

Value Creation In Danish Private Equity Exits

May 2011

Private equity in Denmark: operational improvements – key driver of the value generation

- 70% of value creation is driven by (i) operational improvement in the portfolio companies and (ii) valuation multiple arbitrage
- The operational performance of private equity-backed companies is superior to that of publicly traded peers
- Only 30% of value creation is driven by leverage, i.e. increasing the return on equity by taking on more debt
- The detailed analysis of value drivers in private equity is based on value creation and cash flow data from 44 realized private equity transactions across 11 managers in Denmark. This study follows the 2009 European study for 241 exits. The current study is one of the most comprehensive studies of value creation in Danish private equity from the perspective of the general partner (GP).

Content

Introduction

Sample

Value creation in private equity transactions

Benchmarking private equity

Comparison with European exits study

Objective: a detailed analysis of value drivers in Danish private equity transactions

- The purpose of this study is to identify value drivers in Danish private equity transactions. For this purpose, the common method for analyzing value creation was further refined based on academic insights
- The focus is on separating the value contributions of:
 - the use of leverage
 - operational improvement
 - multiple arbitrage
- The effect of debt on the return on equity can be shown by quantifying the leverage effect which allows quantification of the importance of financial engineering in private equity
- Value creation is examined from a GP's perspective. At the same time, the operational development of the portfolio companies is analyzed
- The validity of the results is reinforced by comparing value creation at private equity-backed companies with that of publicly traded peers.

Key sample statistics

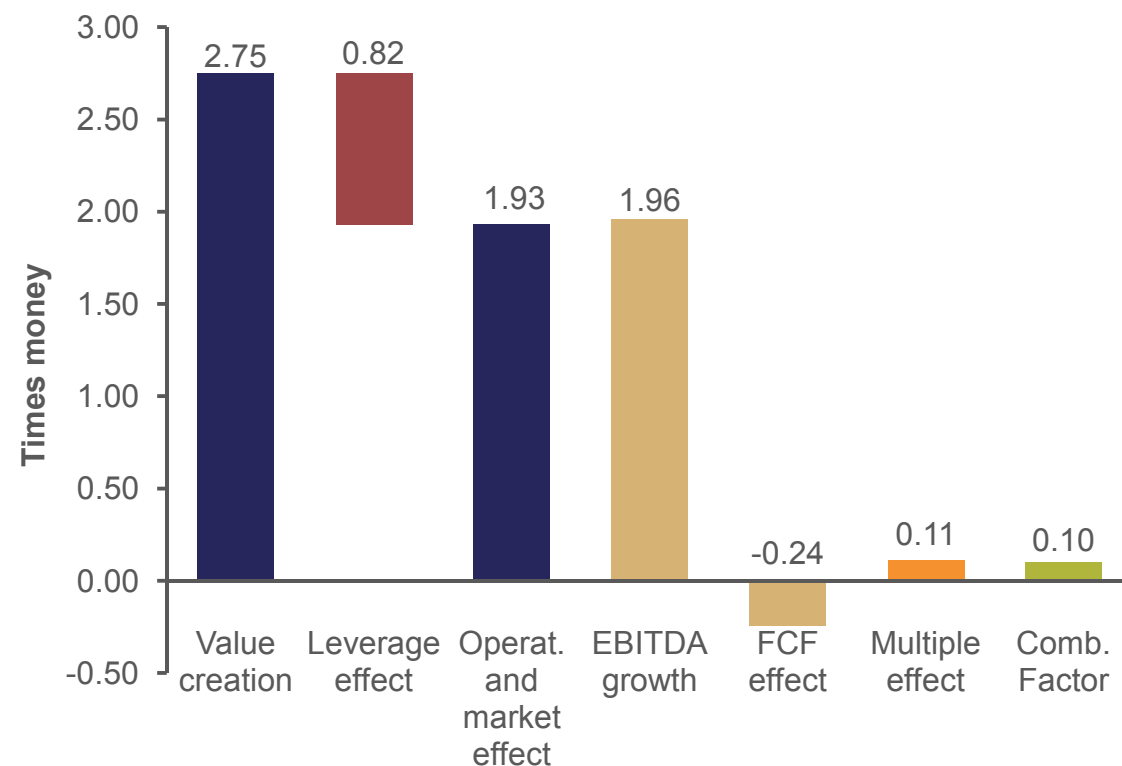
44 Transactions	Average	Median
IRR	37.7%	29.9%
Multiple	3.75x	3.12x
Value creation	2.75x	2.12x
EV/EBITDA (at entry)	7.5x	7.1x
Net debt/EBITDA (at entry)	3.9x	3.9x
Net debt/EBITDA (at exit)	2.3x	2.5x
Debt/equity (at entry)	1.7x	1.3x
Debt/equity (at exit)	0.6x	0.4x
Holding period (in years)	4.6	4.2

