, Private Equity Performance Study 2012; DVCA & Capital Dynamics, Value Creation in Danish Private Equity Exits

Buyout portfolio companies show stronger growth than comparables in employment and value added, similar growth in revenues

Buyout portfolio companies show strong employment creation

- With a **8% CAGR**, buyout portfolio companies **outperform** listed **mid-caps** and the **Swedish labor market** as a whole

Buyout portfolio companies show revenue growth that is essentially in line with that of public comparables

- With a revenue growth of **12.5%,** buyout portfolio firms **lag slightly** behind mid-caps over the course of a 5 year period after the investment
- It has to be noted, though, that in the **first 3 years**, revenues in portfolio companies **grow faster**

Buyout portfolio companies show strong growth in value added after the investment

- This points to the substantial efforts made to **improve the margins** of portfolio companies, as well as to the **expansion** in the number of **employees**, which translates into **higher wage expenses**

It can be concluded that PE investment in buyout portfolio companies provides substantial growth that in most of the cases exceeds that of public firms

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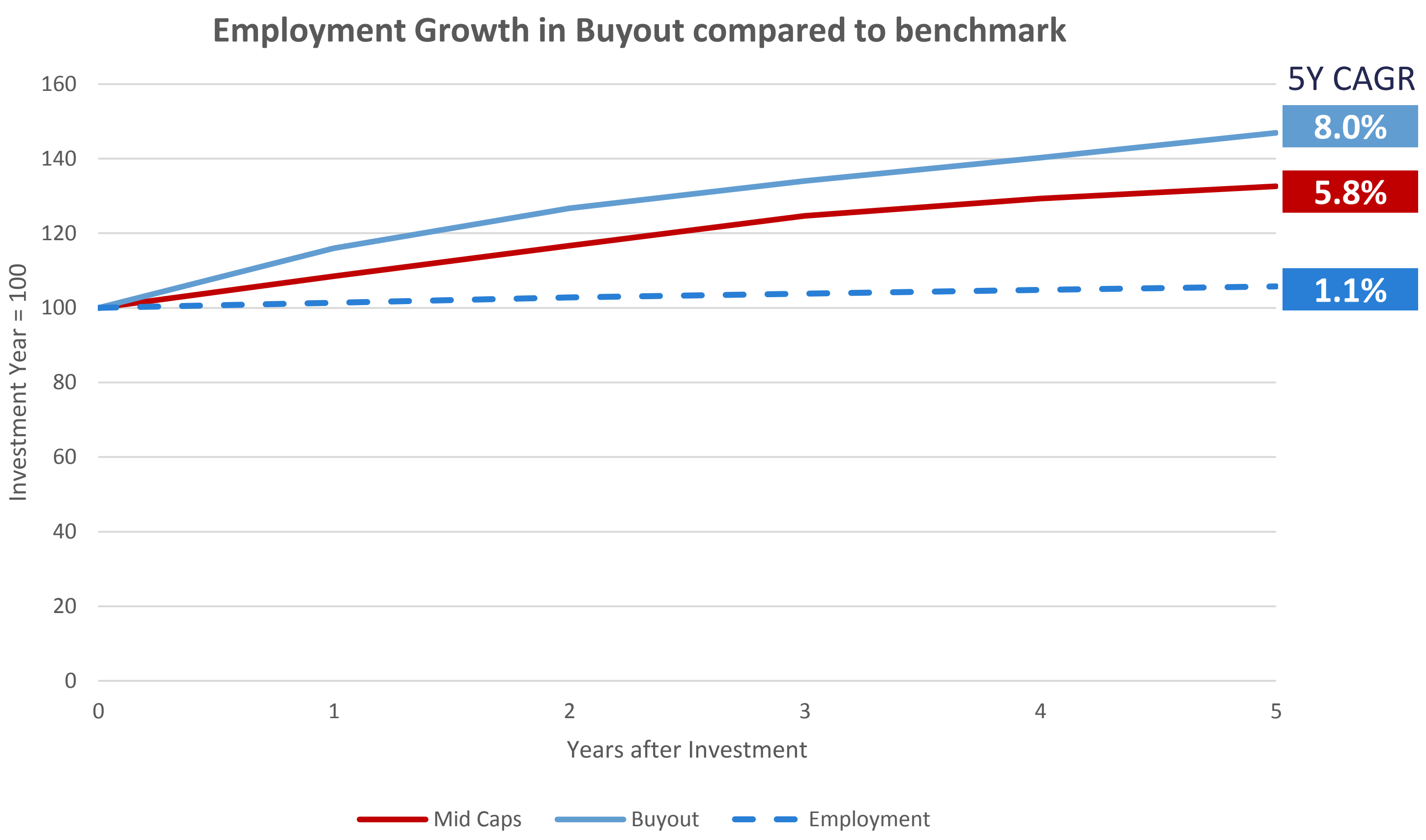
Buyout portfolio firms outperform mid-caps comparables in terms of employment growth

- **Employment** in buyout portfolio firms grows at an average of **8%** over the five years following the investment
- **Mid-cap** listed firms show a weaker growth in number of employees, averaging only ~ 6% p.a.
- The **outperformance** of **buyout** portfolio companies becomes even more **striking** when looking at the aggregate numbers for **employment in Sweden**

