BVCA annual report on the performance of portfolio companies, VIII

Building a better working world

Foreword

This is the eighth 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 Private Equity Reporting Group (PERG, formerly the Walker Guidelines Monitoring Group).

This year's report sees the number of portfolio companies decline to 62 as at 31 December 2014 (2013:71), after a record number of exits in 2014. The report is based on information provided on the portfolio companies by the private equity firms that own them. This year, data was received covering 57 portfolio companies, a compliance rate of 92%, a decline from last year of 96%.

With a large number of portfolio companies, and eight years of information, this report provides a comprehensive and detailed insight into the effect of private equity ownership on large, UK businesses.

Contrary to the general improvement in the economic outlook in 2014, on many measures the aggregate portfolio company performance in 2014 was behind that of 2013. As a result, the outperformance vs. UK economy and public company benchmarks that has been evident in prior years' reports narrowed. However, against the test of absolute performance, and under the high financial leverage that is common in private equity-owned businesses, the portfolio companies, in the period under private equity ownership, continued to deliver positive growth in employment, investment, revenue, profits, productivity and returns to investors.

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 to the contact details at the end of this report.

Yours faithfully,

BVCA, EY

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Summary

This report presents findings on the impact of private equity (PE) ownership on large, UK businesses. The underlying data set has been growing over the past eight years, and represents a robust basis on which to assess several measures of performance, including employment, investment, trading and value creation:

- The total population comprises 62 portfolio companies as on 31 December 2014, with a further 56 businesses owned and exited by private equity investors over 2005–2014. This population is defined by criteria independently set by the Private Equity Reporting Group (PERG)
- In 2014, 57 or 92% of the portfolio companies complied with the request to provide performance data, down from 96% in the prior year.
- At acquisition, the 57 portfolio companies that submitted data were worth £63bn, received £23bn in equity investment from private equity funds and had 259,000 employees.

Analysing the last eight years of data on current and past portfolio companies, over the entire period of their ownership by private equity investors, continues to show positive performance trends, measured by aggregate growth in investment, employment, productivity, revenue, profits and return to equity investors:

- The gross investment return achieved on all of the portfolio companies exited from 2005 to 2014 are 4x the level of benchmarked public company equity return. This reflects both the benefit of additional financial leverage, which is a net positive to equity returns, and private equity strategic and operational improvement. Compared to prior years, the proportion of aggregate equity return attributable to stock market performance and additional leverage has risen from 61% to 76%, and the proportion attributable to PE strategic and operational outperformance has declined from 39% to 24%.
- Employment growth is positive under private equity ownership albeit slightly behind public company and UK private sector benchmarks. Over the period since acquisition by PE, organic employment growth has averaged 0.3% per annum vs. 1.5% in the entire UK private sector.
- Growth in average employment cost is positive under private equity ownership. This has grown at 0.4% per annum, compared to the UK private sector at 3.0%. In the portfolio companies, most employment growth has been in jobs where employment cost is below the average for the data set.
- Approximately, 6% of UK jobs in the portfolio companies are on zero-hours contracts, compared to 5% in the UK as a whole. It should be noted that almost all of these jobs are concentrated in the portfolio companies active in the healthcare sector.
- Investment in capital employed and capital expenditure is positive under private equity ownership. Operating capital employed has grown at an average of 1.4% per annum vs. 4.7% in the public company benchmark.
- Growth in labour and capital productivity is also positive under private equity ownership. In capital productivity, portfolio company growth of 7.2% is ahead of the public company benchmark of 3.0%. Labour productivity growth is broadly in line with public company and UK economy benchmarks.
- Reported revenue growth is positive under private equity ownership at 5.2% per annum and ahead of the public company benchmark of 4.0%. Growth in profits is also positive at 3.6% per annum, albeit now behind the public company benchmark of 4.8%.
- Portfolio companies have higher financial leverage than public companies by a factor of over two times. The current portfolio companies have generated free cash and used this to partially fund significant investments in bolt-on acquisitions instead of reducing third-party debt; this has led to leverage ratios slightly increasing to 7.8x from 7.1x. All of the measures above reflect performance of the portfolio companies under this level of financial leverage.

In contrast to last year's report, performance in the latest year, i.e., 2014 vs. 2013, shows more subdued findings for the portfolio companies than the recent past:

- Year-on-year growth rates on many performance measures in 2014 were well behind the figures in 2013, including revenue growth, profit growth, capital investment, average compensation, and labour and capital productivity.
- In part reflecting the 2014 results, the performance of the portfolio companies vs. public company and UK economy wide benchmarks also narrowed — in revenue and profits growth, in labour productivity, and in the attribution of equity investment returns. Capital productivity growth remained a point of differentiation. These results, set against a generally positive year for the UK economy in 2014, may represent the variations that we have seen in year-on-year performance, and across portfolio companies, due to specific company and sector mix factors.
- One measure where 2014 showed improvement vs. the prior year was organic employment growth. In 2014, year-on-year organic employment growth reached 4.2%, slightly ahead of the UK private sector at 4%.

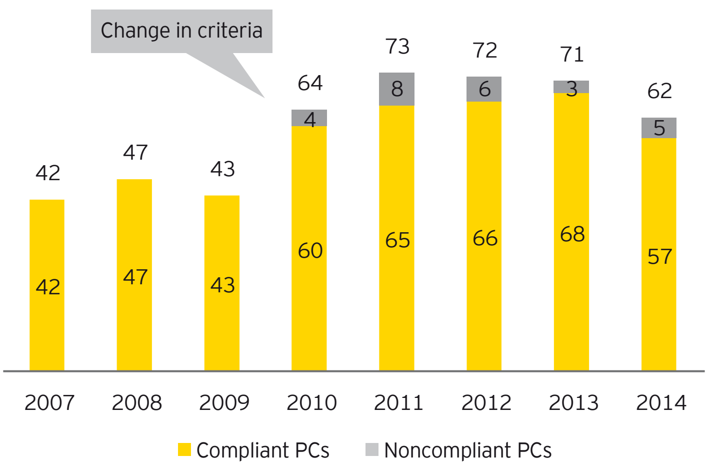
[1] Formerly the Walker Guidelines Monitoring Group

Population and compliance

Number of portfolio companies

On 31 December 2014, there were 62 portfolio companies that met the PERG criteria, nine less than the prior year. The number of exits rose to the highest level recorded, 16, from 10 last year, while the number of new investments declined to 7, also from 10 last year. The last two years have witnessed a significant change in the number of exits by initial public offering on the London stock markets. There were eight exits by IPO in 2014, up from three in 2013 and one in 2012. Details of the annual movements in the number of portfolio companies are in Appendix B.

Fig. 1: Number of portfolio companies on 31 December



The number of portfolio companies that complied with the request to provide performance data for this year's report was 57. The rate of compliance decreased to 92% from 96%, with an expectation that this will improve next year as new entrants in 2014 start to familiarise themselves with the data requirements.

