How do PE act on the performance of their portfolio?

Pan-European PE survey

mazars x arx

Executive summary

Introduction

We have surveyed a panel of pan-European PEs, active / passive and minority / majority shareholders and on average ~70% are satisfied with the performance of their investments:

- Reasons for dissatisfaction are linked to strategy, management teams and operations;
- Capital control and involvement in operations make a difference. Active majority shareholders will also be more quickly satisfied (after 3 years) than passive majority PEs (see graph).

To meet perfomance expectations, all PEs have reported their need for more operations analysis before transaction and more supervision of execution after the deal. Based on their involvement in operations we have identified 3 PE models. (see pyramid on next page).

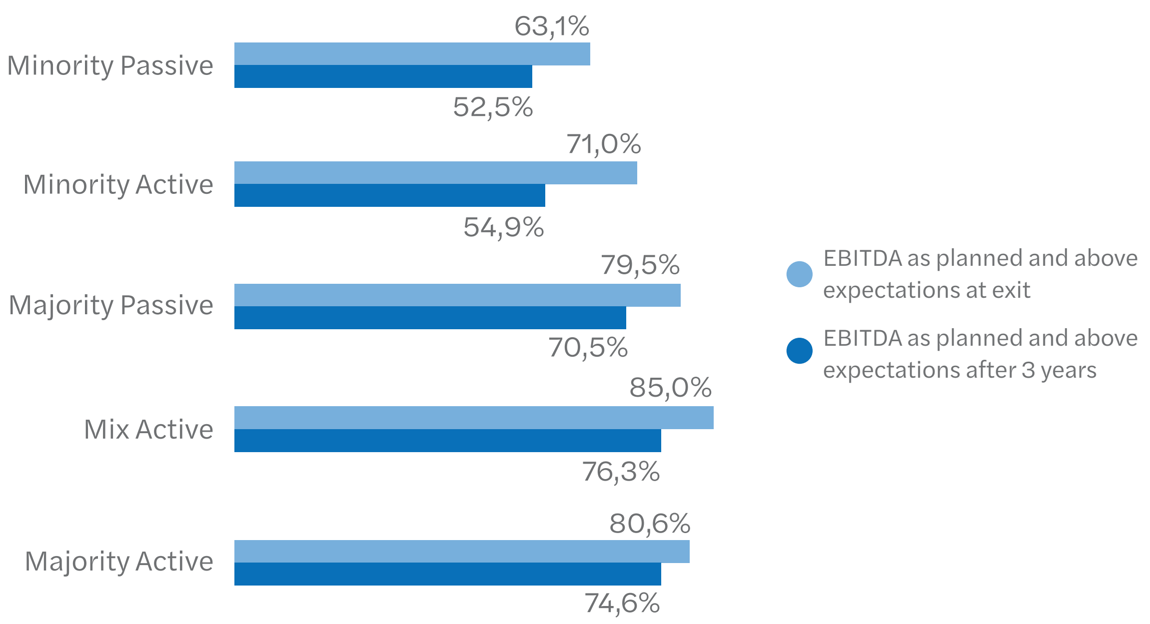
New topics of investigation are coming to the front:

- For 53% of our respondents, ESG is either included in the DD package or is embedded in their DNA, through their internal policy rules;
- 14% have mentioned cybersecurity risks but this topic should grow on top of priorities as it already gains traction in regulatory audit works.

With more topics on their plate and the consciousness that being involved in the management of their investment matters, PEs are left with 2 choices to increase performance:

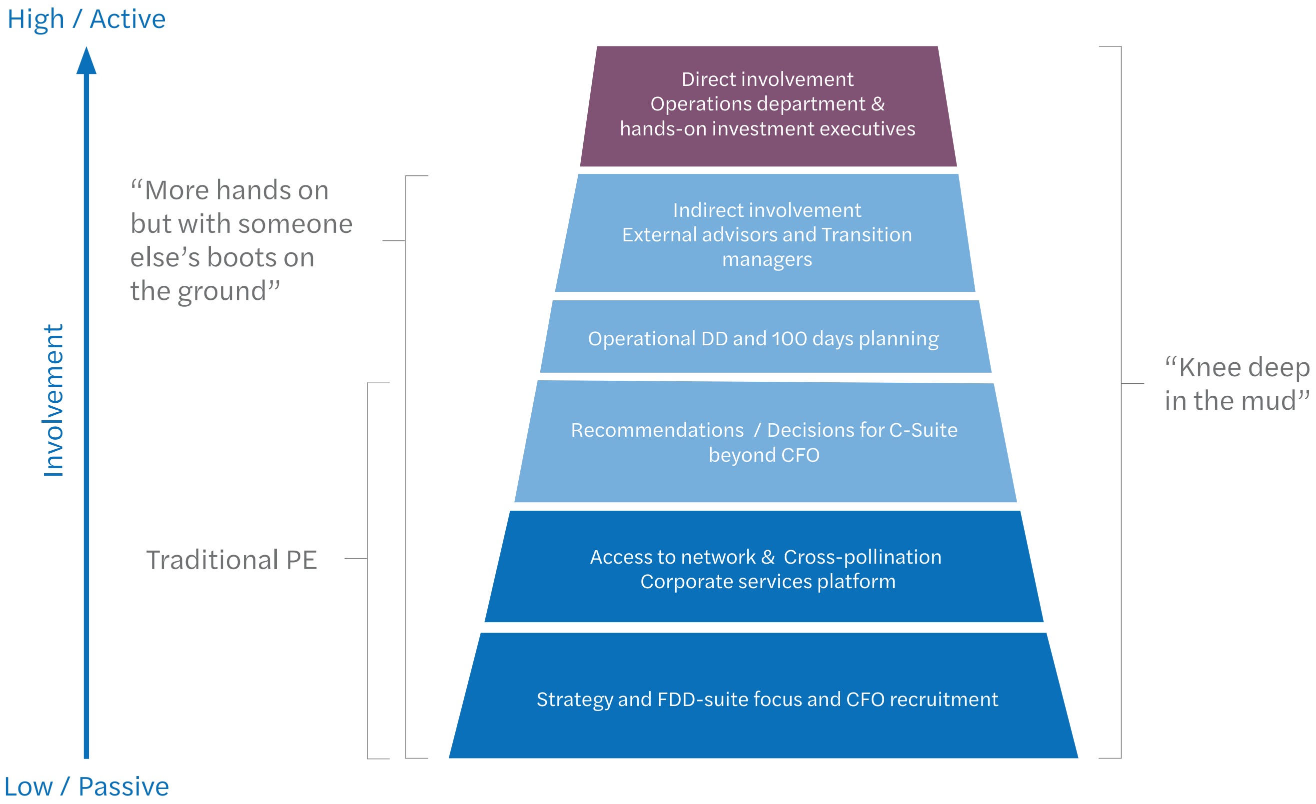
- Developing in-house teams with either specialists like operating partners, ESG managers or more hands-on participation executives;
- Or use of specialised external advisors to handle the job.

% of PE having an EBITDA as planned and above expectations



Introduction

3 PE models



Our survey has been conducted from the 1st of November until the 23rd of December 2023.

We have directly interviewed 43 Private Equity firms from 8 different European countries (with the assistance of the survey institute CSA in France) and collected insights from 141 firms through an online questionnaire delivered with the support of ARX.

List of abbreviations

CDD : Commercial Due Diligence

CEE : Central and Eastern Europe

ESG : Environmental, Social and Governance

FDD : Financial Due Diligence

LDD : Legal Due Diligence

PE : Private Equity

SDD : Strategic Due Diligence

TDD : Tax Due Diligence

Three main areas where PEs try to focus their contribution to performance

Three main areas where PEs try to focus their contribution to performance

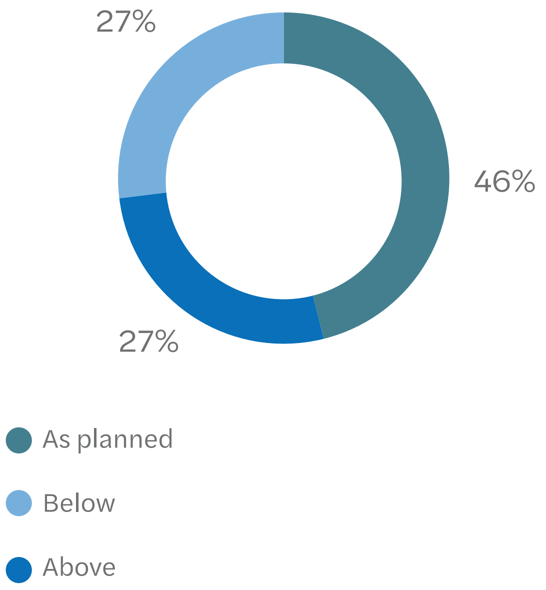
73% of portfolio companies perform as expected or better after 3 years