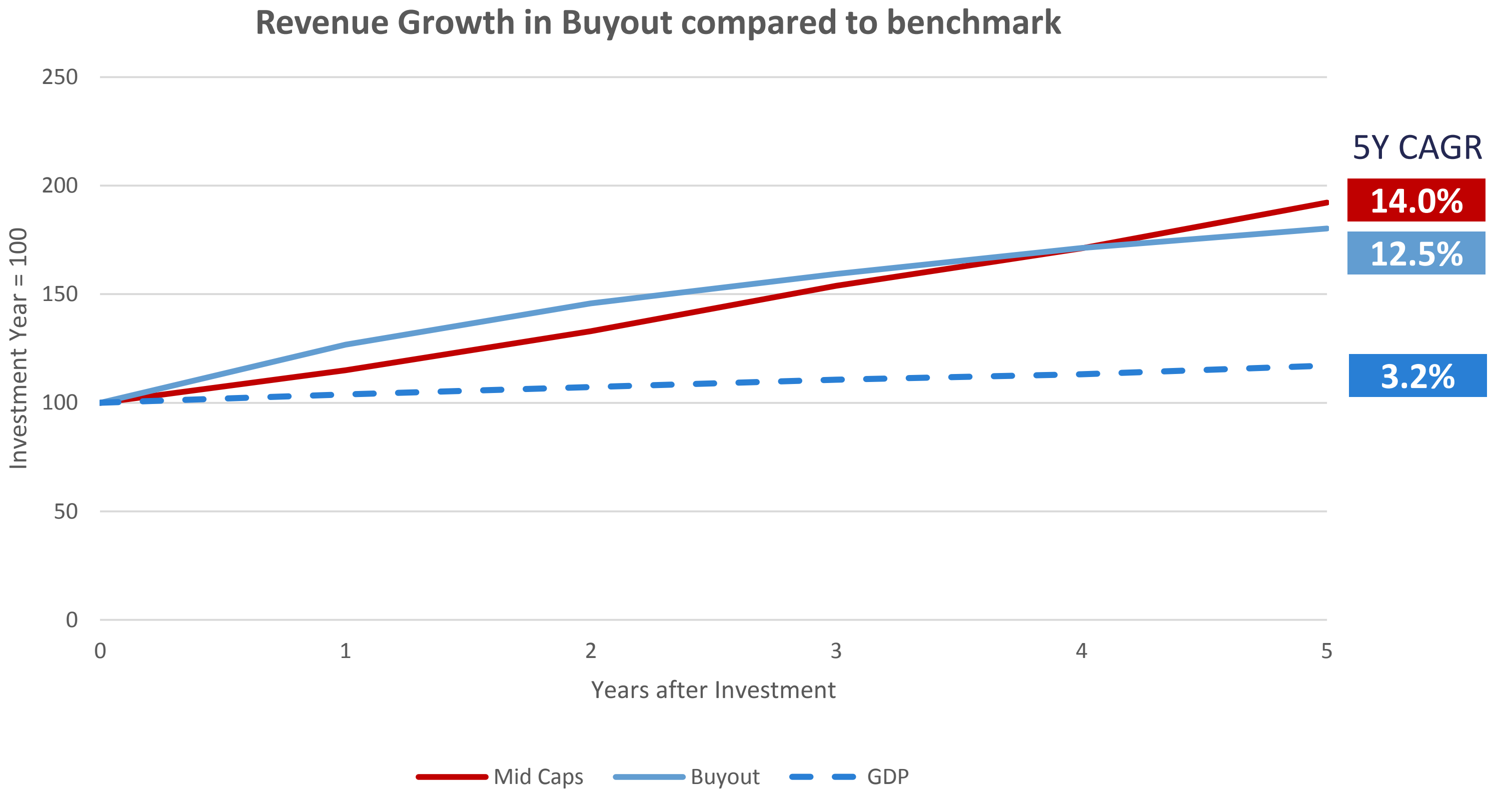
PE-owned firms do not grow by cutting jobs, but rather create employment at a faster pace than comparable firms



Sources: SVCA, Retriever, EVCA, SCB

Buyout portfolio companies show a revenue growth in line with public comparables, but faster in the first years

- In the **five years** following the investment, **revenues** in buyout portfolio companies increase at a **CAGR** of **12.5%**
- **Mid-cap** public firms, a good benchmark for **mid-market** buyouts, **slightly outperform** over the course of the five years
- Overall buyout portfolio companies show a **faster growth** in the **first 2-3 years**, when the Private Equity ownership model adds the most value