Given the increase in the number of exits over the past two years, the compliance of portfolio companies providing data on exits is also being tracked. Since 2005 there have been 56 exits, of which 16 were in 2014. Data has been received for 51 of these exits, representing compliance of 91%. In 2014, data was received for 15 exits, a compliance rate of 93%.

The target for compliance remains 100%, for performance data on portfolio companies and data on exits. Appendix A contains the list of portfolio companies and exits, indicating those that have and have not complied in 2014.

In several charts, aggregated data is presented for current portfolio companies and portfolio companies owned and exited by private equity investors, measured from date of acquisition to the latest date or exit, respectively. This maximises the number of data points and is referenced by 'Total portfolio (CP + exits)'.

Profile of portfolio companies

Key facts and figures on the 57 portfolio companies that complied with this year's process:

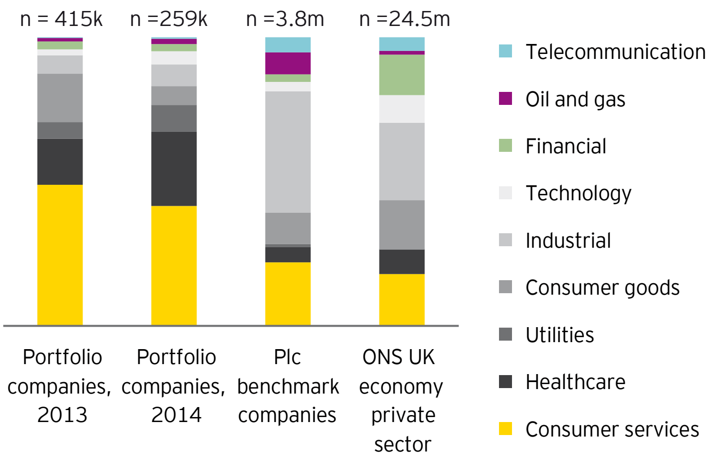
- Total acquisition value of £63b
- £23b of equity investment, led by private equity funds, plus £40b of net third-party debt
- Acquisition value of 9.8 x EBITDA (earnings before interest, tax, depreciation and amortisation); net debt of 6.2 x EBITDA
- At acquisition, there were 259,000 employees, 87% of which were in the UK

The portfolio companies cover a broad range of sizes in terms of their value, from entry enterprise value (EV) of £315m to £9bn, as well as metrics on employment, asset base and profits. For most performance measures, this report uses weighted averages which are the best representation of economic impact.

The portfolio companies are active across a wide range of industry sectors, the mix of which has changed as the composition of the portfolio companies evolves.

67% of portfolio company employment is in the consumer services and healthcare sectors, compared with 26% in the UK economy private sector. Conversely, portfolio company employment in the industrial sector is 8% of the total, compared with 27% for the UK private sector.

Fig. 2: Industry sector mix of employment – portfolio companies, Plc benchmark companies and UK economy private sector



In some charts, the performance of the portfolio companies is compared to a Plc benchmark. This analysis takes all public companies with the London Stock Exchange (LSE) as their primary listing, then filters on size range and primary sector, as described in Appendix D, to make more comparable with the portfolio companies.

Returns attribution

Private equity vs. public equity return

The objective of this report is to evaluate the impact of private equity ownership on the portfolio companies, covering a range of key metrics and perspectives.

The first metric on returns attribution seeks to assess whether the equity investment return achieved by private equity investors is higher than the benefit derived from additional debt (or leverage), and higher than the performance of public companies in the same sector and time frame; that is, do private equity-owned companies deliver better equity investment returns, adjusted for leverage, than comparable public companies. The time frame of this measure starts when the portfolio company is acquired, and ends when it is exited; for the 51 exits, this averages just over five and a half years.

This year we have refined the methodology used, as described in Appendix D, as well as incorporated the additional exits in 2014. The three key findings remain consistent with prior years, albeit the absolute numbers have moved:

1. The portfolio companies owned and exited by their PE owners achieved an aggregate equity investment return significantly in excess of benchmarked public companies, by a factor of almost 4x.
2. The source of the private equity gain over and above public company return comprises both the amount attributable to additional leverage and private equity strategic and operational improvement.
3. There is a material element of the investment return (24%–29%) that relates to the strategic and operational outperformance of the portfolio companies during private equity ownership, beyond that of benchmarked public companies, and over and above the net beneficial impact of additional financial leverage.

Fig. 4 shows how the pattern of returns attribution changes with length of private equity ownership of the portfolio companies. This shows that the effect of additional leverage decreases with time, in part a function of steady growth in profits and business value shrinking the relative mix of debt. It also shows that the stock market factor increases with time, and the PE strategic and operational improvement factor decreases for the longest hold periods. Typical PE investments are made on the basis of a clear plan, aligned incentives and 3–5 years to implement the plan and realise the benefits. Over this period, the portfolio companies evidently outperform. It may be the case that in longer hold periods, these benefits are diminished.

Fig. 3: Returns attribution, portfolio company exits 2005–14

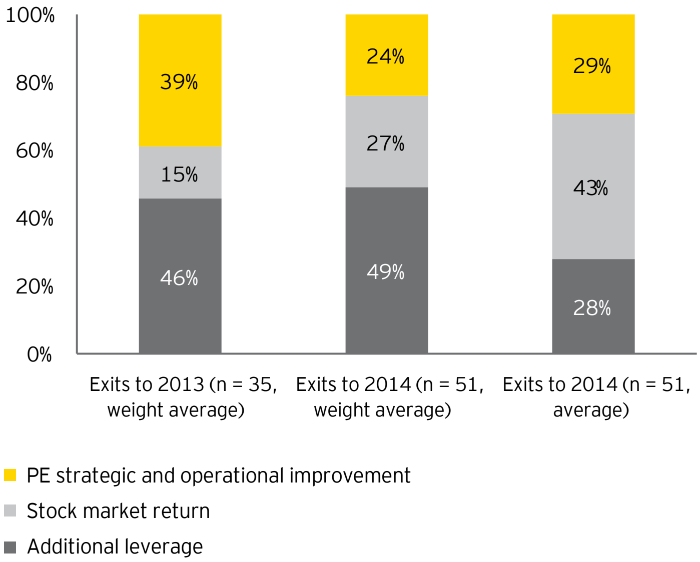
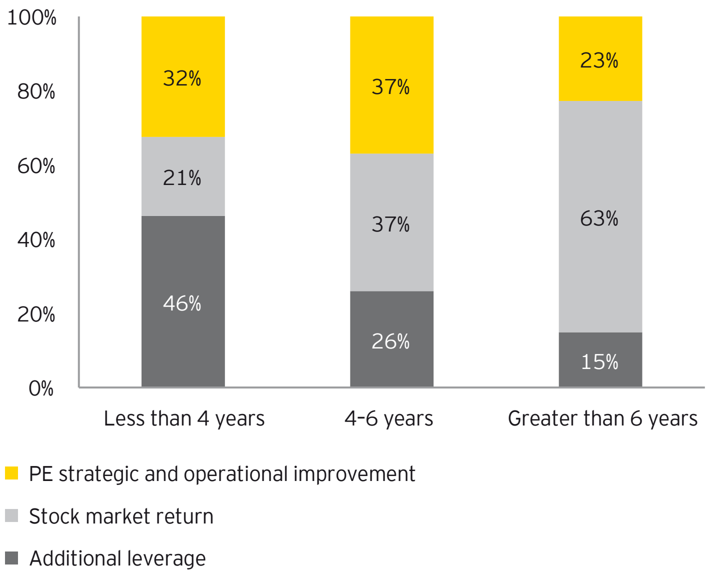


