BVCA Annual Report on the performance of Portfolio Companies, VI

Building a better working world

Foreword

This is the sixth annual report on the performance of Portfolio Companies, a group of large, private-equity-owned UK businesses that met defined criteria at the time of acquisition. Its publication is one of the steps adopted by the Private Equity industry to improve transparency and disclosure, under the oversight of the Guidelines Monitoring Group.

This year's report sees the number of Portfolio Companies decline to 72 as at 31 December 2012 (versus 73 in 2011), with eight exits and seven entrants over the course of the year. Three of the Portfolio Companies that exited the population subsequently re-entered through distressed deals.

This report is based on information provided on the Portfolio Companies by the private equity firms that own them. This year, data was received covering 66 Portfolio Companies, a compliance rate of 92%, which is an improvement on last year (89%) but below the 100% in earlier years. This largely reflects the change in size criteria in 2010 and the growing inclusion of "private equity like" funds into the population that have a lower compliance rate. The Guidelines Monitoring Group, BVCA and EY are working hard to redress this, with the support of a large majority of the industry.

The findings of this report continue to show that, in aggregate, private equity ownership does not lead to adverse effects on large UK businesses, and in most areas of investigation the effect is positive. In absolute terms, and relative to benchmarks, the Portfolio Companies overall grew employment, revenue, investment, profits and productivity. There are no adverse changes to pensions; leverage levels are high and are slowly reducing. In some areas there is growing evidence of out performance by Portfolio Companies — most notably in equity returns and operating capital productivity. These findings hold when measured since acquisition in 2012, when the results were achieved in the wider context of an unexpectedly disappointing year for the UK economy.

A separate document has been produced to summarise the key findings, while this report contains the more detailed performance and benchmarking results.

As in the prior five years, EY, as advisors to the BVCA, has worked with them to conduct this research and jointly publish its findings. Both parties welcome comments and suggestions on this report, which can be sent to the contact details on the back page.

Yours sincerely,

BVCA, EY

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Summary findings

- The number of Portfolio Companies, i.e., those that met the criteria at the time of their acquisition by private equity (PE) firms, fell to 72 as of 31 December 2012, from 73 in the prior year.
- The level of compliance by the private equity firms that control the Portfolio Companies (i.e., the number of Portfolio Companies that have provided data out of those that met the inclusion criteria) has risen from 89% in 2011 to 92% in 2012, representing 66 companies. Two Portfolio Companies that exited and re-entered the population in 2012 failed to comply this year, while a further four that failed to comply last year similarly failed to comply this year. This has been reported to the Guidelines Monitoring Group.
- The Portfolio Companies in the study data set were acquired for a total of £93bn in enterprise value, with 393,926 jobs. Of these, 86% were UK-based.
- The performance of Portfolio Companies on a size-weighted average basis in 2012 versus the prior year was positive:
  - Total revenue grew by 1.8% and EBITDA by 4.2%.
  - Organic employment increased by 1.4%, and total employment increased by 2.0%, with bolt-on acquisitions exceeding disposals.
  - Operating capital employed grew by 1.2%.
  - Labour productivity grew by 2.0%, and capital productivity increased by 0.5%.
  - The average Portfolio Company performance was typically stronger than the figures presented above, which are based on weighted averages. This is because faster growth was reported in some of the smaller Portfolio Companies.
- Absolute performance levels in 2012 remained at the lower levels seen since 2009, compared with stronger performance in 2007-08.
- Comparing Portfolio Company performance to public benchmarks over the period since acquisition shows that the Portfolio Companies have achieved slightly faster growth rates in revenue, profits, employment and labour productivity, as well as faster rates of growth in operating capital productivity. Compared with economy-wide measures, employment growth at the Portfolio Companies was faster, but average compensation growth was slower.
- Financial leverage reduced slightly in 2012, with the ratio of net debt to EBITDA down to 6.7 from 7.0 in the prior year and 7.9 at acquisition. Total net debt increased since acquisition due to an increase in funding for bolt-on acquisitions; however, profits have grown faster to reduce the leverage ratio.
- The gross investment return achieved from exits of Portfolio Companies over the period 2005–12 was 3.3x times, or 332%, the equivalent of the public stock market benchmark on a sector-matched basis — a significant level of outperformance, albeit lower than in prior years due to the impact of three distressed exits in 2012.
- The difference in gross investment return is explained both by faster underlying growth in value in the Portfolio Companies (i.e., PE strategic/operational improvement) and the effect of financial leverage. Of the outperformance of 232%, 94% comes from PE strategic and operational improvement (i.e., faster growth in value in the Portfolio Companies than in the equivalent public companies) and 138% from additional leverage (i.e., the private equity investments had higher net debt than public companies, so the growth in business value led to a faster growth in equity value after deducting net debt).

Compliance and data set

Definition of Portfolio Companies and compliance

This study by the BVCA, and its appointed advisor EY, reports on the performance of the large UK businesses owned by private equity firms that meet the criteria determined by the Guidelines Monitoring Group — the Portfolio Companies. It forms part of the actions implemented by the private equity industry to enhance transparency and disclosure.

The objective of this Annual Report is to present independently prepared information on the performance of Portfolio Companies during their period of ownership by private equity investors. By aggregating information on the businesses that meet a defined set of criteria at the time of their acquisition, there is no selectivity or performance bias in the resulting data set. This is the most accurate way of understanding what happens to businesses under private equity ownership. For example:

- What growth rates are achieved by private-equity-owned businesses?
- How does private equity ownership affect employment, particularly in the UK?
- How do private-equity-owned businesses perform on employment cost, pensions and productivity?
- Do businesses owned by private equity investors invest in capital expenditure?
- Is there evidence of acquisitions and/or asset disposals under private equity ownership? How do such acquisitions and disposals affect overall performance in trading, employment and investing?