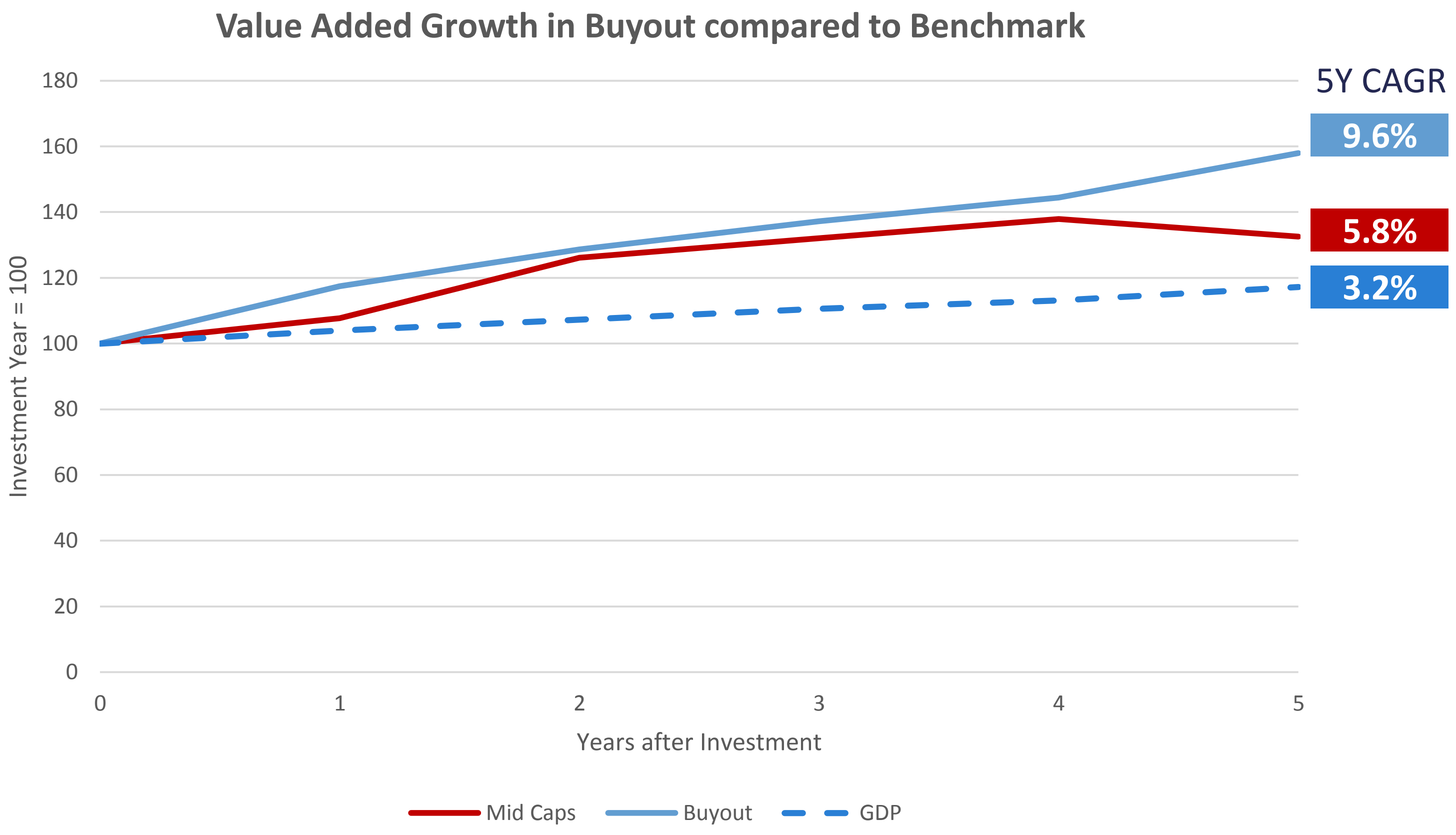
Sources: SVCA, Retriever, EVCA, SCB

Buyout portfolio companies show a revenue growth that outpaces the economy as a whole

Buyout portfolio companies are the best performers in terms of value creation

- In the **five years** following the investment, **value added** in buyout portfolio companies increases at a **CAGR** of **9.6%**
- **Small-cap** listed firms show a **similar growth** profile which then becomes **subdued** in later years
- Overall buyout portfolio firms manage to **increase** their **value added** at a **much faster pace** than both **listed comparables** and the **economy** as a whole

Buyout portfolio companies create real value for their owners and their employees by boosting their value added



Sources: SVCA, Retriever, EVCA, SCB

Venture portfolio companies show stronger growth than comparables in employment and value added, similar growth in revenues

Venture portfolio companies show strong employment creation

- With a 12% CAGR, VC portfolio companies outperform listed small-caps and the Swedish labor market as a whole

Venture portfolio companies show revenue growth that largely exceeds that of listed firms

- With a revenue growth of 35.9%, venture portfolio firms outperform substantially small-caps over the course of a 5 year period after the investment
- It has to be noted, though, that small-caps are poor benchmark given that their starting size is significantly larger than that of VC portfolio companies, making it harder to achieve comparable growth

Venture portfolio companies show strong growth in value added after the investment