Fig. 4: Average returns attribution by length of portfolio company ownership, 2005–14, n = 51



Employment

Organic employment growth

The second area to review is the employment record of the portfolio companies while under private equity ownership. The reported growth in employment of all the portfolio companies covered in this report, from acquisition to the latest date or exit, is 2.3% per annum. This is slightly behind a sector matched public company benchmark of 2.5% per annum.

A more accurate measure of employment growth is organic change, i.e., removing the effect of both bolt-on acquisitions and partial disposals. On this measure, portfolio company organic employment has grown by 0.3% per annum. This result is behind the employment growth in the UK private sector overall, which is 1.5% over an equivalent time frame. This difference may reflect differences in PE ownership, and/or the differing exposure to sector trends notably UK consumer expenditure which has been subdued over much of this period.

The pattern of year-on-year organic employment growth is shown in Fig. 6. The UK private sector has been growing employment at an increasing rate since the downturn in 2009, reaching 4% growth in 2014 vs. 2013. Against this economy-wide trend, the year-on-year performance of the portfolio companies has been more variable. The portfolio companies grew employment in 2011 ahead of the broader economy, and then slowed in 2012 and 2013. In 2014, employment growth in the portfolio companies increased by 4.2%, its highest level since 2008 and slightly ahead of the UK private sector overall.

Fig. 7 is an update of a chart shown in last year's report. It shows the absolute level of organic employment growth from acquisition to latest date (for the current portfolio companies) or exit (for portfolio company exits). The chart shows that there is a wide range of organic employment growth at the individual portfolio company level that sits behind the totals and averages presented above. There are 10 data points out of 85 where the change in organic employment has been plus or minus 50% since investment by private equity. This wide range of outcomes reflects specific market, competitive and management factors, as well as differing business strategies implemented under PE ownership. Only by aggregating data across a consistent population of businesses, can the true effects of private equity ownership be seen.

Fig. 5: Reported and organic employment growth since acquisition, n = 85

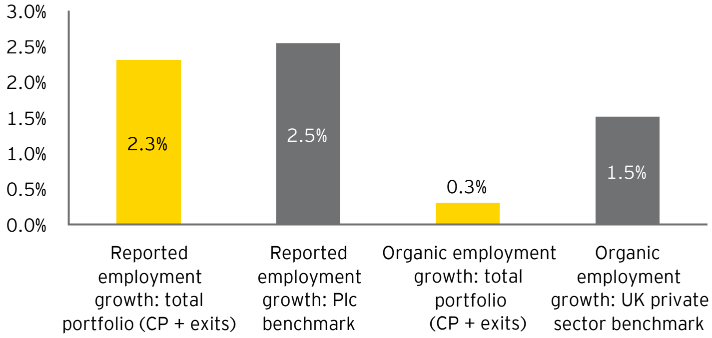


Fig. 6: Year-on-year organic employment growth

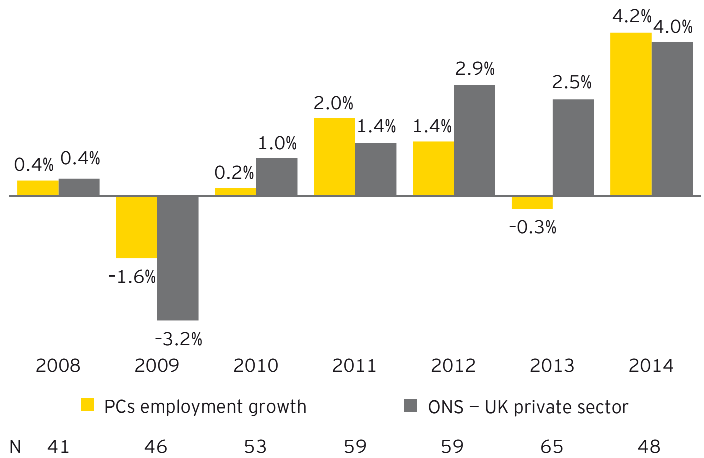
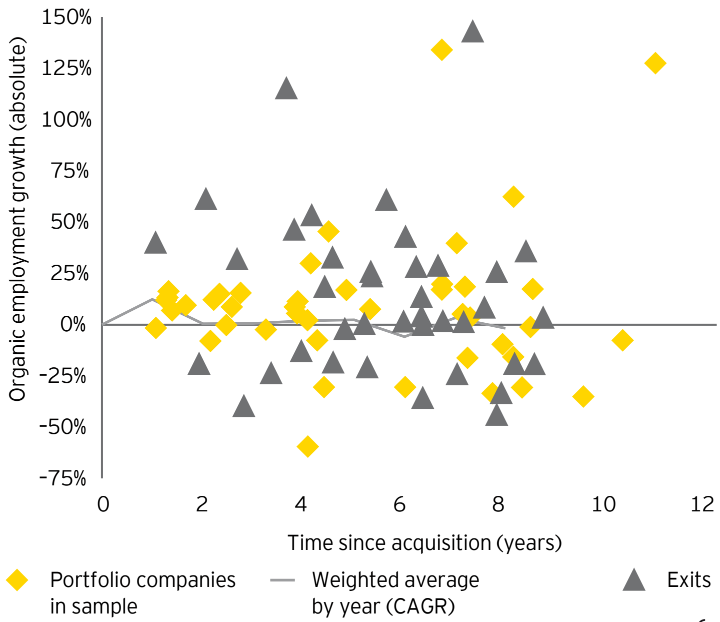


Fig. 7: Organic employment growth since acquisition vs. time since acquisition, n = 85

(Chart excludes two outliers)



Employment costs and pensions

Employment cost per head growth

A further test of employment trends in the portfolio companies under private equity ownership is to consider compensation. There is no easy, single measure of like-for-like change in employee compensation in large companies, due to changes in the composition of companies, numbers of employees at differing pay levels, company and individual performance, as well as annual base pay awards. We have analysed average employment cost per head as the best proxy for employee compensation, which shows that the portfolio companies have grown this measure by 0.3% per annum under the entire period of private equity ownership. This is positive, but less than the 3% per annum growth in the UK private sector as a whole.