The findings of this report are a unique source of information to inform the broader business, regulatory and public debate on the impact of private equity ownership, by evidencing whether and how its distinctive features (including investment selection, governance, incentives and financial leverage) affect the performance of large UK businesses.

Definition of Portfolio Companies

A Portfolio Company, as defined for this report, meets the criteria set out by the Guidelines Monitoring Group (GMG). A Portfolio Company, at the time of its acquisition:

- "Acquired by one or more private equity firms in a public to private transaction where the market capitalisation together with the premium for acquisition of control was in excess of £210 million, and either more than 50% of revenues were generated in the UK or UK employees totalled in excess of 1,000 full time equivalents"; **or**
- "Acquired by one or more private equity firms in a secondary or other non-market transaction where enterprise value at the time of the transaction is in excess of £350 million, and either more than 50% of revenues were generated in the UK or UK employees totalled in excess of 1,000 full time equivalents"; **and where**
- Private equity firms are those authorised by the FSA that manage or advise funds that own or control Portfolio Companies, or are deemed after consultation on individual cases by the GMG to be "private equity like" in terms of their remit and operations.

The companies, and their investors, that meet the criteria were determined by the BVCA, through consultation with the GMG. As in prior years, the investee companies that volunteered to comply with the Guidelines, but did not meet all of the criteria at acquisition, are excluded from this report.

Compliance by private equity firms

Private equity firms were requested to complete a data template, specified by the BVCA and EY, for each of their Portfolio Companies.

Private equity firms representing 66 Portfolio Companies complied with the data request. Private equity firms representing six Portfolio Companies did not comply. The compliance rate of 92% is a slight improvement on the 89% in last year's report. The six Portfolio Companies that did not comply involve four that did not comply last year and two Portfolio Companies that exited and re-entered the population this year. The private equity firms that did not comply are not members of the BVCA.

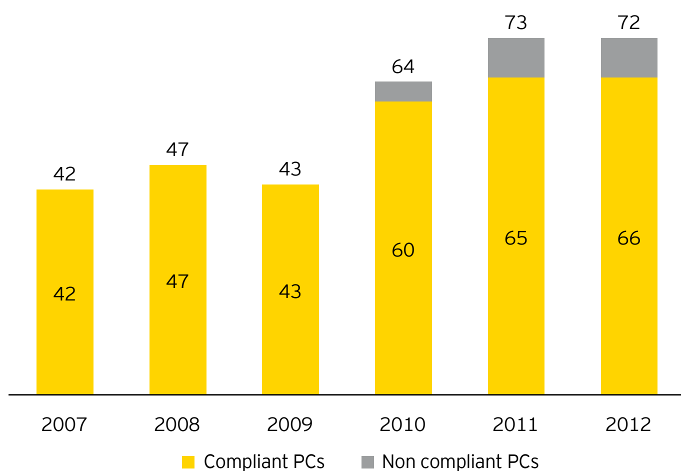
Appendix A contains the list of Portfolio Companies and private equity firms, indicating those that complied and those that did not.

Profile of the Portfolio Companies

Number and size of Portfolio Companies

At 31 December 2012, there were 72 Portfolio Companies that met the GMG criteria, one fewer than the prior year. There were eight exits and seven entrants over the course of the year. Three of the Portfolio Companies that exited the population also count as entrants, but with new private equity investors (see Appendix B for details on the annual movements in the number of Portfolio Companies).

Fig 1. Number of Portfolio Companies at 31 December



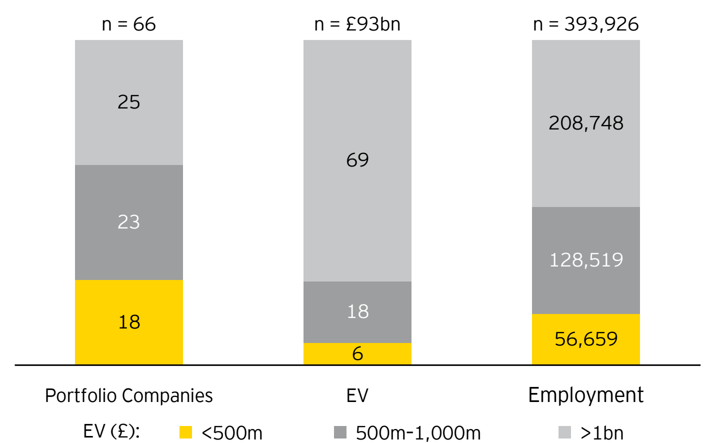
The performance data in this report is based on 66 Portfolio Companies as at 31 December 2012 that complied with the data request. These 66 companies were acquired for a total consideration of £93bn in enterprise value, represented by £33bn of equity investment and £60bn of net debt. This represents an aggregate valuation multiple at acquisition of 11.6x EBITDA (earnings before interest, tax, depreciation and amortisation) and net debt multiple of 7.9x EBITDA. At acquisition, they accounted for 393,926 jobs, of which 86% were in the UK.

For the purposes of this report, the latest year is referred to as "2012" and prior year as "2011".

Size mix

As shown in Fig 2, the Portfolio Companies cover a broad range of size as measured by entry enterprise value (EV). The sample is skewed towards larger companies, evidenced by the fact that the 25 Portfolio Companies (of the 66 that have submitted data) with EVs of over £1bn represent 74% of the EV of the total population and 51% of total employees.

Fig 2. Size mix by enterprise value at acquisition



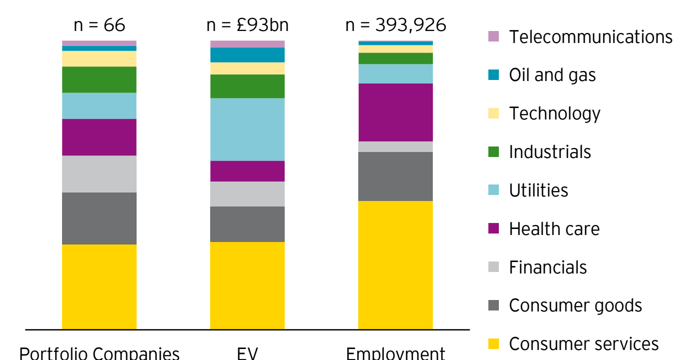
Industry sector mix

The industry sector mix of the Portfolio Companies also covers a wide range, but with a strong focus on consumer industries. By number of companies, EV and employment, 40%, 41% and 52% of Portfolio Companies, respectively, were in the consumer services sector (which includes retail).