- The **sample** average IRR of the transactions is 37.7%. However, the median IRR, as well as the median multiples, are lower than their respective averages due to a few very successful transactions
- The average increase in value of 2.75x equals the investment's value generation from the GP's point of view **and must not be confused with the net multiple to investors**
- The average gearing (debt-to-equity ratio) after the entry of a GP is 1.7x but decreases to 0.6x over the holding period
- The sample includes all Danish exits (not-written off) up to December 2010, including partially realized IPO-exits TDC and Christian Hansen
- The sample excludes two private equity deals that produced the highest and lowest results (outliers) with respect to a public benchmark.

70% of the value creation is generated by operational and market effects

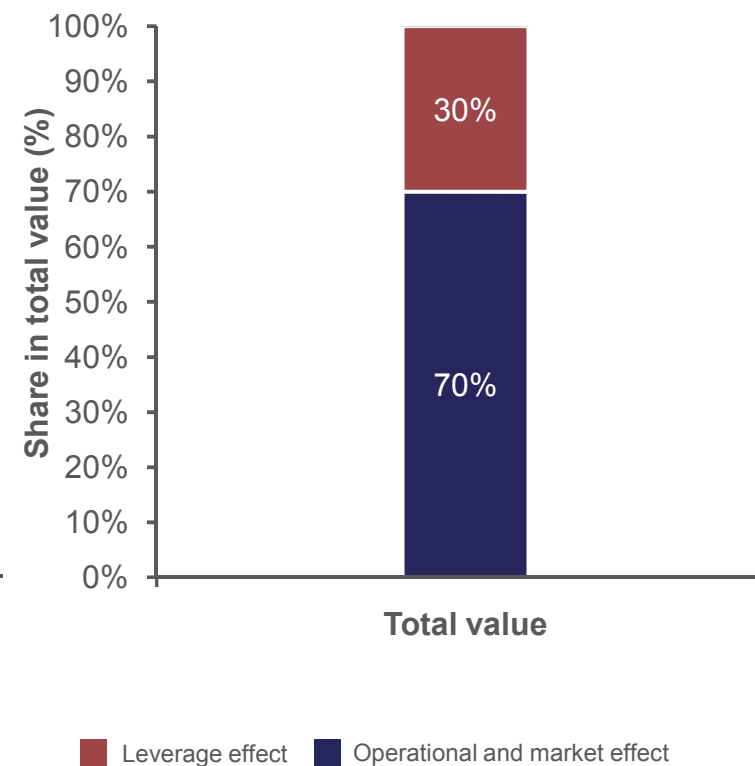
Comparison of value drivers

N = 44 companies, Holding Period = 4.6 years



Comparison of value drivers

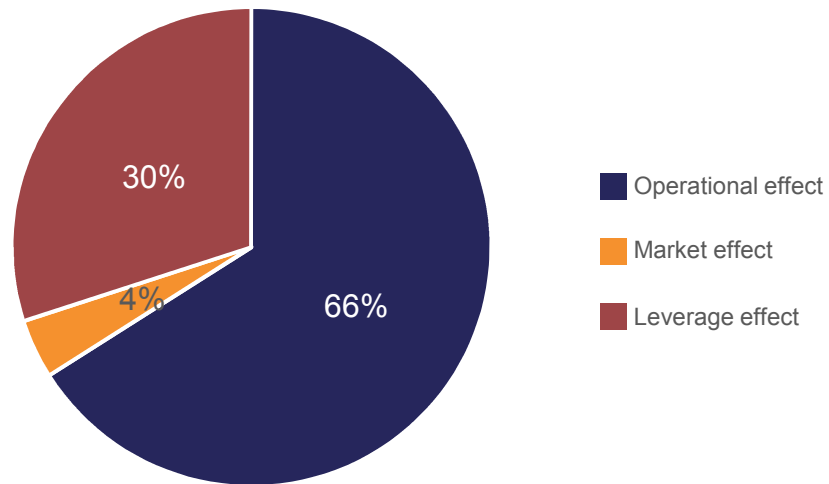
N = 44 companies, Holding Period = 4.6 years



Value creation drivers – Danish exits vs. European exits

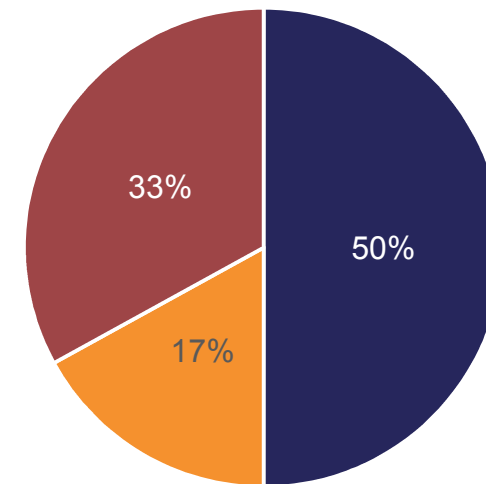
Danish exits: Comparison of value drivers

N = 44 companies, Holding Period = 4.6 years



European exits: Comparison of value drivers

N = 241 companies, Holding Period = 3.5 years

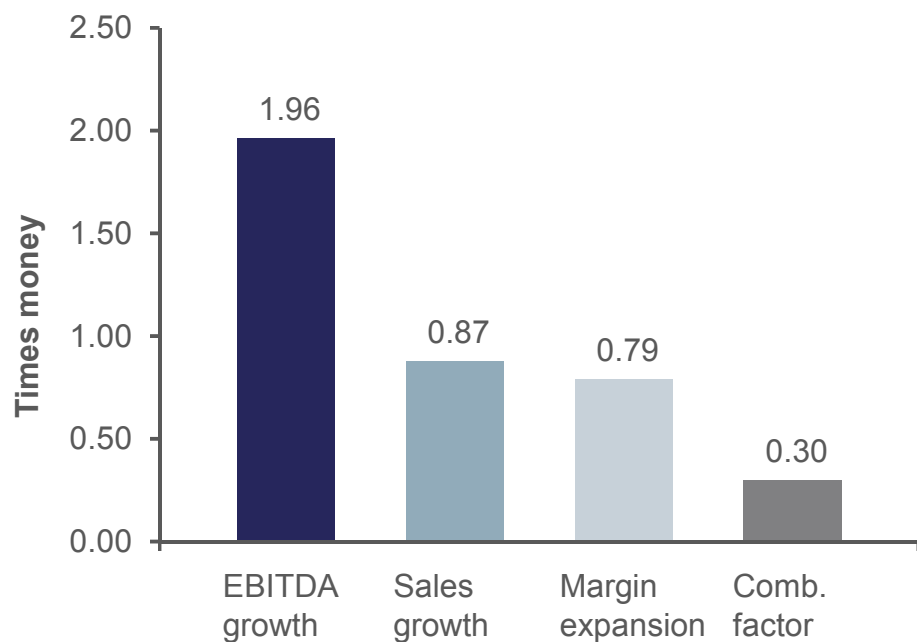


- Danish companies were held longer than those in the European study
- There was less leverage and multiple arbitrage, and more operational drivers, in Danish exits, compared with European exits.