Looking at the year-on-year growth trend in Fig. 9 shows a relative stable pattern of average compensation increases in the UK private sector, over 3% for the past three years. Against this trend, the performance of the portfolio companies is variable, ahead in some years, including 5% in 2013, and behind in others, including -2.4% in 2014.

Comparing Fig. 9 with Fig. 6 indicates some relationship between growth in organic employment and growth in employment cost per head, with one rising at the expense of the other for the portfolio companies. For example, in 2014, organic employment growth was at its highest level of 4.2%, while growth in average employment cost was its lowest. This might imply that most employment growth is taking place in jobs where employment cost is below average for the data set.

To understand this better, the number of employees by compensation range was collected in 2014, as shown in Fig. 10, to obtain further data on this topic, and beyond normal company reporting. The distribution of UK jobs by annual compensation band shows a large percentage at the lowest band, with a strong skew towards the portfolio companies in the consumer services (e.g., leisure, retail) and healthcare sectors where there is demand for part-time work. As shown in Fig. 2, the portfolio companies have 67% of employment in these sectors, compared with 26% in the UK economy private sector. Next year, year-on-year comparisons can be made to analyse changes in jobs by salary banding and its effect on average employment cost growth.

Fig. 8: Growth in employment cost per head, n = 86

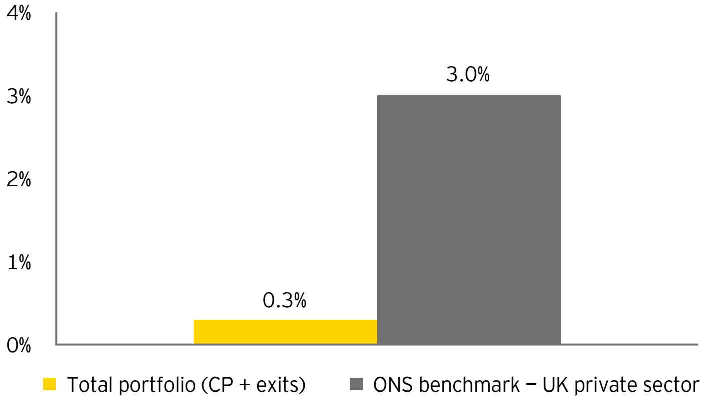


Fig. 9: Year-on-year average employment cost per head growth

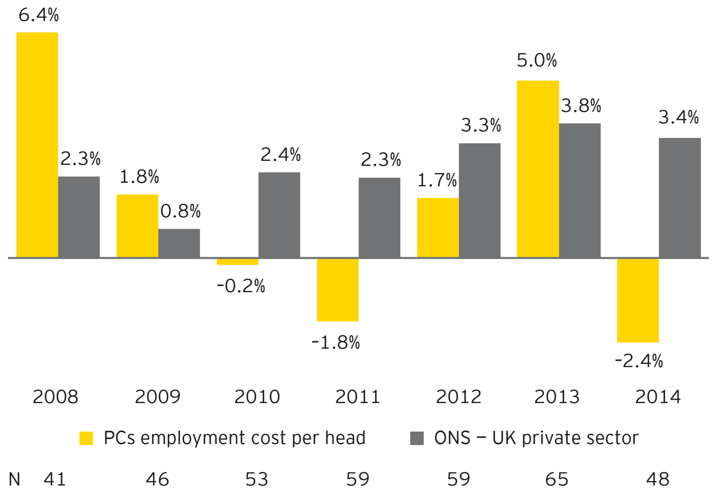
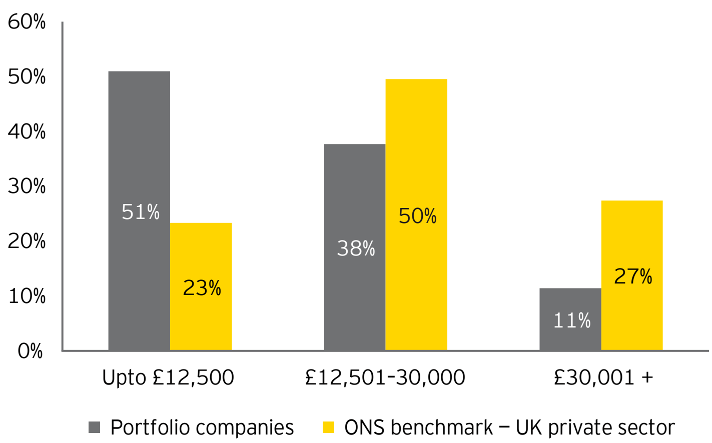


Fig. 10: Percentage of portfolio company UK jobs by annual compensation band, 2014, n = 50



Zero-hours contracts

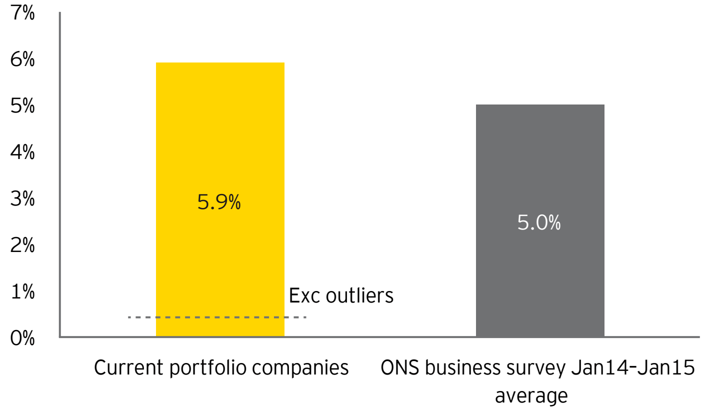
In addition to data on employment by compensation band, this year the portfolio companies were asked to disclose the number of jobs on zero hours contracts. Fig. 11 shows the results of aggregating this data. Across 51 portfolio companies, 5.9% of UK jobs were on zero hours contracts. This compares with data from ONS which shows that the proportion of all UK employees on zero hours contracts is 5%.

Within the portfolio companies, there is a significant concentration of use of zero hours contracts, with three companies active in the healthcare sector each having a significant proportion of their employees on zero hours contracts. It is understood that this form of employment is more common in the healthcare sector. Excluding these three companies, the percentage of portfolio company employees on zero hours contracts falls to 0.3%.

Pensions

Another element of employee compensation is pensions. The pensions regulator is responsible for reviewing pension arrangements, including at the time of change in ownership, and PE investors comply with these procedures. In the current population of portfolio companies, there has been one instance of a defined benefit scheme being discontinued, while one has been initiated, along with three new defined contribution schemes initiated and one discontinued. An issue facing the portfolio companies, along with other providers of defined benefit schemes, is the persistent low interest rate environment that creates accounting net liabilities in defined benefit schemes, which were (6.9)% in 2014, a slight increase on the prior year of (6.8)%.