For other sectors, differences arise depending on which size measurements are used. When assessed by number of companies, consumer goods represents the second-biggest sector (10 companies); however, when assessed by EV or employees, utilities (18%) and health care (17%) are the second-biggest sectors, respectively.

The sector mix is different to that of the London Stock Exchange, where consumer services represent 9% of market capitalisation and 13% of employees, much smaller proportions than for the Portfolio Companies.

Fig 3. Industry sector mix by portfolio companies, EV and employees at acquisition



Performance of Portfolio Companies

Year-on-year, 2012 versus 2011

Performance in 2012

The Portfolio Companies grew revenues, profits, employment and investment in 2012 versus the prior year – whether measured in aggregate as an average weighted according to each individual metric (as reported in prior years) or on a numerical average.

Considering headline financial performance measures, the numerical averages are higher than the weighted averages for all measures, reflecting the fact that some of the largest Portfolio Companies reported slower growth in the year that was not mirrored across the wider group.

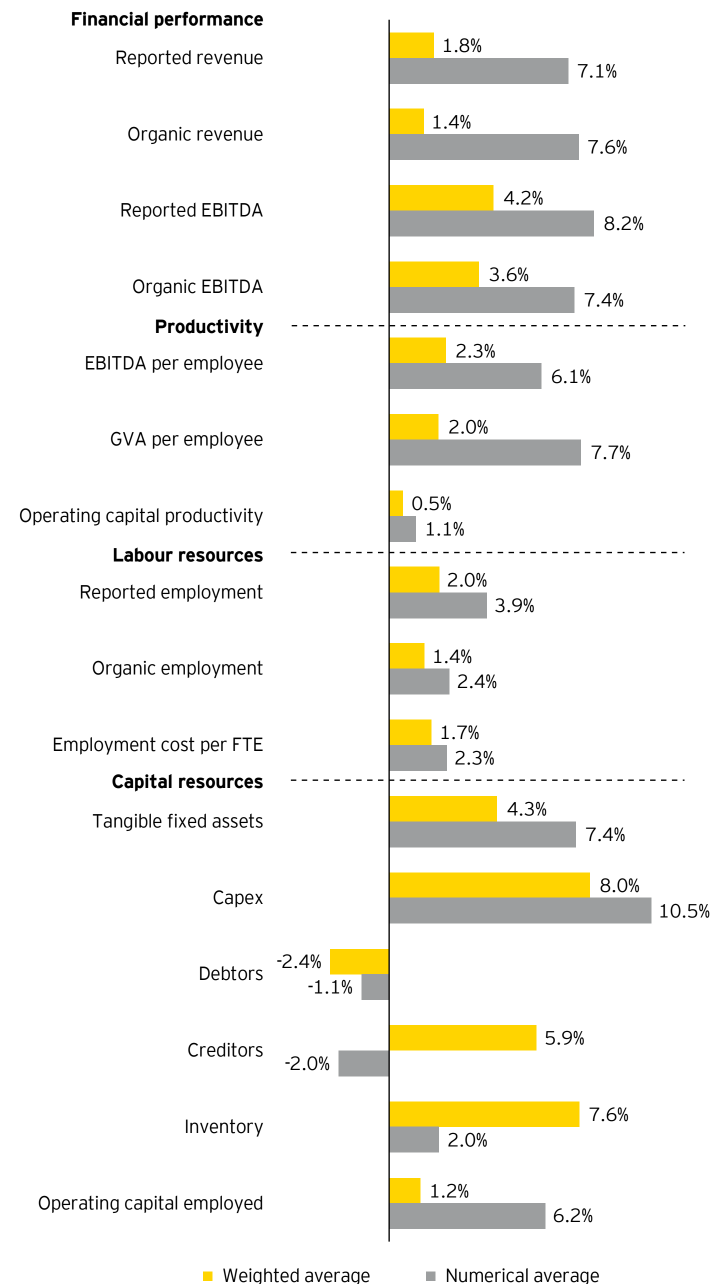
The reported revenue and profit growth rates are higher than the underlying organic growth rates, i.e., the net effect of acquisitions and disposals is positive, showing that in aggregate the Portfolio Companies were net acquirers, not disposers, of businesses during the year. This has been a consistent finding in this research.

Productivity metrics show positive growth in labour and capital metrics. Growth in labour productivity is notable given the national trend in labour productivity, which saw overall Gross Value Added (GVA) per employee rise by 0.2%[1] in 2012 versus 2.0% for the Portfolio Companies. Operating capital productivity has slowed versus prior years but remains positive.

There was positive growth in labour resources during the year, measured by employment (2.0% growth), underlying organic employment (1.4%) and employment cost per FTE (1.7%). The employment growth rates compare favourably to economy-wide measures, which saw 1.4%[2] growth year-on-year.

Portfolio Companies increased capital resources versus 2011. This was driven by tangible fixed assets and underlying growth in capital expenditure of 8.0%. However, debtors and creditors moved in favour of reducing aggregate investment in working capital, limiting overall growth in operating capital employed to 1.2%.

Fig 4. Performance of Portfolio Companies in 2012 versus 2011, year-on-year growth



1. Office of National Statistics. Real output per worker, rebased using GDP deflator to provide nominal output per worker. Quarterly result calculated on an LTM basis (year ending March 2013).
2. UK Labour Market Statistics Dataset, Office of National Statistics. Quarterly result calculated on an LTM basis (year ending March 2013)

Performance of Portfolio Companies

2012 and since acquisition

Performance in 2012 and since acquisition

In addition to a year-on-year assessment, the performance of the Portfolio Companies has been analysed since acquisition by their current private equity investors. The average age of the Portfolio Companies at 31 December 2012 was 5.0 years (up from 4.8 last year), so for many, the measurement of performance since acquisition covers the macroeconomic downturn and slow recovery from 2008 onwards.