EBITDA growth was driven by both acquisitions & organic growth and margin improvement

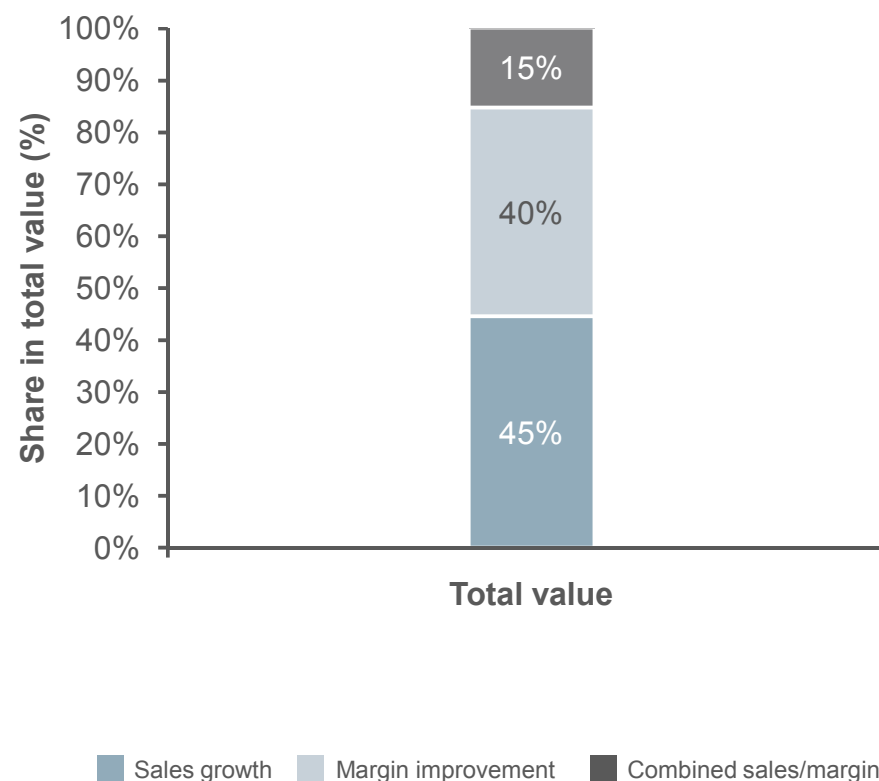
Comparison of EBITDA components

N = 44 companies, Holding Period = 4.6 years



Comparison of EBITDA components