Fig. 11: Percentage of UK jobs under zero hours contracts, 2014, n = 51



Investing

Growth in operating capital employed

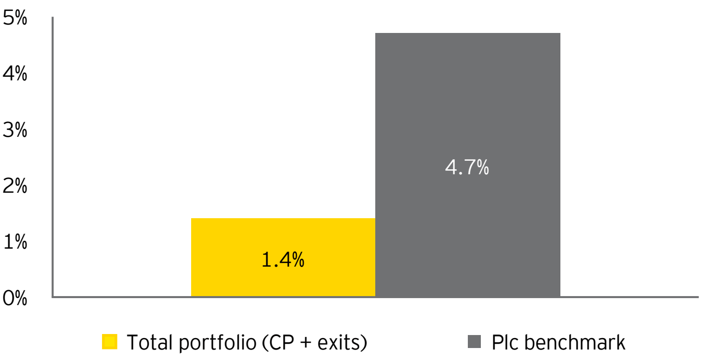
In addition to the review of the change in employment under private equity ownership, changes in capital resources have been analysed.

The portfolio companies, in aggregate, have grown operating capital employed by 1.4% per annum during the entire period of private equity ownership. About 80% of this increase has come from organic investment, with the remaining change from the net effect of acquisitions and disposals, i.e., there has been more growth in capital employed from bolt-on acquisitions than decline from partial disposals.

To benchmark this performance, we have analysed public companies on the same metric which shows a faster rate of growth of 4.7%, on the basis of time and sector matched.

The year-on-year growth in operating capital employed shows more variation for both the portfolio companies and the public company benchmark. In 2009–10, when the UK economy was most fragile, the portfolio companies tightened their control of operating capital employed, by reducing capital expenditure (see Fig. 14) and working capital leading to reductions in operating capital employed. In contrast, public companies allowed capital employed to increase, building up inventories and allowing customers to extend payment terms. From 2011, the portfolio companies have steadily increased operating capital employed, in 2011–13 by boosting capital expenditure and in 2014 from growth in working capital. Over this period, public company benchmarks lagged the investment of the portfolio companies – although this changed in 2014 when the public company benchmark increased by almost 10%.

Fig. 12: Growth in operating capital employed since acquisition, n = 86



Sources	Increase in op. cap. (£b)	Percent of growth (%)
Acquisitions and disposals	2.5	0.2%
Organic	11.6	1.2%
Total	14.1	1.4%

Fig. 13: Year-on-year operating capital employed growth

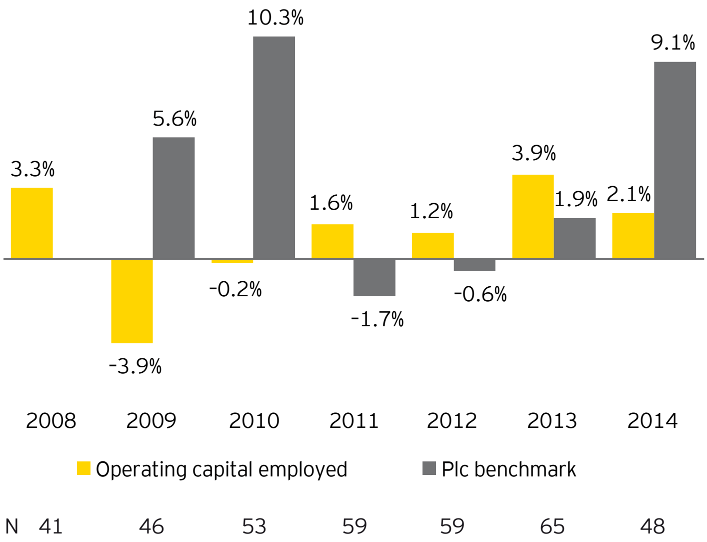
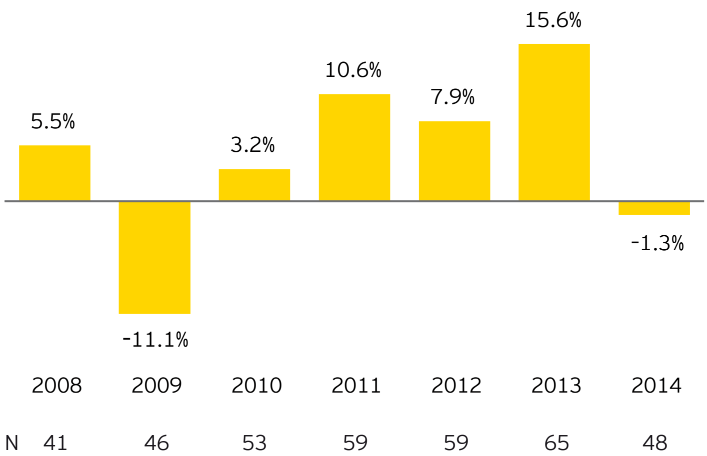


Fig. 14: Year-on-year capital expenditure growth



Productivity

Labour productivity growth

While the focus of much commentary on private equity's ownership focuses on resources – both labour and capital – economic impact is also a function of changes in productivity. To assess the performance of the portfolio companies on labour productivity, we have analysed two measures.

A simple measure of labour productivity, that can also be benchmarked to public companies, is profit per head. On this measure, the portfolio companies have grown profit per head by 2.5% per annum, which is comparable to the public company benchmark.

The measure of labour productivity used by economists, that can be benchmarked to national statistics, is gross value added per employee. In aggregate, the portfolio companies during the entire period of private equity ownership have grown labour productivity by 1.8% per annum, which is slightly below the UK economy-wide benchmark. In previous years, we have reported that portfolio companies have outperformed the economy in labour productivity. Part of the explanation of this change in finding is the decline of 1.4% in labour productivity in 2014, as shown in Fig.17. Beyond this, as in prior years, we note that the rate of organic employment growth has an in-year effect on labour productivity growth, i.e., faster employment growth leading to slower productivity growth in that year, and vice versa. This may explain some of the 2014 result.

Capital productivity growth

In addition to labour productivity, we have analysed capital productivity, measured as revenue over operating capital employed.

The portfolio companies have demonstrated strong performance on capital productivity growth. Capital productivity has grown at 7.2% per annum during the entire period of ownership by private equity investors, well ahead of the public company benchmark of 3.0%.

Capital productivity growth was strongest during the economic downturn, when the portfolio companies restricted growth in operating capital employed, and has been positive in every year so far, being 1.8% in 2014.