Top 3 reasons of underperforming portfolio companies

Market evolution	28%
Operations complexity	18%
Relationship with management	16%

Based on 141 responses out of 141 respondents

Surveyed PE breakdown according to their satisfaction with EBITDA after 3 years of tenure



Based on 117 out of 141 respondents

This study aims at elaborating on, **how PE firms contribute to the performance** of their investment, whatever the measure of success: via EBITDA multiple, IRR, money for money, burn rate for early stage or even ESG KPIs in some instances.

Both our qualitative and quantitative surveys have highlighted **3 areas that PEs consider foundational for the success of their ventures**, and they are mirroring the top 3 reasons why companies failed to meet their expectations.

Market downturns are neither predictable nor DD-able. In order to mitigate these, **PEs' primary focus is the protection of the Top Line**. Opposite, **Operations' complexity and alignment with management** can be assessed and prepared before the deal but are not always analyzed.

Three main areas where PEs try to focus their contribution to performance

73% of portfolio companies perform as expected or better after 3 years

The very same causes of failures happen to be behind their deception for deals, they would have walked away, if they had known better and earlier.

108 of our 141 respondents have made one or more bad encounters!

Reasons why PE would have walked away from deals they signed

% of Deals PE would have walked away from if they had known better before investment	Numbers of answers	Market evolution	Operations Complexity	Relationship with management	Strategy / Completion	People (retention / adherence)	Total of reasons given
None	9	0	0	0	0	0	0
Less than 10%	28	19	14	6	10	9	49
10%-30%	68	37	19	21	23	9	100
30%-40%	9	5	4	3	1	1	13
More than 40%	3	1	1	2	1	1	5
Total	**117**	**62**	**38**	**32**	**35**	**20**	**167**

Figures represent the choices made by 117 respondents out of our 141 panel.
They were able to pick multiple reasons.

Three main areas where PEs try to focus their contribution to performance

1. Top line development, the primary point of focus especially in adverse market conditions

As economic downturn is the main reason for unsatisfying performance, PEs try to avoid or smooth its effect by protecting / increasing their top line. All consider that their main role is to bring strategic vision and help repositioning companies when they need to.

1. Supporting international expansion and build-up

PEs are usually strong at identifying fragmented markets to conduct consolidation, diversify / spread their risks and sources of income between different markets and economic conjunctures.

A couple of PEs that we have interviewed are **deploying permanent capabilities for such market screening, including for carve-out opportunities of non-core business by multinational companies.**

One Spanish PE explained that "*For a medical equipment and value-added solutions distributor, we have contributed to doubling the revenue in 5 years helping with 10 acquisitions and expanding in the Peninsula." One CEE PE firm told us: "We have been very successful in a transport / travel / mobility build-up, where we have conducted consolidation (approximately 12 transactions) in a fragmented industry with a few cross-border transactions. We have multiplied revenue and EBITDA by 5 and IRR at exit reached 47%*".

> In these build-up transactions, the PE firm brings its technical expertise while, as emphasized by a Dutch PE familiar with cross-border build-ups, the platform company will conduct the integration because they are conscious that "The better the cultural match, the more value is created."

Three main areas where PEs try to focus their contribution to performance

1. Top line development, the primary point of focus especially in adverse market conditions

2. Strengthening sales and marketing teams

Management in family businesses or SMEs are mostly product-focused and lack the required skills and experience in sales and marketing.

PEs can help in attracting talented sales directors or they can provide temporary experts. "*We have an in-house expert who is a former marketing director for a Coca Cola-like multinational. Every time we introduce him to our portfolio companies, he hits the target*".

A CEE PE about their investment in a dietary catering provider where they have double sales and quadruple EBITDA: "*We helped creating the marketing functions to ensure better market visibility. Our CDD also revealed that their business is loyalty driven hence, we helped developing loyalty programs. During the pandemic, we promoted a strategic shift, with a stronger (successful) focus on orders from families at home instead of following the initial BP targeting employees at their workplace.*"

3. Opening doors thanks to the PE network

PE firms also contribute to sales development by giving access to their own network. Some are even encouraging commercial relationships between their portfolio. It can take the form of client-supplier relationship or cross-marketing and cross-selling.