As can be seen in Fig 5, the performance of Portfolio Companies in 2012 was 1-2 percentage points lower in terms of profit growth and growth in both labour and capital resources, compared with the entire period since acquisition. Revenue growth was 3-5 percentage points lower in 2012 versus the weighted average since acquisition.

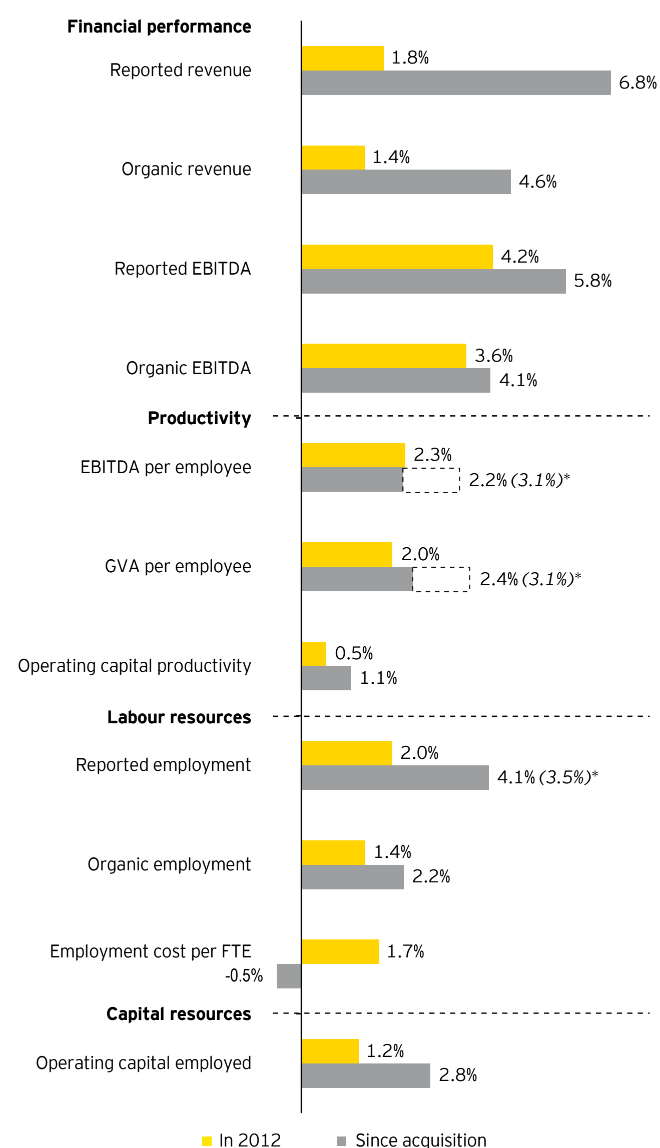
Considering numerical averages (which are not shown), the results are largely consistent for growth since acquisition in profits and employment. The main differences are that the numerical averages show faster revenue growth and lower growth in capital employed, and therefore improved capital productivity.

These results reflect, in part, the ongoing pressure of the broader economic environment, set against the stronger growth many experienced before the downturn.

Behind the headline figures there are some interesting observations. Whilst profits grew faster than revenue in 2012, in aggregate, this is not true over the entire period since acquisition, which showed the opposite. Profits have been improved through expansion and top-line growth, not through cost cutting and retrenchment.

Labour and capital productivity have both grown at similar rates since acquisition, suggesting relatively equal focus on both of these underlying drivers of improved performance and value under private equity ownership.

Fig 5. Performance of Portfolio Companies in 2012 and since acquisition (weighted-average CAGRs)



Performance of Portfolio Companies

Portfolio Company performance over time

Performance of Portfolio Companies over time

Looking at the year-on-year performance of Portfolio Companies over time gives further information as to the trajectory of key metrics under private equity ownership.

Figures 6 to 7 show the trend over the past five years. Organic profit growth shows relatively strong growth rates in 2008, slower growth rates in 2009 and 2010, and then some recovery in 2011 and 2012. The trend in organic employment also shows a slowdown in 2009 versus 2008, but a more variable pattern of year-on-year growth surfaces later.

The pattern of growth rates over time broadly mirrors the development of the UK economy over this period, with 2008 marking the turning point. Overall, the Portfolio Companies have outperformed over this period, as shown in Figure 8 (next page).

As the results are shown for the entire data set in each year, a part of the variation is due to changes in composition of the population due to Portfolio Companies entering and exiting the population each year. Figures 6 and 7 also include the group of 33 Portfolio Companies acquired pre-2008 that have traded throughout this period to remove the potential mix effects. While there are differences, the overall trends are similar. The decline in employment growth in 2012 for the 33 Portfolio Companies acquired pre-2008 reflects some of the variation in individual company trends that have been described in the reports of prior years. Overall organic employment growth in 2012 was 1.4%.