N = 44 companies, Holding Period = 4.6 years



Two key questions need to be answered

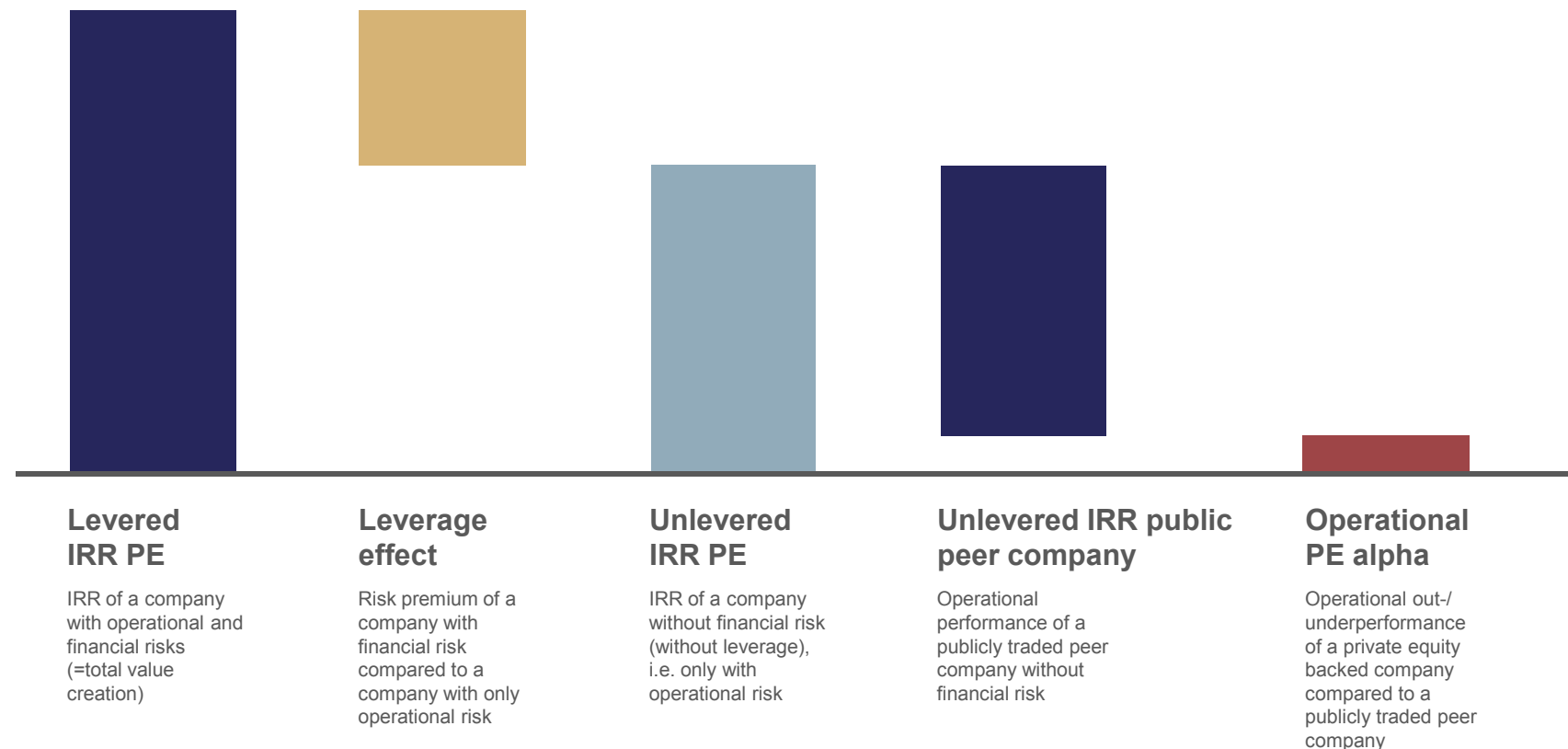
Did Danish private equity-backed companies generate more value than publicly traded companies?