For example, a pan-African PE recalled the success story of one of their manufacturing company's. While Covid was delaying administrative authorizations, they had lobbied the north African government to unlock the opening of their factory; then, they reached out to their address book to find local subcontractors.

For a French regional PE investing in SMEs, it is even part of their DNA: "*We are funded by more than 150 local entrepreneurs, and they act themselves as advisors to our portfolio and help them connect with potential partners.*"

A UK based investor in 1st round, creating Sales and Marketing is a constant priority: "The founders that we meet, need to refocus and we always help with Sales and Marketing", not by putting in place complex CRM system but by identifying and tracking the right KPIs across the product portfolio.

Three main areas where PEs try to focus their contribution to performance

2. Improving operational performance: solutions from internally dedicated teams to strict assessment of managers' operational capability

Our survey shows that "Support to implement turn over plan", "Key people retention" and "Operations" are the 3 items before deal sign-off that have the highest percentage for improvement.

However, a majority of PEs do not develop a clear after deal execution plan, while a few PE funds have internalized "Operational Excellence" and have built specific approaches from DD, action planning to implementation.

An international PE managing more than €10bn and targeting enterprise value between €200m and €1,5Bn, explained: "***We have started our own Operations team*** *in 2010 and it is today strong of 20 permanent staff (among 180). They participate to all the DDs with an in-depth analysis of organization and processes supporting the strategy and after the acquisition they are in charge of executing an improvement plan. It goes from the Top line to the Bottom line.*"

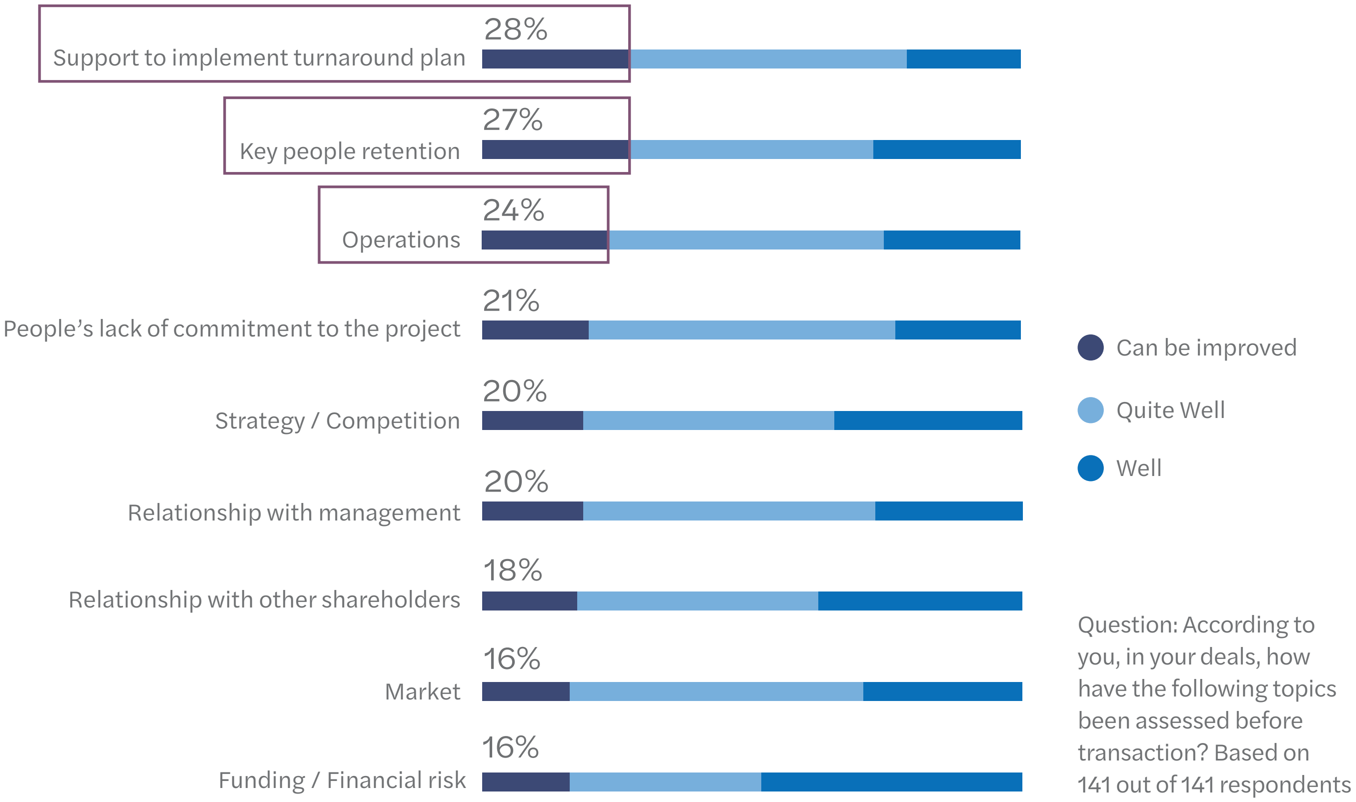
A French boutique investor, putting upfront their entrepreneurial mindset, explains that at the DD stage, they **assess the capabilities of the management** and based on that, either provide limited operational support or are fully hands-on in the company, dealing with all topics and sometimes fully replacing the CEO. They prefer that option than having a short-term transition manager as they think that turn-arounds require long term involvement.