Fig. 15: Growth in profit per employee and gross value added/employee since acquisition, n = 86

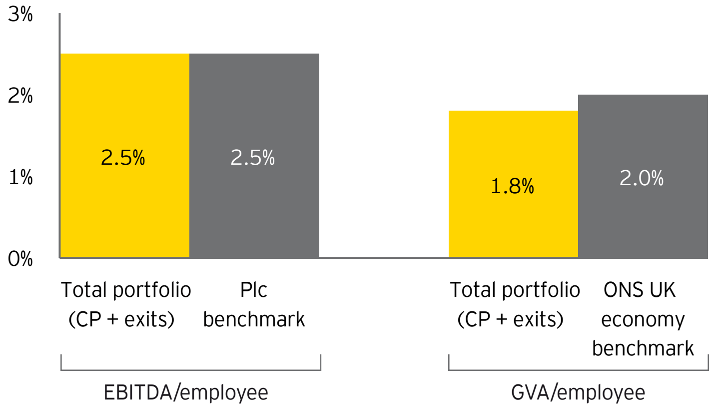


Fig. 16: Growth in capital productivity since acquisition, n = 86

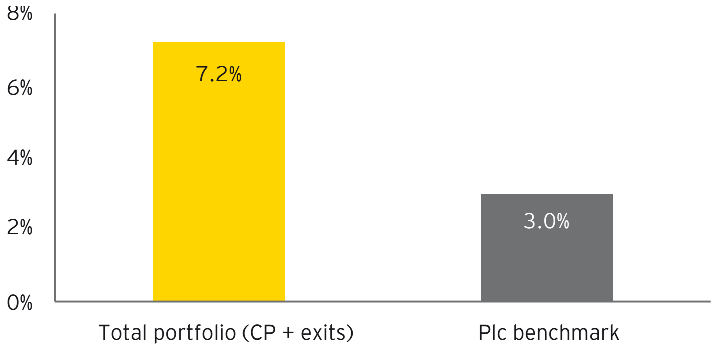
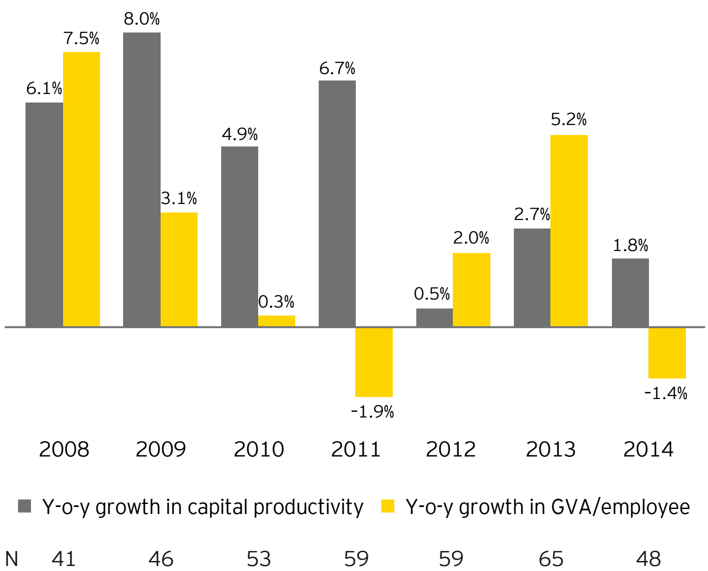


Fig. 17: Year-on-year growth in capital productivity and growth in GVA/employee



Trading performance

Reported revenue and profit growth

The two tests of trading performance analysed in this report are revenue growth and profit or EBITDA growth.

Reported revenue growth of the portfolio companies averages 5.2% per annum since acquisition, explained directionally by more growth in capital productivity than growth in operating capital employed, including acquisitions. These factors also explain the faster revenue growth than the public company benchmark of 4%.

In terms of reported EBITDA growth, for the portfolio companies this averages 3.6% per annum, a little behind reported revenue growth. The public company benchmark of 4.8% per annum is ahead of the portfolio companies, in contrast to the findings in prior years' reports.

Organic revenue and EBITDA growth

Reported revenue and EBITDA growth include the effects of organic and inorganic growth, i.e., bolt-on acquisitions and partial disposals. The portfolio companies, under private equity ownership, invest more in bolt-on acquisitions than is realised in partial disposals. This has been shown in the analysis of investment, and is evident in trading performance as reported growth exceeds organic growth, by 2.0% and 0.8% per annum for revenue and EBITDA, respectively.

The year-on-year growth in organic revenue and EBITDA shows a variable pattern, reflecting the broader economy trend, company specific factors and change in portfolio mix. Organic growth remained positive but slowed in 2009 and 2010. From 2011 to 2013 the rates of organic revenue and profit growth increased. However, 2014, for the portfolio companies if not the broader economy, was a year of slower growth. Operating capital employed growth and capital productivity were both positive but at lower rates than 2013, explaining the revenue slowdown. Employment increased, but labour productivity declined, which together lead to slower profits growth than in the prior year.