and

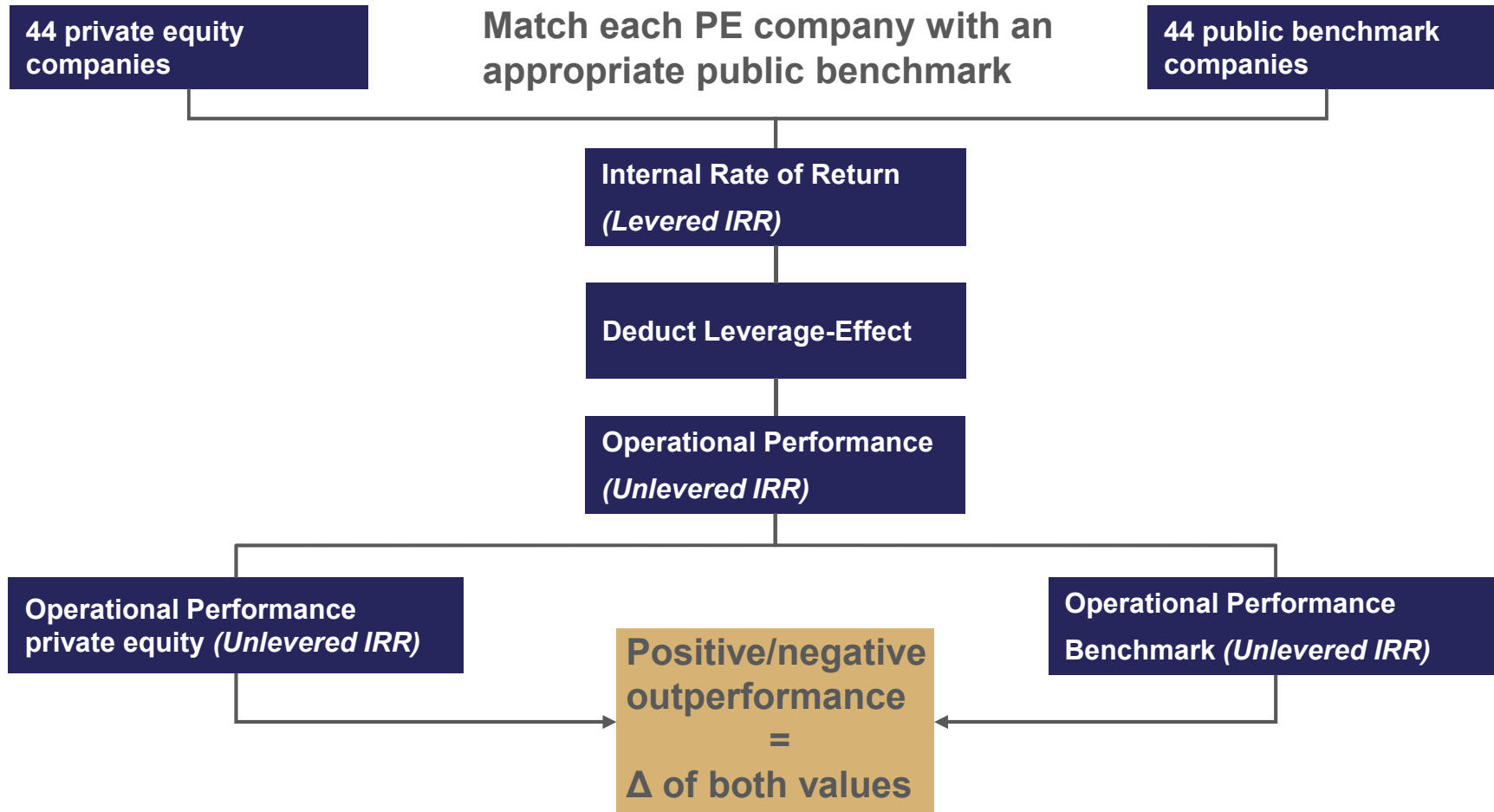
How large was the operational private equity alpha?

Identification of the operational private equity alpha in two steps

Indicative




Approach



Selection of peer companies in four steps

- Peer companies are part of the Dow Jones Europe Total Market Index
- Same ICB-sector-code as private equity-backed company
- Complete availability of a peer company's data for the entire holding period of the private equity transaction
- Selection of a peer company with lowest possible deviation with respect to sales and EBITDA (absolute percentage difference) at entry