Less than 30% of our 43 interviewees have declared developing their own "100 days plan". The majority would instead delegate this work to the management in place or the talents they will bring aboard later.

Three main areas where PEs try to focus their contribution to performance

2. Improving operational performance: solutions from internally dedicated teams to strict assessment of managers' operational capability

How good had assessment been done before deal sign-off



Question: According to you, in your deals, how have the following topics been assessed before transaction? Based on 141 out of 141 respondents

Three main areas where PEs try to focus their contribution to performance

2. Improving operational performance: solutions from internally dedicated teams to strict assessment of managers' operational capability

The founders of another French PE boutique have taken from their large experience in M&A a golden rule. **In every acquisition, the performance improvement plan must consist of precisely 6 modules**, neither 5 nor 7, because then "*you either spare time that could be employed to address an opportunity or you are spreading your attention and resources too widely*".

For example, they cited the recent acquisition of a consumer electronics manufacturer that they plan to transform following 6 workstreams: two of them regarding Sales Development, one for Cost effectiveness, two dedicated to innovations, and the 6th for reducing Inventories & Working capital.

Our own experience of performance improvement at Mazars fits with this assessment based on the **available bandwidth of operational teams**.

A typical performance plan, mobilizing 20 to 30% of a company's middle management over 12 / 18 months, would normally comprise of 40 to 50 initiatives across 6 workstreams (Sales, COGS, Supply chain / Lean operations, People and skills, G&A and IT) with a different emphasis on each depending on the situation.

According to this PE again, the 6 modules need to be properly scoped during the DD. Indeed, "*You will need to **anticipate the costs of conducting that kind of improvement** otherwise after the transaction you will be short of (financial) resources, you will have to take them from an already agressive budget, which will already drive you beyond the limits of your initial business plan.*"

Understand operations before the transaction and care for execution are more and more seen as a game changer.

Preferred actions to better apprehend and manage challenges

Criteria	Average rate (/5)
Identify and carefully choose leadership team / key people	3,8
Conduct additional or focused HR / Operational DD	3,8
Develop more KPI and adequate / timely reporting	3,5
Develop more performance improvement planning	3,4
Develop PE team skills (like including operations managers in your team)	3,2
Get more support to execute the transformation / build up / performance Improvement	3,2
Conduct additional or more focused Financial / Tax / Legal DD	3,0
Conduct more Industry / Company Benchmark	2,8

Question: Score from 1 to 5 (most preferred) the actions that you think might improve the performance of your investment. Based on 141 out of 141 respondents

Three main areas where PEs try to focus their contribution to performance

2. Improving operational performance: solutions from internally dedicated teams to strict assessment of managers' operational capability

On what would you put more attention to improve performance?

Criteria	Identify and carefully choose leadership team / key people	Analyze and prepare Transformation and operations	Conduct additional FDD / TDD or market analysis and Benchmark
Majority Active	16%	71%	14%
Majority Passive	16%	69%	15%
Minority Active	14%	70%	16%
Minority Passive	17%	59%	23%
Mix Active	18%	70%	12%

Analysis based on 141 out of 141 respondents. Consolidation of preferred choices (Score 4 and 5)

Three main areas where PEs try to focus their contribution to performance

3. Having the right, and fully aligned, management team in companies

For all of our respondents, the management team is the first asset of the company, and our quantitative survey has demonstrated that **Misalignment between PE and Company management can be fatal.**

Alignment with the founders and management team is critical but **the right alchemy "*does not fit into an excel formula*"** as said by a French investor supporting entrepreneurs.