Fig. 18: Revenue and EBITDA growth since acquisition, n = 86

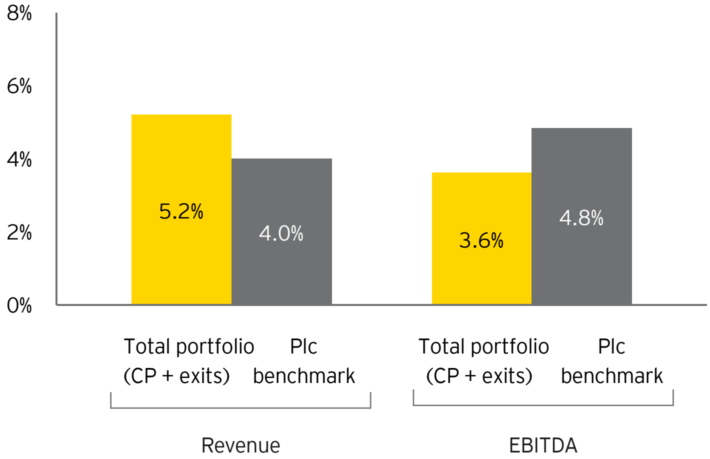


Fig. 19: Reported and organic revenue and EBITDA growth, n = 86

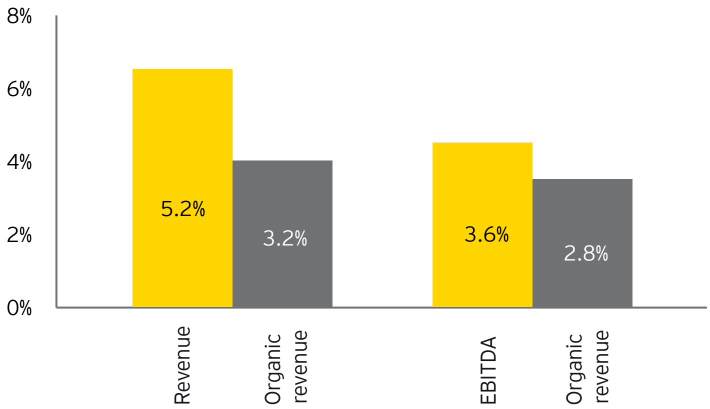
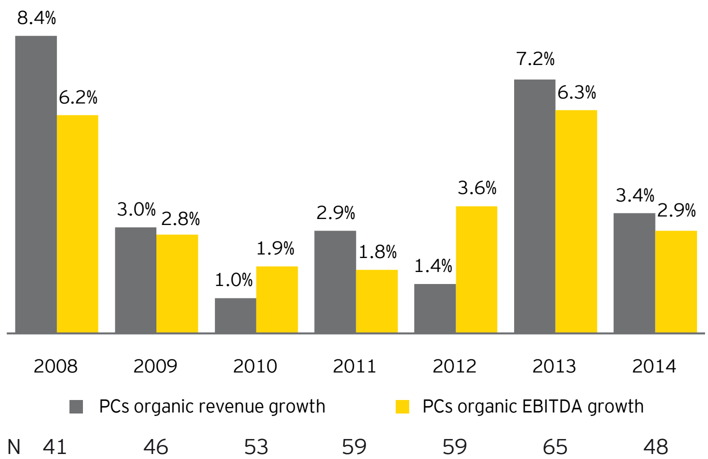


Fig. 20: Year-on-year organic revenue and EBITDA growth



Financial leverage

Debt ratio

One distinctive feature of the private equity business model is to use greater financial leverage than the typical public company. More debt and less equity at the time of investment increases the effect of change in enterprise value at exit on equity return, both up and down. The effect of this on the equity investment return has been shown in the returns attribution analysis on page 5.

To illustrate the difference in financial leverage between the portfolio companies and public companies, Fig. 21 shows the ratio of third-party debt to EBITDA. The portfolio companies have more than double the amount of debt, per £ of EBITDA, than the public company benchmark, i.e., a ratio of 7.1 at time of acquisition vs. 2.9. All of the performance measures in this report for the portfolio companies, therefore, reflect this higher level of financial leverage.

Change in leverage ratio

One test related to financial leverage is to understand how it changes post acquisition, i.e., whether cash flows are diverted away from investment towards debt (and equity) repayment.

The table at Fig. 22 summarises the change in debt for the current portfolio companies since acquisition. It shows that debt has increased since acquisition for the current portfolio companies, and that the amount of debt relative to profits has also increased as debt has grown a little faster than EBITDA.

To date, the current portfolio companies have produced surplus cash flow after investing in working capital and capital expenditure, and paying interest and taxes, of £1.6b that could have reduced debt. Instead, this cash flow plus additional debt was raised to fund bolt-on acquisitions (i.e., operating capital employed plus goodwill), representing significant additional investment into the portfolio companies by their providers of capital.

Fig. 21: Opening and latest debt to EBITDA ratio
Current portfolio, n = 48

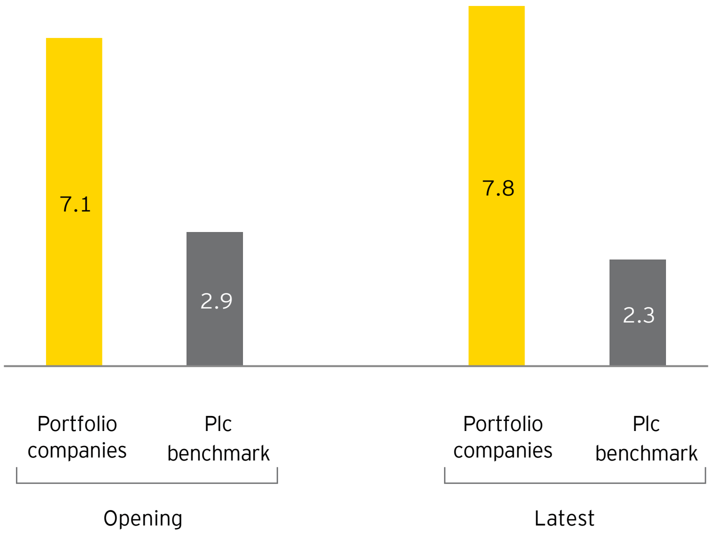


Fig. 22: Capital structure – acquisition to latest date
Current portfolio, n = 48

Debt (£b)	Acquisition to latest date	Debt/ EBITDA
Opening debt	42.4	7.1
Debt-funded acquisitions (net)	15.4	
Net equity withdrawals	0.8	
Operating cash flow post-investing and funding charges	(1.6)	
Change in debt	14.6	
Debt at latest date	57.0	7.8

Appendix A
List of portfolio companies

Portfolio companies (on 31 December 2014)

Portfolio company	GP(s)
Affinity Water	Morgan Stanley, Infracapital
Airwave Solutions	Macquarie
Ambassador Theatre Group	Providence Equity, Exponent
Amdipharm Mercury (AMCo)	Cinven
Annington Homes	Terra Firma
Associated British Ports	GS Capital, Infracapital, Borealis, GIC
Biffa	**Sankaty Advisors, Babson Capital Europe, Angelo Gordon, Avenue Capital**
Birds Eye Iglo	Permira
Brakes Group	Bain Capital
British Car Auction	Clayton Dubilier & Rice
Callcredit Information Group[1]	GTCR
Camelot	**Ontario Teachers' Private Capital**
Care UK	Bridgepoint
CenterParcs	Blackstone
Civica	OMERS PE
D&G group	CVC
David Lloyd Leisure	TDR Capital
DFS	Advent International
Edinburgh Airport	Global Infrastructure Partners
Enserve	Cinven
Equiniti	Advent International
Eversholt Rail	3i, Morgan Stanley, STAR Capital
Expro	Goldman Sachs
Fat Face	Bridgepoint
Findus Group	Lion Capital, Highbridge Capital, JP Morgan Chase
Fitness First	Oaktree Capital, Marathon Capital
Four Seasons Health Care	Terra Firma
Gala Coral	Apollo, Cerberus, Park Square, York Capital Management
Gatwick Airport	Global Infrastructure Partners
HC-One[1]	**Safanad, Formation Capital**