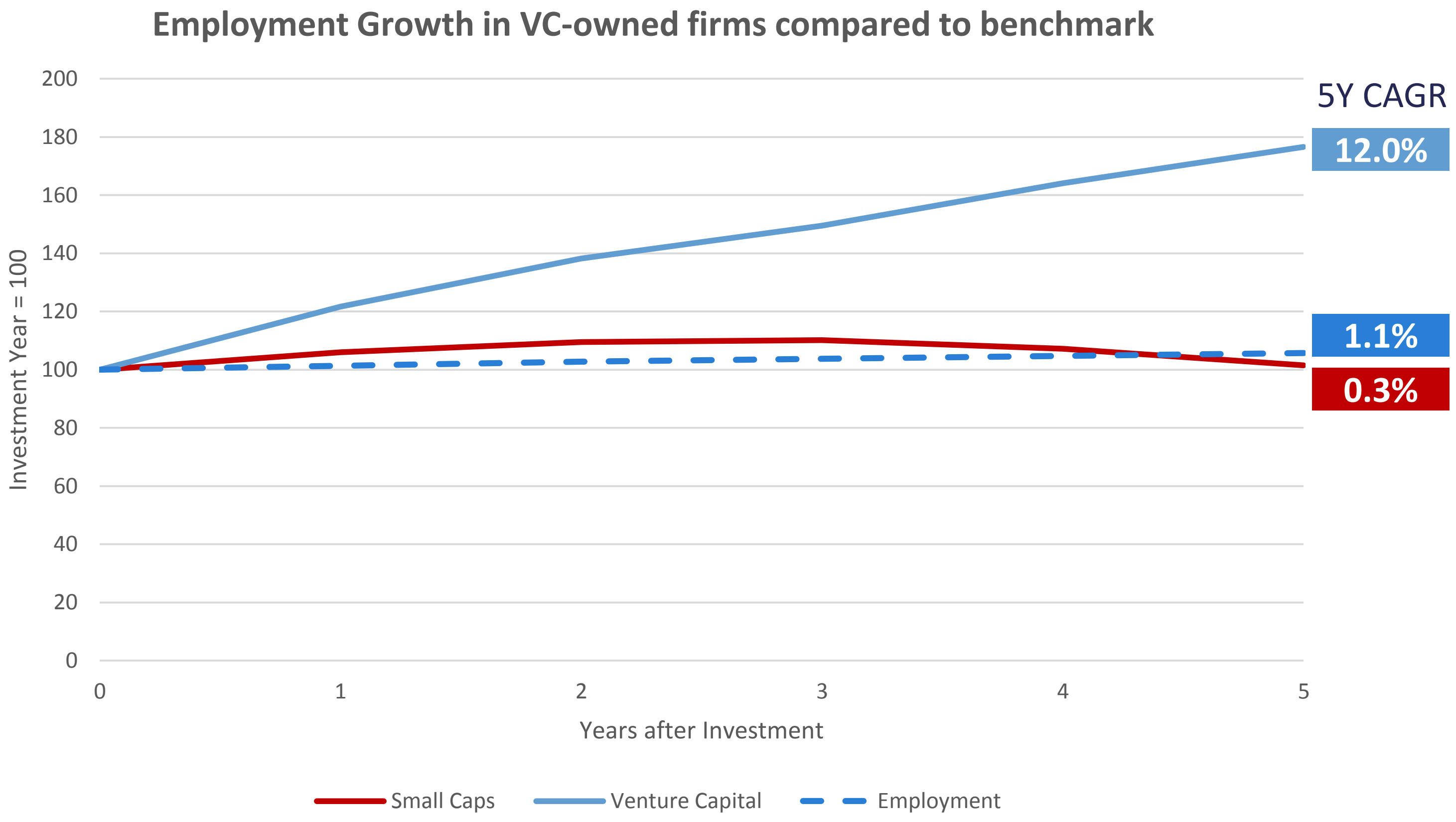
- VC investment seems to add most value in the first 2 years after the investment
- Overall, VC portfolio companies outperform small-cap listed firms in terms of growth in value added

Despite many benchmarking caveats, VC portfolio firms grow at a faster pace than comparables and show a remarkable growth path after the investment

VC-backed firms create more jobs than public comparable companies

- **Employment** in VC-owned firms grows at an average of **12%** over the five years following the investment
- **Small-cap** listed firms are a **poor benchmark** given their larger starting size
- The **difference** in growth trends is nonetheless **striking**, since both **small-caps** and **Sweden** as a whole show **weak job-creation** trends

VC portfolio companies are among the fastest-growing firms in Sweden in terms of job creation