All firms interviewed have confessed that **the lack of building intuit personal relationships has been the root of future failures**. As trivial as it sounds "*You don't go to bed with someone that you don't know well*".

At least, **a must-have is a good CFO**. Indeed, he / she will be able to track performance, do reporting and address quick or obvious wins in terms of debt management improvement.

For a Dutch PE, **"*Investing in management, management and management*." is the best recipe for success**. Indeed, this firm has revised their hand-on approach and has left the management with more space.

Other changes in the management team are necessary and must be done on day 1, otherwise the plan will not be correctly executed. "*There should be no hesitation when you feel that there is any gap in the management team or that some of its members do not fit with what you are expecting*" said one French Tech investor. Indeed, "*The right team can deliver a performance above their peers in the market*" confirms a UK investor.

One large US PE firm based in France always replaces the CFO in the companies they acquire. "This is a matter of being able to control and trust any numbers that come out of the company".

Three main areas where PEs try to focus their contribution to performance

3. Having the right, and fully aligned, management team in companies

Then, at DD stage, the management review may help learning where to focus and it may take different forms.

Most PEs simultaneously conduct a reputation-check with people around the management company and **spend as much time as possible in meetings with each member of the managing team to form their judgment to build confidence**. "*...and this is not just a one-way street*"; the investment managers must also share who they are and what they can bring beyond funding.

Few are investing in more detailed assessment. **Psychological analysis like MBTI may help in understanding the team dynamics**. One UK firm with an average ticket size of £10m, is, from time to time, using a behavioral psychologist. This is still rare and is observed with PE having recruited former consulting professionals, used to change management techniques. As a French PE said that "*On a few occasions, we have used the Map and Match tool but driven by one of our investment directors, who was familiar with it due to her consulting background*".

When asked if it makes a difference, they said **that the small cost incurred is worth the benefit of avoiding "*psychos*" that you will have to deal with** for the rest of the investment tenure.

Eventually the management assessment gives insights about future costs. As a Central European PE explained: "*...in the DD process and discussions prior to transaction we identify that the figures are to be adjusted with additional costs to change or strengthen the management team.*"

Only PE having the majority can really change teams while others know they are in the backseat for the best and sometimes the worst. Those PE firms, in a minority position, will rely on the lead PE to, at least, being able to implement a stronger governance with a Supervisory Board.

Three main areas where PEs try to focus their contribution to performance

4. Other best practices and Golden rules

Besides the 3 areas of focus, interviews have left us with numerous golden rules that PE executives have learned and written on the wall.

Back to basics

From the beginning, the investment structure should respect a few fundamental rules:

- Making a good entry with the right multiple. That sounds (and is) trivial but a bad assessment of market positioning, or of the team, or a bad evaluation of operations complexity, or a combination of all often puts you in contradiction with this principle.
- The funding must be kept flexible with a sufficient capital injection, reducing debt leverage and when possible, with a positive cash position, "*It is better to have a lower equity return and keep some wiggle room for asking additional loans*" according to a Dutch PE firm.

For this CEE PE, the path for a successful transaction is: "*A combination of quality sourcing (we come across almost 250 projects per year among which we need to select very effectively), clear strategy regarding both the target and the industry, an excellent seasoned management team and an efficient transaction process covering quality external advisors and effective due diligence*".

Be pragmatic

"***Every situation is an exception***" *and staying close to the companies with regular and consistent meetings*.

"***Take nothing for granted***". Every decision should be challenged especially those that are deemed to be the most obvious and where you think that there is no need for more rationale.

"***Less hard-nosed in negotiations, leads to more transactions***": this motto from a Dutch PE, means that there's no need to push negotiations too far, if the transaction is sound and the timing is right.