Portfolio company	GP(s)
Host Europe Group	Cinven
Integrated Dental Holdings	Carlyle
John Laing	Henderson
Keepmoat[1]	TDR Capital, Sun Capital
London City Airport	Global Infrastructure Partners, Highstar Capital
Moto	Macquarie
National Car Parks	Macquarie
New Day	Varde Partners
New Look	Permira, Apax
Northgate Information Solutions	KKR
Northgate Public Services[1]	Cinven
Odeon & UCI Cinemas	Terra Firma
Osprey (AWG)	3i, Colonial First State Global Asset Management, Canadian Pension Plan Investment Board, Industry Funds Management
Pizza Express[1]	Hony Capital
Pret a Manger	Bridgepoint
Priory Group	Advent International
R&R Ice Cream	PAI Partners
RAC	Carlyle
South Staffordshire Water	KKR
Stonegate Pub Company	TDR Capital
TES Global (previously TSL Education)	TPG
Thames Water	Macquarie
The Vita Group	TPG
Top Right Group	Apax
Trader Media	Apax
Travelodge	Goldman Sachs, Golden Tree Asset Management, Avenue Capital Group
Virgin Active	CVC
Viridian Group	**Arcapita**
Voyage Healthcare[1]	Partners Group, Duke Street, Tikehau
Vue Cinemas	OMERS PE
World Pay	Advent International, Bain Capital
Village Urban Resorts[1]	**KSL Capital**

Exits of portfolio companies during 2014

Portfolio company	GP(s)
Acromas Holdings	Charterhouse, CVC, Permira
Alliance Boots	KKR
Pets at Home	KKR
B&M Retail	CD&R
Exova	CD&R
Brit Insurance	Apollo, CVC
Gondola	Cinven
Partnerships in Care	Cinven

Portfolio company	GP(s)
Spire Healthcare	Cinven
Phones4U	BC Partners
United Biscuits	Blackstone, PAI
Travelex[2]	Apax
PHS	Charterhouse
Card Factory	Charterhouse
DX Group	Arle
Tomkins	**Onex Partners, Canadian Pension Plan Investment Board***

Portfolio companies in **bold** text are those GPs and portfolio companies that have not complied; * indicates where the GP has provided an explanation for non-compliance.

Note 1: Denotes portfolio companies that are new entrants
Note 2: Deemed a 2014 exit although completion took place in early 2015

Appendix B

Movement in the number of portfolio companies, 2007–14

	2007	2008	2009	2010	2011	2012	2013	2014
At 1 January	37	42	47	43	64	73	72	71
Portfolio companies introduced/excluded with changes in PERG criteria				12	4	(2)	(1)	-
Acquisitions of portfolio companies	10	5	-	11	8	7	10	7
Exits of portfolio companies	(5)	-	(4)	(2)	(3)	(6)	(10)	(16)
Portfolio companies at 31 December	**42**	**47**	**43**	**64**	**73**	**72**	**71**	**62**
Exits and re-entrants	1	-	-	1	1	3	5	-
Number of exits by IPO	-	-	-	-	-	1	3	8

- In 2010, the criteria used to determine the portfolio companies were changed by the PERG, by lowering the entry enterprise value threshold. This brought in a total of 16 new portfolio companies. In 2012, the PERG decided that one ‘PE-like’ investor entity that owned two portfolio companies had restructured in such a way that it was no longer ‘PE-like’. In 2013, the PERG decided that one portfolio company, that had made significant disposals and was as a result well below the size criteria, would be excluded from the population.
- The effect of private equity ownership on 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.

Appendix C
Report objectives and definitions

Report objectives

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 PERG (formerly 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 if 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 PERG. A portfolio company, at the time of its acquisition, was:

- '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 £210m, 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 £350m, 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, and approved by the PERG. 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.

Private equity firms were requested to complete a data template, specified by the BVCA and EY, for each of their portfolio companies, for the purposes of preparing this report. This year the data template was extended to capture additional data on employment, including employment by salary band and the use of zero-hours contracts.

Appendix D
Methodology

Process

The approach to producing the 'annual report on the performance of portfolio companies' has been debated and agreed with the BVCA and the PERG.

EY contacted the private equity firms in July 2015 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 data further 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. Data gathering was completed in November 2015.

Measuring performance

The data set is built up from the individual companies under their period of ownership by private equity investors. In total, there are 62 current portfolio companies and a further 56 portfolio companies that have been exited since 2005:

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 trading and other measures, including revenue, profit, organic employment, capital expenditure and cash flow, require full year comparison with full prior year (to avoid the error inherent in annualising partial year figures), and the provision of additional data beyond annual accounts. These measures can be determined for 86 of portfolio companies, comprising 48 current portfolio companies (62 less 7 non-compliers, less 7 for whom year-on-year performance is not available — 8 in the case of organic employment), and 38 exits (56 in total less five non-compliers, less 12 exits 2005–7 for whom this detailed information was not requested, less one in 2014 who did not provide all the data requested).
- Year-on-year growth figures include, in each year, all current portfolio companies for whom the information is available, and also the results of portfolio companies that exited in that year if the majority of their trading was under PE ownership.
- Data to calculate returns attribution has been provided for 51 of the 56 portfolio companies that were exited over the period 2005–14.

Publicly listed benchmarks

The public company benchmarks are drawn from the 646 primary listed companies on the LSE to 31 December 2014, from which 363 companies are excluded for the purposes of this report:

- 292 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).
- 42 companies were excluded because their market capitalisation was less than £210m, the size threshold for take-privates in the GMG criteria.
- 27 companies were excluded because their market capitalisation was greater than £11b (the market capitalisation of the largest portfolio company over the period of this study).

This results in 283 public companies in the benchmark group.

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.

Changes in benchmarking methodology

This year, we have reviewed many aspects of the approach, in particular with regards to the selection and calculation of benchmarks. This has led to a number of changes compared to prior years' reports that are summarised below:

- Public company benchmarks are now based on primary listings on the LSE. This removed a large number of businesses with secondary listings, many of whom trade outside the UK.
- Certain ONS figures for employment and compensation were altered to present the UK private sector, vs. the UK economy as a whole.

As in prior years, we note that there are limitations in the selection of appropriate benchmarks. These include, but are not limited to:

- Reported figures include the effect of acquisitions and disposals, which for public companies in aggregate, it is not possible to separately analyse.
- 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 the gross equity multiple (equity realised divided by equity invested, before all fees and charges), into three components:

1. **Additional leverage:** The effect on equity multiple of the additional leverage PE firms place on a company above the average public company 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 adjusted for dividends.
    - The difference between original deal equity multiple and the adjusted equity multiple is the benefit of additional leverage.
2. **Public stock market return:** The total shareholder return (TSR) earned in the LSE sector over the same time frame as the private equity investment:
    - The TSR is calculated using public stock market indices. TSR captures the effects of sector earnings growth, multiple changes and dividend payments.
    - The public stock market return is converted into an equivalent equity multiple figure and applied to a deal return that has equivalent capital structure after the adjustment for additional leverage.
3. **PE strategic and operational improvement:** The component of equity multiple that relates to above benchmark performance:
    - The component of the equity multiple for PE strategic and operational improvement is calculated by subtracting the public stock market return from the equity multiple adjusted for additional leverage.

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EYG No. FR0174

45145.indd (UK) 01/16. Artwork by Creative Services Group Design.

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