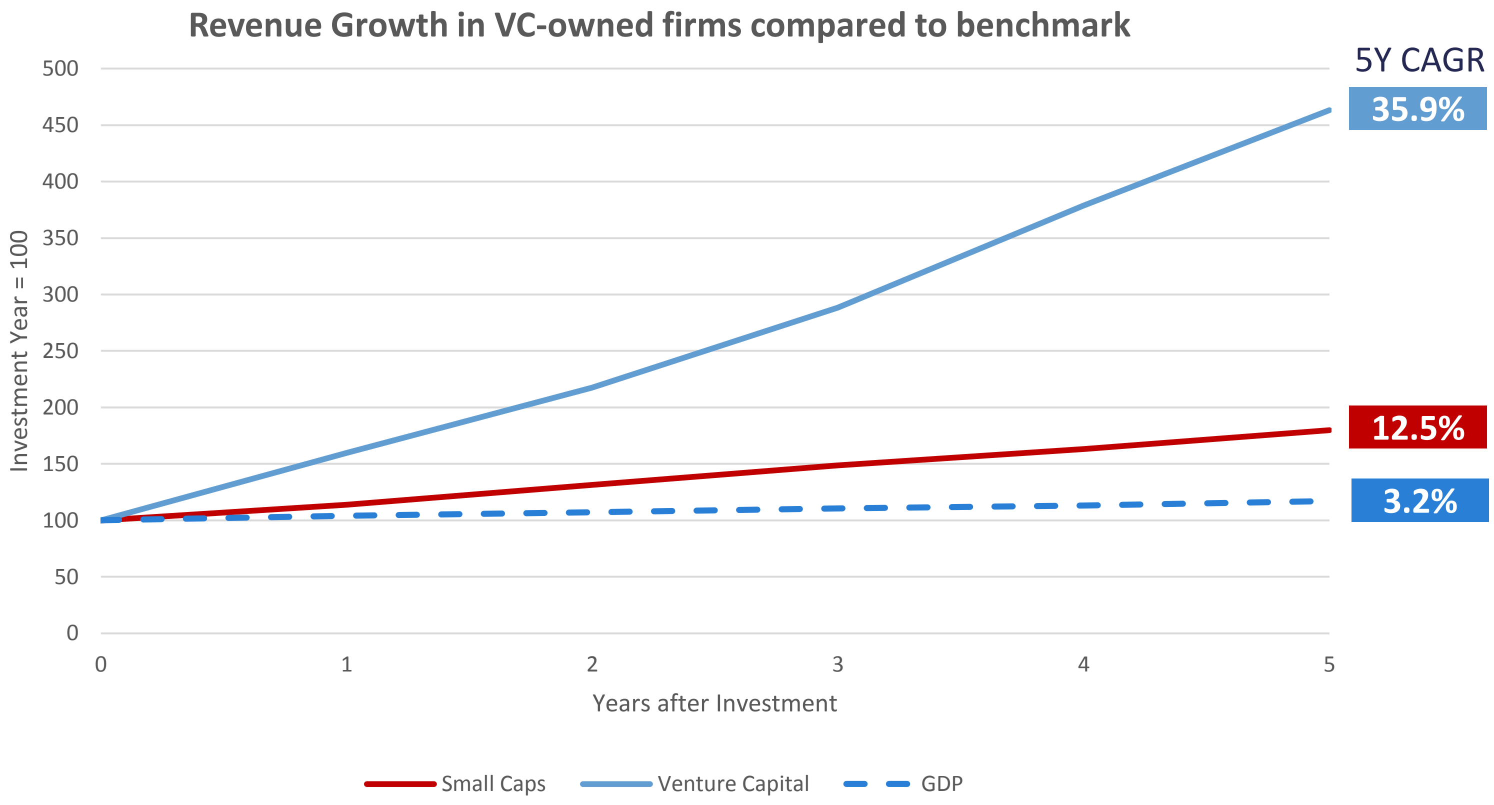


Sources: SVCA, Retriever, EVCA, SCB

VC-backed firms show rapid revenue growth after the first investment

- In the **five years** following a VC investment, **revenues** in VC portfolio companies increase at a **CAGR** of **~ 36%**
- **Small-cap** public firms are much larger in size, and thus an **imperfect benchmark**
- It is clear, however, that VC-backed Swedish firms manage to increase revenues at a **faster pace** than **any** other **comparable** group

VC investment helps unleash the great revenue growth potential of Swedish start-ups