Three main areas where PEs try to focus their contribution to performance

4. Other best practices and Golden rules

Be realistic

Stick to your evaluation criteria: *"We had known from the start that we would not get along well with this guy, but the other merits of the investment thesis, unfortunately, made us do it anyway".*

Exit strategy: *"Should be debated very early in order to align expectations and vision and avoid unrealistic expectations on both sides".*

Tenure strategy: *"Should be flexible but you should never hesitate to pull the plug earlier… or give more time and accept more risk".*

Married but not for life; *"Accept that you are no longer the right partner"* based on what the investment company needs for its development otherwise risking to delay / destroy value creation.

Is it worth being patient?

EBITDA at exit vs expectations by Tenure

Tenure in years	As planned	Above	Below
> 7	49%	36%	16%
5-7	45%	35%	20%
3-5	38%	42%	19%

Cross-analysis of 107 out of 141 PE profile and declared EBITDA performance

IRR at exit by Tenure

Tenure in years	[0% – 5%]	[5% – 10%]	[10% – 15%]	[15% – 20%]	[20% – 25%]	Sup. 25%	Total
3-5		1		5	6	12	24
5-7		1	12	10	17	28	68
> 7	1		5	5	2	2	15
Total	**1**	**2**	**17**	**20**	**25**	**42**	**107**

107 data points out of 141

PE Models

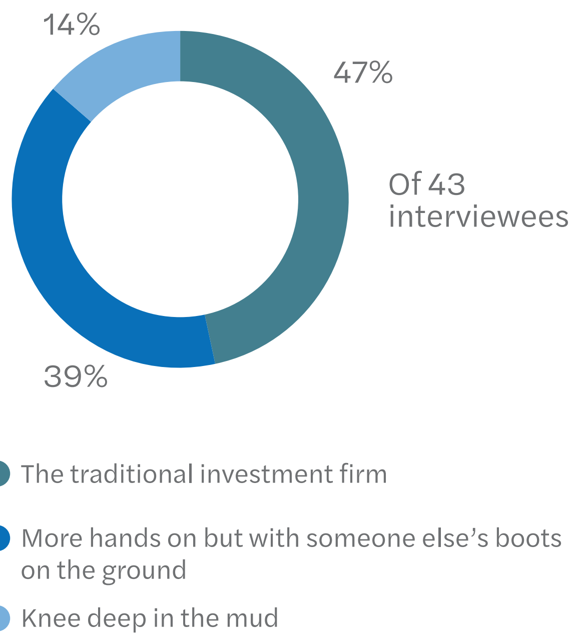
PE models

Introduction

Our study has helped us characterizing 3 different profiles of PE firms by the way they contribute to the performance of their investments. PE firms might, of course, be moving across the lines of those models, however some patterns are distinctive:

- The traditional investment firm
- “More hands on but with someone else’s boots on the ground”
- “Knee deep in the mud”

These categories made in the course of our survey do not strictly align with the online data collection but they are close.



Based on their answers, we have categorized the 43 interview respondents in these 3 groups. This is our analysis, and it may differ from the perception these firms would have of themselves.

43 PE interviewed and how we believe their active or passive behaviour matches with our 3 models

Online survey segments	Firms interviewed	% ot total interviews	Model type
Majority Active	8	19%	“More hands on but with someone else’s boots on the ground”
Majority Active	6	14%	“Knee deep in the mud”
Majority Passive	13	30%	The traditional investment firm
Minority Active	5	12%	“More hands on but with someone else’s boots on the ground”
Minority Passive	7	16%	The traditional investment firm
Mix Active	4	9%	“More hands on but with someone else’s boots on the ground”
Total	**43**	**100%**	

A CEE majority investor, active with its own resources, in a gym business: “*We provided operational support in the finance department... our Chief Investment Officer has been delegated as the company’s CFO for 12 months and we have grown revenue 4 times in 2 years*”.

A majority CEE PE, active through their external senior advisors, explained building-up a dental business from 3m EUR of revenues and 300k EUR EBITDA to 40m EUR revenues and 10m EUR of EBITDA.

A UK firm, acting mostly as a passive shareholder: “*3 out of our 10 holding investments, have been underperforming*”.

The traditional investment firm

This profile is centered on **being a strategic sparring partner and bringing financial discipline without being involved in operations.**

Focus on strategy

Traditional investment firms claim that strategic vision and definition is their core and they often rely on their investment team's industry skills. Additionally, they will be complemented by a network of sector or technology experts. Focused CDD can be performed by 3rd parties, especially when the investment team is short of market knowledge.