Fig 6. Year-on-year organic EBITDA growth

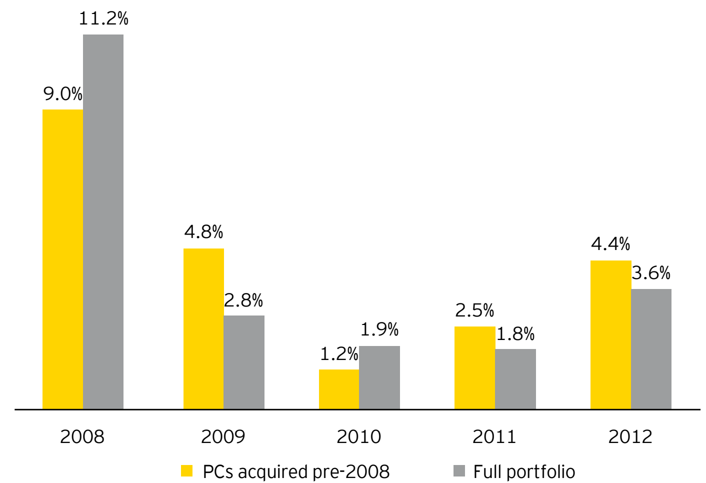
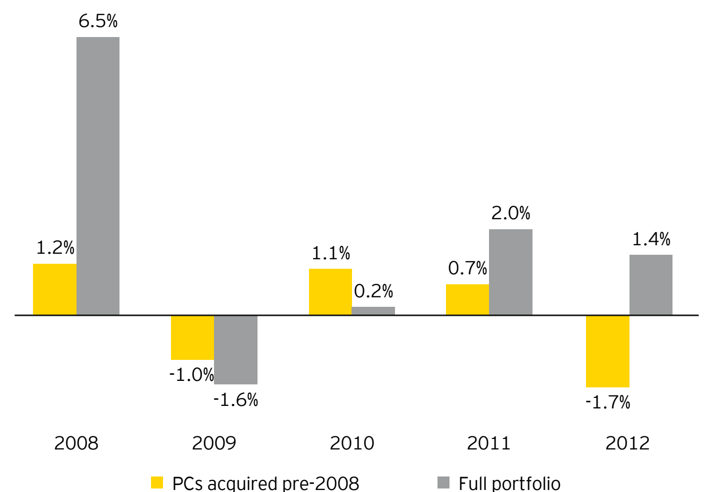


Fig 7. Year-on-year organic employment growth



Performance of Portfolio Companies

Since acquisition versus public benchmarks

Performance since acquisition versus public company benchmarks

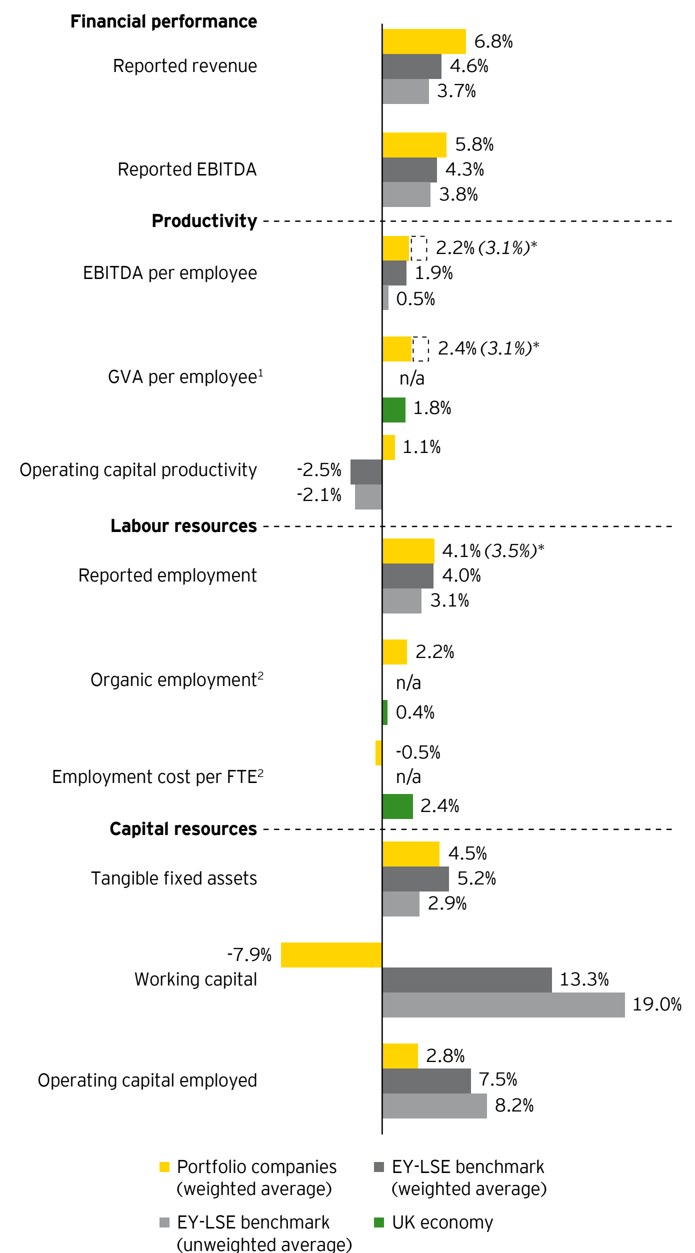
To gauge the effect of private equity ownership of the Portfolio Companies, it is also useful to compare performance to benchmarks. Three benchmarks are used in this report: a sector-weighted benchmark of listed companies to match the sector weighting of the Portfolio Companies, a broad selection of companies listed on the London Stock Exchange, and government statistics on employment and productivity. Appendix E describes the benchmarking methodology.

Against these benchmarks, the overall finding is that the private equity-owned companies perform well, being ahead of benchmarks on most metrics. Specific findings include:

- Slightly faster reported revenue, profits and employment growth
- Faster organic employment growth than the economy as a whole
- Slightly faster growth in labour productivity
- Slower growth in employment cost per FTE than the economy as a whole
- Faster growth in capital productivity, despite similar growth in capital expenditure; this difference is largely due to a wide disparity in working capital management and has been a consistent finding in this analysis over time

Comparing these findings to prior years, there is a consistent trend of equal or faster growth in organic employment and labour productivity, as well as faster growth in capital productivity.