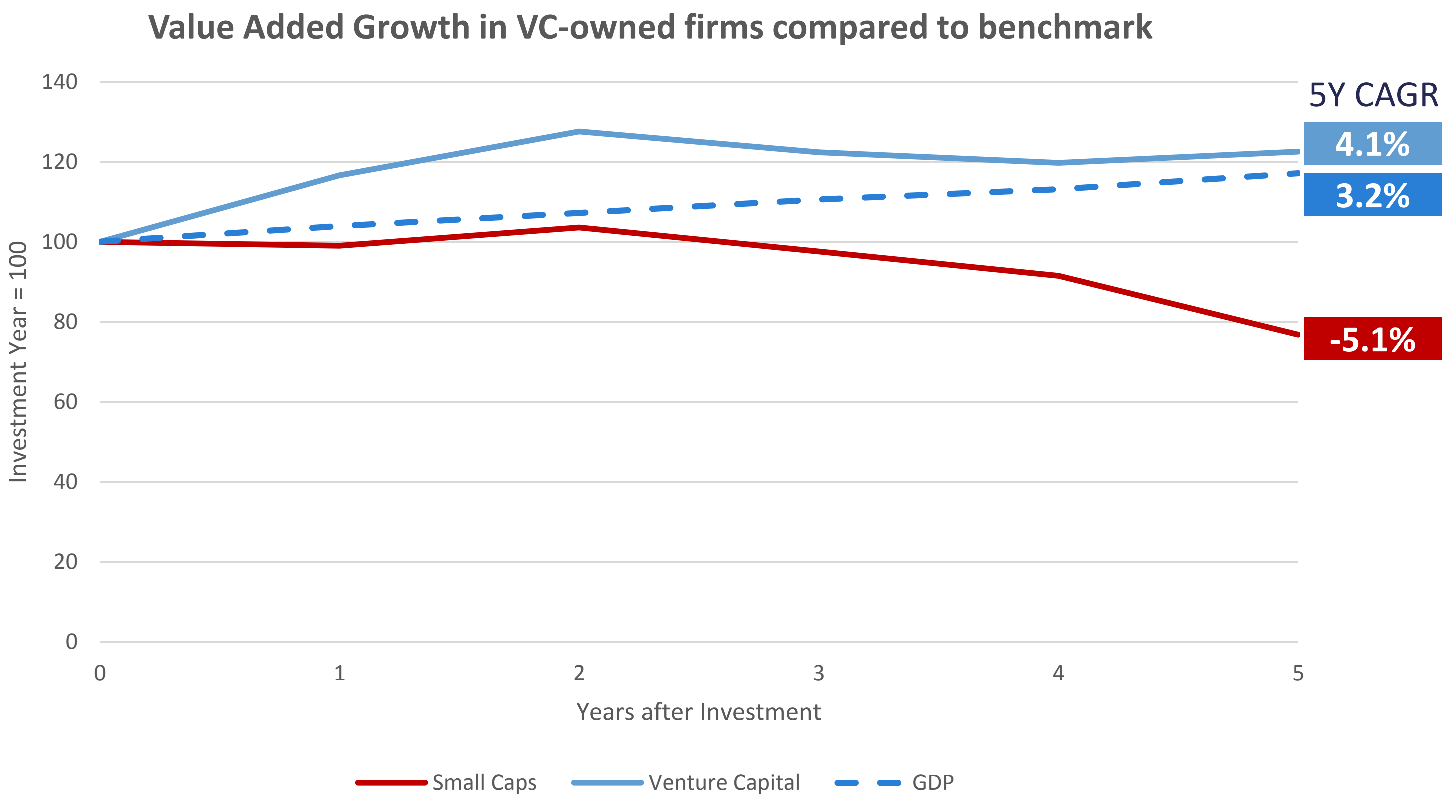


Sources: SVCA, Retriever, EVCA, SCB

VC-backed firms show a rapid increase in Value Added in the first years after the investment

- In the **five years** following the investment, **value added** in VC-backed companies increases at a **CAGR** of **4.1%**
- **Small-cap** listed firms show a **stagnant** growth that turns **negative** in the second half of the period
- Overall **VC**-backed firms manage to increase their **value added** at a **faster pace** than the **economy** as a whole

VC portfolio companies not only expand by increasing revenues, but also create real value for owners and employees



Sources: SVCA, Retriever, EVCA, SCB

Private Equity provides most value in the first years after the investment without compromising long-term potential

Private Equity firms tend to hold their investments for an average of 4-6 years [1]

- **After** this period most investments are **exited** through either a **listing** or a **trade sale**
- It is natural that **most operational improvements** come in the very **first years** of PE-ownership
- The **relatively small size** of porfolio companies upon the investment also contributes to the growth **outperformance** in the **first years**

Outperformance compared to public benchmarks continues also in later stages

- For most variables we see that both **Buyout** and **VC** portfolio companies **keep on outperforming listed** firms and the economy as a whole even in **years 4-5**
- Even **after** the investment is **exited**, PE-backed firms continue to have an **edge** in terms of **performance**
  - For instance, **PE-sponsored IPOs** tend to **perform better** than **non-sponsored IPOs**, and **the market** as a whole over both short and long horizons [2]

[1] At the beginning of 2015, the average holding period for European PE firms was 5.6 years. Source: Preqin, May 2015.
[2] SVCA, Private Equity IPOs beat the market, 2015-02-19.

Previous academic and empirical literature supports the findings of superior performance of PE portfolio firms

Results of previous studies on Private Equity portfolio companies

Key Findings	Academic Literature	Empirical Literature
Private Equity portfolio firms add employees at a faster pace than comparables	**Davis et al. (2011):** PE has a positive impact on net employment that exceeds that of control firms	**SVCA and PwC (2012):** Buyout and VC portfolio companies employment grows faster than comparables **Frontier Economics (2013):** PE portfolio companies show higher employment growth and employees satisfaction
Private Equity portfolio companies grow faster and PE investment drives growth	**Bernstein et al. (2010)**: Industries where PE investment is more present have grown faster in terms of employemnt and productivity in the five years up to 2007	**A.T.Kearney (2013):** PE fund companies outperform public industry peers. The strongest outperformance occurs in stable and low-growth sectors
Private Equity portfolio companies improve margins more than peers	**Acharaya et al. (2009):** PE improves EBITDA multiples even after taking into account the effect of leverage. Margin growth outperforms that of quoted peers	**BCG (2012):** Market conditions are making it more crucial for PE firms to focus on operational improvements. Boosting EBITDA is a key concern for General Parners
The improvements brought by the PE governance model do not die out in the short-term	**Lerner et al. (2008):** Buyout portfolio companies do not sacrifice long-term investments but rather switch to more innovative investments	**Ratio Institute (2014):** PE portfolio companies show very strong post-exit results in terms of financial performance