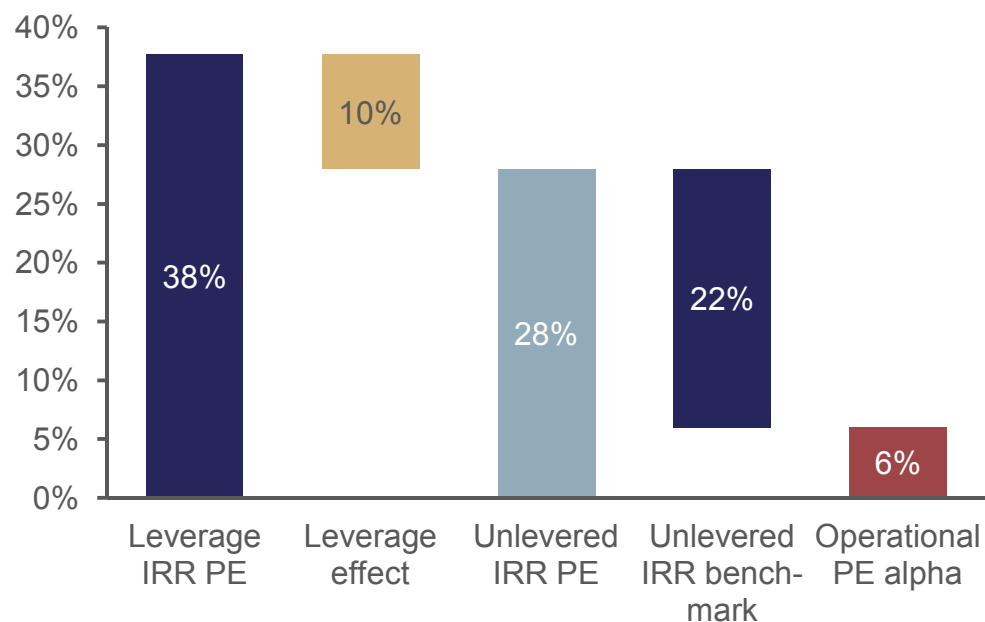


This process enables the identification of a publicly listed peer company with similar features for each private equity transaction. This allows a comparison of the performance of publicly traded and private equity-backed companies for the holding period.

Operational alpha of Danish private equity exits amounted to 6%

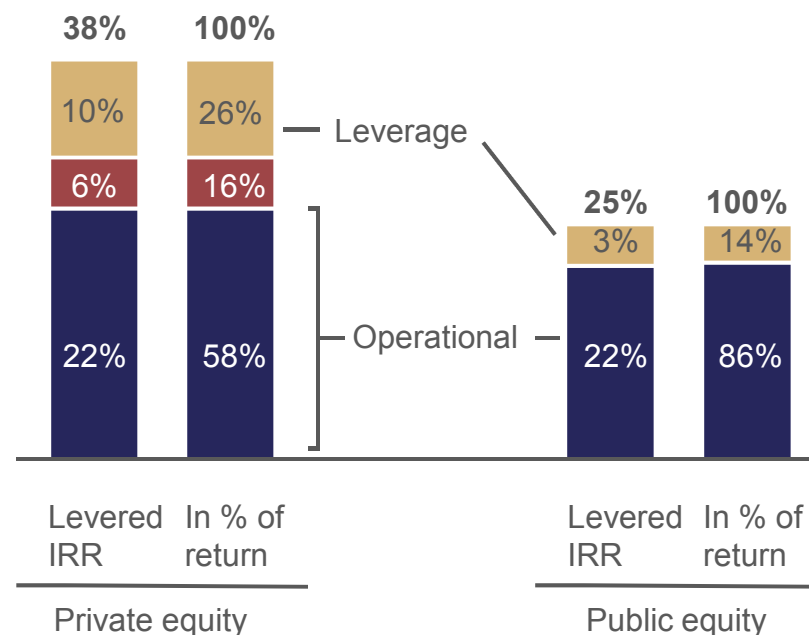
Value drivers

N = 44 companies, Holding Period = 4.6 years



Value drivers

N = 44 companies, Holding Period = 4.6 years



Danish private equity exits vs. European exits – Summary

	Value creation	Use of leverage	Growth and operational improvement	Alpha generation
Danish exits	Exceeds slightly European exits Value created 2.75	Lower Leverage contribution 30%	Higher Operational and market contribution 70%	Same 6%
European exits	Excellent Value created 2.72	Moderate Leverage contribution 33%	Significant Operational and market contribution 67%	Significant 6%

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