Fig 8. Performance of Portfolio Companies since year of acquisition vs. EY-LSE benchmark (CAGR) (see appendix D for methodology and notes)



**Excluding large bolt-on acquisition*

1. Office of National Statistics. Real output per worker, rebased using GDP deflator to provide nominal output per worker. Quarterly result calculated on an LTM basis (year ending March 2013).
2. UK Labour Market Statistics Dataset, Office of National Statistics. Quarterly result calculated on an LTM basis (year ending March 2013)

Performance of Portfolio Companies

Returns attribution

Gross investment return

There were 32 exits of Portfolio Companies between 2005 and 2012, eight of which were in the last year.

Overall, the gross investment return (IRR) for Portfolio Company exits was 3.3x the return available from investing in public stock markets. This shows a substantial level of investment outperformance from private equity ownership. This return is lower than that achieved last year (4.1x) as three of the eight exits were distressed situations, which lowered the average return.

Returns attribution

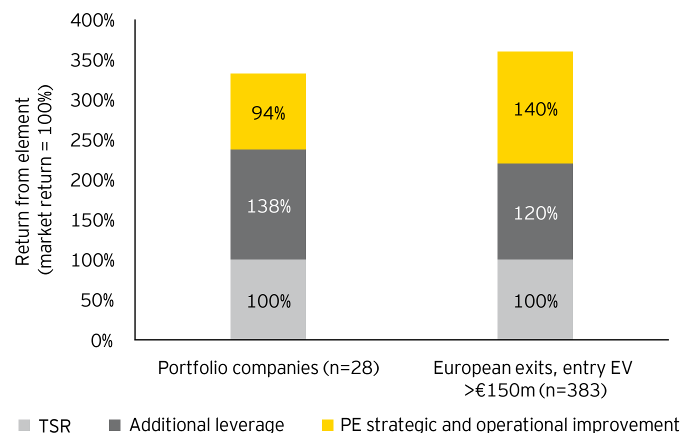
While the absolute return is a matter of fact and a key measure of private equity investment performance, the returns attribution analysis shows the sources (or contributors) to that return.
We analyse the return of three elements: 1) the return available from public stock markets, 2) the extra return delivered from private equity ownership and 3) the impact of additional financial leverage. See Appendix D for a description of the methodology and the left-hand bar of Figure 9 for a graphical presentation of the results.

The public stock market return is set as a benchmark of 100%, and the other elements are then measured against this. Private equity strategic and operational improvements add a further 94%, i.e., almost doubling the gross investment return. This includes the incremental benefit, over and above public company performance, of a wide range of actions taken under private equity ownership related to productivity, investment, growth and cash flow improvements, as shown earlier in this report.

Another aspect of the private equity business model is to increase the financial leverage in Portfolio Companies at acquisition, with an average gearing ratio of 127% compared with a sector-weighted public benchmark of 54%. The increased financial leverage acts both as incentive to use capital more productively and to increase the return on invested equity. Considering the latter effect only, the benefit of the additional leverage, relative to the market return, is 138% — a significant and positive increase to returns.

The effect of additional leverage in the PE investing model is that less equity is invested with the same increase in enterprise value, thereby boosting the equity return. The same is also true on the downside, in that a reduction in enterprise value creates a bigger decline in equity return. Some of the individual investments experience this effect, including the distressed exits in 2012.

Fig 9. Returns attribution analysis, Portfolio Company exits, 2005-12



Comparison to other studies

Figure 9 also shows a comparison of the returns attribution result with separate research undertaken by EY, but with a larger European population, over the same time frame, and calculated with the same methodology.

Both studies show that the financial returns from private equity investments are significantly in excess of public stock market returns and that there is a significant positive effect of private equity ownership that is over and above the effect of financial leverage.

However, there are differences. The European study shows gross investment returns of 3.6x the return from investing in public stock markets, which is higher than the UK result of 3.3x. Further, this was achieved with less benefit from financial leverage and more from private equity strategic and operational improvements. There are a number of factors that lie behind these differences, including the higher rate of creditor exits in the UK that depress overall equity returns and a higher leverage ratio of the public stock market benchmark for the European sample.

Appendices

Appendix A
List of Portfolio Companies

Portfolio Companies (at 31 December 2012)

Portfolio company	GP(s)
Acromas	Charterhouse, CVC, Permira
Affinity Water[1]	Morgan Stanley Infrastructure Partners, Infracapital
Airwave Solutions	Macquarie
Alliance Boots	KKR
AMCO[1]	Cinven
Annington Homes	Terra Firma
Associated British Ports	Goldman Sachs, Infra Capital, Borealis, GIC
Biffa[1]	Sankaty, Babson Capital, Angelo Gordon, Avenue Capital
Birds Eye Iglo	Permira
Brakes Group	Bain Capital
Brit Insurance	CVC, Apollo
British Car Auction	Clayton, Dubilier & Rice
Camelot	*Ontario Teachers' Pension Plan*
Card Factory	Charterhouse
Care UK	Bridgepoint
CenterParcs	Blackstone
Civica	3i
DFS	Advent International
Domestic & General	Advent International
DX Group	Arle Capital Partners
Edinburgh Airport[1]	Global Infrastructure Partners
Enserve	Cinven
Enterprise	3i
ESG	3i
Equiniti	Advent International
Eversholt Rail	3i, Morgan Stanley, STAR Capital
Exova	Clayton, Dubilier & Rice
Expro	Goldman Sachs
Fat Face	Bridgepoint
Findus Group	Lion Capital, Highbridge Capital
Fitness First[1]	*Oaktree, Marathon*
Four Seasons Health care[1]	Terra Firma
Gala Coral	Apollo, Cerberus, Park Square, York Capital
Gatwick Airport	Global Infrastructure Partners
Gondola Holdings	Cinven
Integrated Dental Holdings	Carlyle, Palamon
John Laing	Henderson
Just Retirement	Permira
Kellen Group	Terra Firma
London City Airport	Global Infrastructure, Highstar Capital
Merlin Entertainment Group	Blackstone, CVC
Moto	Macquarie
National Car Parks	Macquarie
New Look	Apax, Permira
Northgate Information Solutions	KKR
Odeon & UCI Cinemas	Terra Firma
Osprey, (Anglian Water Group)	3i, Colonial First State, Canadian Pension Plan, Industry Funds Management
Park Resorts	GI Partners
Partnership in Care	Cinven
Pets at Home	KKR
Phones 4 U	BC Partners
PHS	Charterhouse
Pret a Manger	Bridgepoint
Priory Group	Advent International
RAC	Carlyle
SAV	Värde Partners
South Staffordshire Water	*Alinda Capital*
Spire Healthcare	Cinven
Stonegate Pub Company	TDR Capital
Thames Water	Macquarie
Tomkins	*Onex Partners, Canadian Pension Plan*
Top Right Group	Apax
Trader Media	Apax
Travelex	Apax
Travelodge[1]	*Goldman Sachs, Goldentree, Avenue Capital*
TSL	Charterhouse
United Biscuits	Blackstone, PAI
The Vita Group	TPG
Virgin Active	CVC
Viridian Group	*Arcapita*
Vue Cinemas	Doughty Hanson
WorldPay	Advent, Bain Capital