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Final Summary:

1. Private Equity portfolio companies represent a relevant part of the Swedish economy, accounting for 8% of GDP and 4% of total employment
2. PE-backed companies grow at a faster pace than the economy as a whole and than other firms of comparable size
3. Overall, Buyout and Venture portfolio companies manage to grow faster in terms of number of employees, revenues and value added
4. PE-owned firms outperform especially at the earliest stages of the investment, with Venture portfolio companies growing faster in the very first years and Buyout portfolio companies keeping pace over a longer horizon

Disclaimer

Limitations in the data:
All relevant information regarding the portfolio companies have been collected directly from private equity firms active within the Swedish market. In addition, data from SVCA's databases and public information has been incorporated into the dataset. Data from annual accounts for both private equity backed firms and relevant peer groups has been supplied by Retriever.
Private Equity funds themselves report the details of their deals to EVCA: the classification of investments, investment stages and types of portfolio firms is therefore based on the funds' own assessments. This implies that there might be some limitations in the degree of accuracy and that some data from the smallest funds/firms might be omitted. Moreover, the fact that organization numbers are used for the classification might imply that all operations that are PE-backed but do not constitute an independent firm are omitted from the study. The use of organization numbers implies also that, whenever a company decides to use different legal entities to conduct its operations, it might be hard to capture the full scope of the operations. Whenever possible, this study has made use of several organization numbers in order to capture both the broadest scope of the operations and the specific limits of the Swedish operations. Several firms in the sample however lack this completeness of data, something that could potentially lead to biased results.

Limitations in the methodology:
In order to give a more precise picture of the growth of PE-backed firms, it has been chose to exclude the outliers in the top and bottom 5% of the sample. Following a thourough screening of the data, we have concluded that the most part of these extreme values had been caused by faulty financial reports (e.g. use of different companies in the corporate structure to conduct operations, switching to consolidation of financial statements, etc.). Therefore, these data entries, with most likelihood do not constitute a meaningful and informative part of the sample. However, in adopting a consistent statistical methodology throughout all the sub-samples, some relevant entries could have been lost. In the construction of the index of public comparable companies, it has been decided to use index weights that replicate the investment patterns and holding periods of portfolio firms. This methodology is, to the best of the authors' knowledge, a sensible way to assess the impact of PE investment of firm growth. However, the use of yearly financial data for the indices and for the portfolio firms, as well as the above-mentioned data limitation that might be due to subjective reporting, might induce slight approximation errors.

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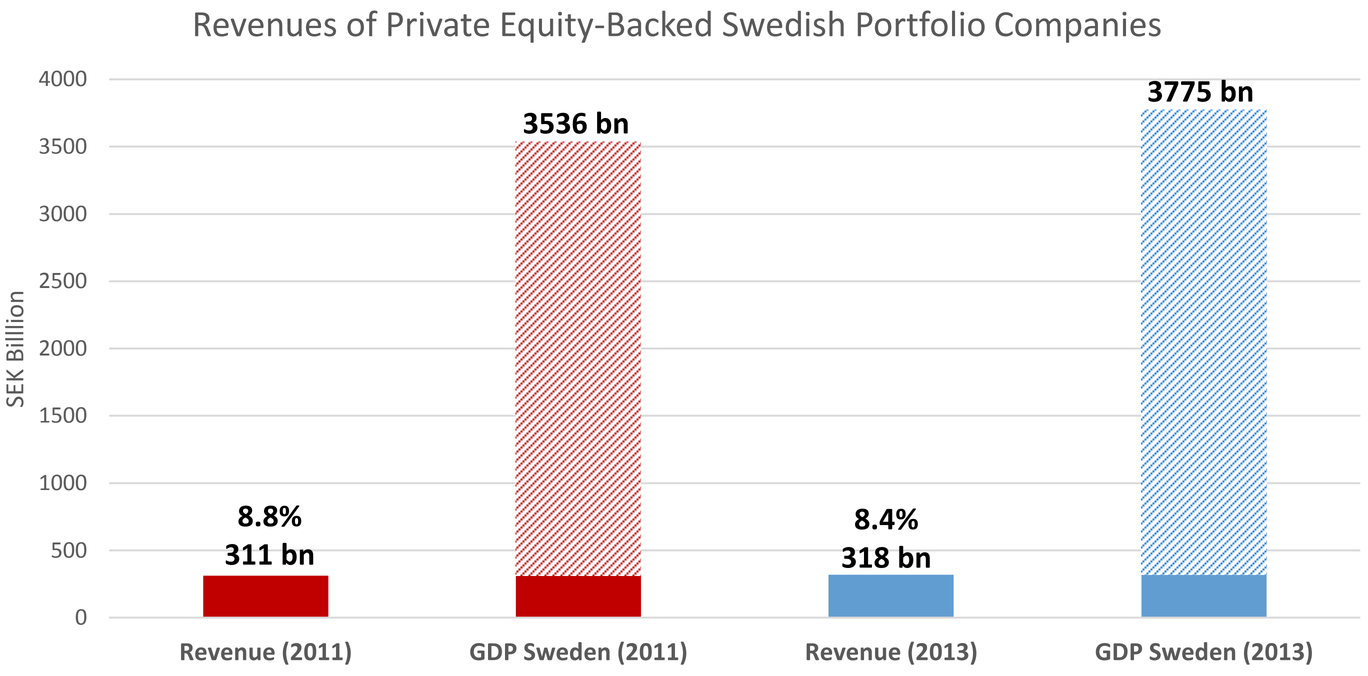
Appendix