Exits of Portfolio Companies during 2012

Portfolio company	GP(s)
Biffa[2]	Montagu
Doncasters	*DIC*
Edwards Group	CCMP Capital Advisors
Fitness First[2]	BC Partners
QMH	Goldman Sachs
Travelodge[2]	*DIC*
Weetabix	Lion Capital
West & Wales Utilities	Macquarie

Portfolio Companies in italics denote those GPs and Portfolio Companies that have not complied.
Note 1: Denotes Portfolio Companies that are new entrants.
Note 2: Denotes portfolio companies that have exited and re-entered population during the year.

Appendix B
Movement in the number of Portfolio Companies, 2007–12

	2007	2008	2009	2010	2011	2012
At 1 January	**37**	**42**	**47**	**43**	**64**	**73**
Portfolio Companies introduced with new criteria				12	4	-
Acquisitions of Portfolio Companies	10	5	-	11	8	7
Exits of Portfolio Companies	(5)	-	(4)	(2)	(3)	(8)
Portfolio Companies at 31 December	**42**	**47**	**43**	**64**	**73**	**72**
Exits and re-entrants	**1**	**-**	**-**	**1**	**1**	**3**

Exits of Portfolio Companies

- The effect of private equity ownership of a business is evaluated from the date of acquisition to the date of exit. The date of exit is defined as the date of completion of a transfer of shares, which means that the private equity fund no longer has control, or, in the case of IPO onto a public stock market, the date of first trade.
- Between 2007 and 2012, six Portfolio Companies have exited the population and then re-entered under the ownership of a new private equity fund. Three of these transactions took place in 2012.
- Two of the exits in 2012 arose from a decision by the GMG that the "PE-like" entity that owned these companies had restructured in such a way that it was no longer deemed "PE-like".

Acquisitions of Portfolio Companies

- Acquisitions of new Portfolio Companies represent all companies entering the group of Portfolio Companies, as acquisitions of businesses from other companies, private equity funds, private shareholders or take-privates.

Appendix C
Capital structure

Debt ratios

The ratio of debt to EBITDA is a key measure of a company's ability to service its debt from cash flow. The Portfolio Companies had an average net debt to EBITDA ratio of 7.9 at acquisition. In aggregate, this has reduced to 6.7 at the latest date. This was predominantly because growth in third-party debt was slower than the level of growth in reported EBITDA.

Composition of net debt

At latest year-end, the Portfolio Companies reported aggregate cash balances of £9.2bn and third-party debt of £69.3bn, giving a net debt of £60.1bn.

Change in net debt

Net debt increased from acquisition to latest date by £1.6bn, as in Figure 10. The main reason for the increase in third-party debt was to fund bolt-on acquisitions, representing £8.9bn of the increase. Cash and debt-funded equity withdrawals were £2.6bn. Operating cash flow, after investing, financing and tax payments totalled £9.8bn.

In 2012, net debt fell by £0.6bn versus the prior year. Operating cash flow, after investing and financing payments totalled £0.9bn. This was partially offset by acquisitions increasing net debt by £0.1bn and equity withdrawals of £0.2bn.

Fig 10. Capital structure — acquisition to latest date

Net debt (£bn)	Acquisition to latest date
Opening net debt	58.5
Debt-funded acquisitions (net)	8.9
Net equity withdrawals[1]	2.6
Operating cash flow after investing and funding charges	(9.8)
Change in net debt	1.6
Net debt at latest date	**60.1**

Fig 11. Capital structure — movement in latest year

Net debt (£bn)	Movement in latest year
Opening net debt	60.7
Debt-funded acquisitions (net)	0.1
Net equity withdrawals[1]	0.2
Operating cash flow after investing and funding charges	(0.9)
Change in net debt	(0.6)
Net debt at latest date	**60.1**

Appendix D
Pensions

Pension provision: DB and DC schemes

Of Portfolio Companies, 36 offered defined benefit (DB) pension schemes for their employees at acquisition. As at 31 December 2013, 37 Portfolio Companies offered DB schemes because two were introduced as a result of bolt-on acquisitions, but one was discontinued.

Of the 36 companies that offered a DB scheme at acquisition, 27 continue to pension the service of existing employees through the DB scheme, with 3 companies also offering a DB pension for new joiners.

Sixty-four Portfolio Companies offered defined contribution (DC) pension benefits at acquisition, and all these schemes continued. As at 31 December 2013, 66 Portfolio Companies offered DC schemes.

Financial position of DB pensions

Looking at the accounting data of the DB schemes at the latest year-end, there was a net deficit equal to (7.0)% of the value of liabilities, a level that has increased since acquisition and since the prior year, following industry-wide trends.

Over the period since acquisition, the holding of equities by Portfolio Company DB schemes has fallen from 42% to 29% of total assets. This is partly due to market movements and partly due to changes in investment strategy towards lower-risk and alternative assets. These movements are in line with the broader trend of pensions schemes moving towards more secure asset classes.

Fig 12. Value of defined benefit pension assets and liabilities[1] — acquisition to latest date
(n=36)[2]

£'bn	At acquisition	Prior year	Latest data
Value of assets	12.5	14.1	15.0
Value of liabilities	(11.7)	(14.9)	(16.1)
Net deficit	0.7	(0.8)	(1.1)
Deficit as % of liability	6.3%	-5.6%	-7.0%

Fig 13. Mix of defined benefit pension assets – acquisition to latest date
(n=36)[2]

	At acquisition	Prior year	Latest data
Equities	41.6%	27.9%	28.5%
Fixed interest	50.0%	58.4%	56.5%
Cash and deposits	2.9%	1.1%	0.8%
Alternative investments	0.7%	6.0%	6.2%
Other	4.7%	7.4%	8.0%
Total	**100%**	**100%**	**100%**

1. Assets and liabilities are presented on an accounting basis at latest year-end and under the relevant accounting standards.

2. Relates to companies that offered DB throughout the period from acquisition.

1. Net equity withdrawals refer to debt- and cash-flow-funded equity withdrawals net of equity cash injections; this adjustment updates reports prior years.

Appendix E
Methodology

Process and measuring performance

Process

The approach to producing the *Annual Report on the performance of Portfolio Companies* has been debated and agreed with the BVCA and the Guidelines Monitoring Group (GMG).

The list of Portfolio Companies, and their private equity owners, was provided to EY by the BVCA for the purposes of preparing this report.

EY contacted the private equity firms in July 2013 and requested a standard data template to be completed for each Portfolio Company. For exits, the same data template was updated for the final year of private equity ownership, as well as data required to complete the returns attribution analysis. Completion of the data template drew on information available in company accounts, and further information that was prepared from Portfolio Company and private equity firm sources. This further data enabled analysis, inter alia, of the impact of acquisitions and disposals, and movements in pension liabilities and assets.

The data returned to EY was checked for completeness and iterated with the private equity firms as required. EY undertook independent checks on a sample of the returns against published company accounts. This found no material discrepancies.

EY submitted its draft statement of compliance to the GMG on 20 November 2013. Data gathering was completed in November 2013.

Measuring performance

The data set is built up from the individual companies under their period of ownership by private equity investors. For the 66 Portfolio Companies that have submitted complete templates, the data set extends from the date of acquisition to the date of the latest annual report.

The maximum number of data points that can be drawn from the data set depends on the type of performance measure.

- Change in the value of point-in-time measures, including employment, fixed assets and capital structure, are analysed from the date of acquisition to the latest year-end in the company accounts/date of exit. Given that 7 of the 66 Portfolio Companies for which data was submitted were new entrants, these measures can be determined for 59 companies.
- Changes in the value of trading measures, including revenue, profit, capital expenditure and cash flow, require full-year comparison to full prior year (to avoid the error inherent in annualising partial-year figures). Again, these measures can be determined for 59 of the 66 Portfolio Companies, although one Portfolio Company had negative EBITDA at acquisition and in the prior year, meaning that an annualised growth rate cannot be calculated. Therefore, for profit growth the number of companies is 58.

Publicly listed benchmarks

This year marks a change in approach to defining the benchmark group, to increase its size and relevance.

The public company benchmarks are drawn from an initial total of 1,643 companies listed on the London Stock Exchange (LSE) to 31 December 2012, from which 949 companies are excluded for the purposes of this report:

- 696 equity investment trusts, OEICs and other financial or non-comparable sector entities (e.g., real estate investment and services, real estate investment trusts, banks, equity and non-equity investment instruments)
- 181 companies were excluded because their market capitalisation was less than £210m
- 72 companies were excluded because their market capitalisation was greater than £11bn (the market capitalisation at acquisition of the largest Portfolio Company)

The 694 companies in the benchmark group is an increase of 89% by number versus prior years.

For the sector-weighted public benchmark, public company data is aggregated at an industry group level — as defined by the Global Industry Classification Standard — and then matched to individual Portfolio Companies. The aggregate result is then weighted by the sector mix of the Portfolio Companies.

Issues with approach to benchmarking

There are a number of issues with regard to the approach to benchmarking that may influence the results:

- Reported figures include the effect of acquisitions and disposals, which it is not possible to analyse separately for public companies in aggregate.
- The mapping of companies to Global Industry Classification Standard groups is important to take account of differential trends at the sector level. However, the mapping is high level and may be inaccurate for any individual Portfolio Company. By contrast, more specific sector mapping reduces the size of the benchmark group.
- For some figures, e.g., employment, the definitions captured in the LSE company databases may not be wholly consistent with the definitions adopted in our data gathering.

Returns attribution

The 'returns attribution' calculation analyses gross internal rate of return (IRR) into three components:

1. Additional leverage: the effect on Gross IRR of the additional leverage PE firms place on a company above the average sector levels
    - Adjusted deal returns are calculated by adjusting the capital structure to match average leverage levels of LSE sector benchmarks. The adjusted capital structure takes into account interest savings over the holding period as well as the changes in net debt that took place during ownership.
    - In addition, any leveraged dividends received by equity investors are moved to the date of exit, and the exit capital structure is adjusted for dividends.
    - The difference between original deal IRR and the adjusted IRR is the benefit of additional leverage.
2. Market returns: the total shareholder return earned in the LSE sector over the same timeframe as the private equity investment.
    - The TSR is calculated using market indices. TSR captures the effects of sector earnings growth, multiple changes and dividend payments.
    - The market return TSR is applied to a deal IRR that has equivalent capital structure after the adjustment for additional leverage.
3. Strategy and operational improvement: the component of gross IRR that relates to above-benchmark performance
    - The component of the gross IRR for strategy and operational improvement is calculated by subtracting the market return from the gross IRR adjusted for additional leverage.

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