Private Equity represents a substantial part of the Swedish economy

- **Revenues** by PE-owned firms totaled 318 bSEK in 2013, corresponding to **8.4% of Swedish GDP***
  - In 2011 the proportion was **8.8%**
- Despite a **growth in absolute size** of the sector, PE portfolio companies represent a **slightly smaller part** of the **Swedish economy**
- **Buyout** portfolio companies represent **91%** of the **revenues** in PE, despite making up only for **35%** of the **firms**
  - **VC-backed** firms start very often from a much **smaller size** and **expand** thereafter



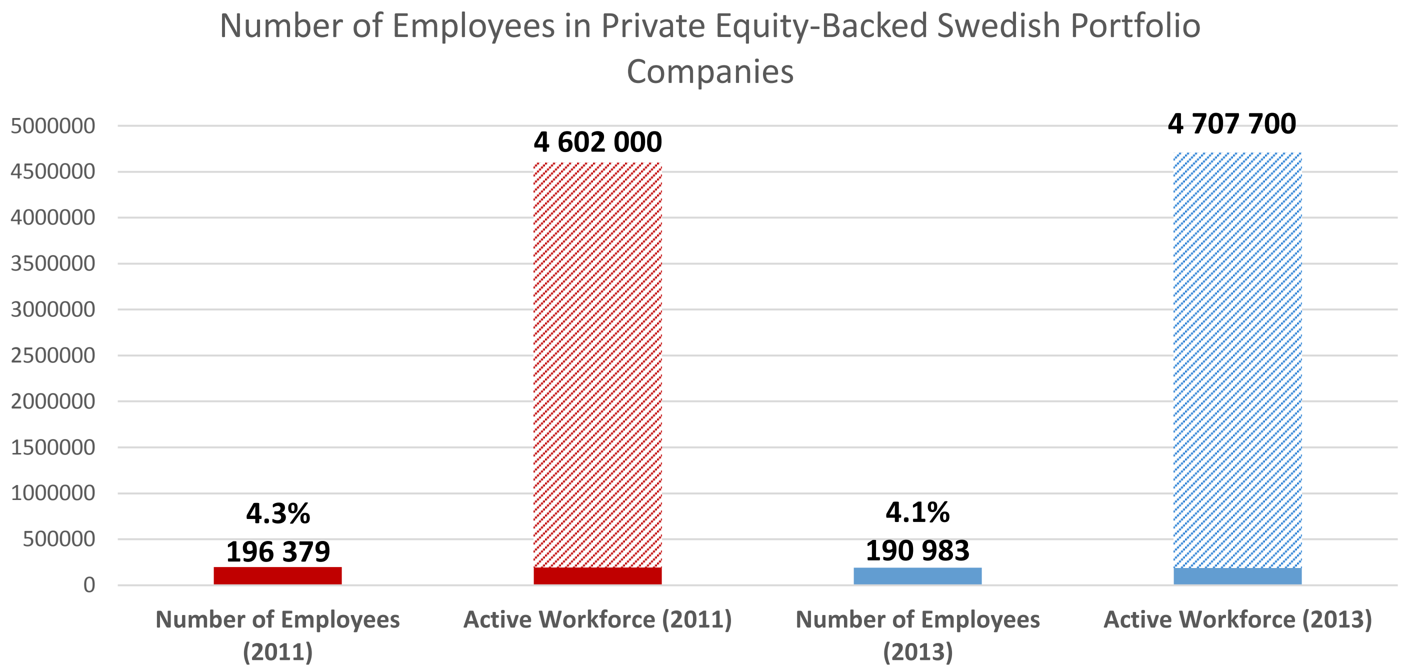
A limited number of new investments has caused a relative decrease in the importance of the Private Equity sector

	Number of companies	%	Revenues 2013 (bSEK)	%
Total	885	100%	318	100%
Buyout	312	35%	290	91%
Venture	573	65%	28	9%

* Despite the fact that GDP is not directly comparable to revenues, it can be an intuitive benchmark measure to gauge the size of the industry. GDP is also the standard benchmark in similar studies on PE, see SVCA (2012), EVCA (2014)

Private Equity represents a substantial part of the Swedish economy

- PE portfolio companies employ about 191 000 people, corresponding to **4.1% of the Swedish employed workforce**
  - In 2011 the proportion was **4.3%**
- PE-backed firms employ **5.9%** of the people working in the **Swedish private sector** (6.1% in 2011)
- As for revenues, **buyout** portfolio companies account for **most** of the **employees** (94%)



The decrease in number of employees, also in absolute terms, is due mainly to the current phase in the investment cycle

	Number of companies	%	Employees (2013)	%
Total	885	100%	190 983	100%
Buyout	312	27%	179 026	94%
Venture	573	73%	11 957	6%