As a UK firm, specialised on software and information technology, stated: *"Being able to assess the maturity of the product portfolio is key. The CDD is crucial to understand whether new variants or new products are needed in order to plan investment quickly and budget resources."*

Before the signing, most of the strategy is defined. According to a Dutch PE specialised in build-up, *"70% of it is ready for Day 1, the rest will be set during the investment tenure depending on market conditions and opportunities."*

However, they are not bullet proof and when they fail it might precisely be because of strategy assessment: "The market was misjudged, risks were miscalculated, and the market dynamics also changed. The competitive position was overestimated, and customer lock-in was overestimated."

The traditional investment firm

The FDD-suite: main investigation tool

The FDD-suite including TDD and LDD is the principal toolkit that these PE would favor to confirm risks that have been identified through the Info Memo and discussion with management.

The FDD-suite will help define cleaning priorities; "*You need housekeeping to be done, tidying up…*", said a UK firm… and framing out where there are the blind spots in terms of financial discipline and where to concentrate your fire like, "*Implementing chains of reporting to feed KPIs aligned onto the levers of value creation*". adds another UK PE specialised in growth and buy-out.

The FDD-suite is widely outsourced; A Dutch PE also active in Belgium considers that "*Advisors enlisted by the PE firm act as the first line of defense, ensuring that the financial and legal aspects are sound*". But another Dutch PE firm told us that they carry their own analysis in parallel to audit firms, following a "*4 eyes principle*" that leaves no stone unturned.

Those DDs may push these firms to be more intrusive and impose CFO candidates. Whilst for other C-suite positions, they may act more on demand and would rather propose than impose.

Insurance DD has been scarcely mentioned during our survey (4 out of 43 interviews). However, it is not clear what is the driver behind it, whether it is to reassure the investor that operational risks are covered and that there are no underlying liabilities or whether insurance coverage and spending is a source of potential savings.

There are very few surprises after the FDD-suite and it is rarely a cause for later unsatisfaction. Conducting more of it, is therefore not cited as a lever to avoid pitfalls in our quantitative survey.

PE models

The traditional investment firm

Evolution of their role

Traditional firms are used to assist their portfolio by opening their network and connections, would it be for lawyers, lobbyists, IT specialists or distributors.

They will organize **cross-pollination within their portfolio** through events gathering management teams or founders, specific workshop between Finance or Marketing teams for example.

Some are going beyond that and structuring **platform of corporate services** acting as shared services center for the whole portfolio.

One PE, that is specialised in building pan-European platforms, with a track record of more than 40 deals past and present, explained that they leave day to day operations to the management but would take care of all of the corporate functions that would be found in a multinational. It includes IT under the helm of CFO, that they appoint in each company, legal services and of course all specialties related to transaction support.

IRR at Exit by PE profiles

IRR at Exit	[0% – 5%]	[5% – 10%]	[10% – 15%]	[15% – 20%]	[20% – 25%]	Sup. 25%	Total
Majority Active			11	13	22	35	81
Majority Passive		1	1	3	2	6	13
Minority Active	1		5	5	1	5	17
Minority Passsive		1	3	1	3		8
Mix Active			1	2	2	4	9
Total	**1**	**2**	**21**	**24**	**30**	**50**	**128**

Cross analysis of data from 128 answers out of 141 respondents

PE models

More hands on but with someone else's boots on the ground

This model of PE adds to their workload more operational activities in different ways.

They will also be more directly involved in the operations and they prepare it from the start with **more extensive DD**:

- One CEE PE: "*Beyond FDD and CDD, we always investigate the following areas, margin growth, operational excellence & processes, HR related topics, ESG and environmental and / or IT when applicable.*"
- Another Eastern Europe PE "*As a component of our due diligence, we obtain operational due diligence with the aim of identifying all challenges company might have while operating the business. We produce a standard DD report but also a 180-360 day action plan as an important part.*"

Then they follow on their more operational DD with different ways of assisting management:

Assistance to management

- An **ecosystem of senior advisors** that will serve companies generally after the approval of the management. A German PE declared: "*Bringing operational expertise into the company via industry experts or seasoned advisors is clearly superior to a passive financial investor role*".
- To this **layer of Senior advisors**, they can add a talent pool made of former C-Suite that are directly involved in transformation and paid by the portfolio companies on a fee per hour basis.
- **Transition management resources**: CFO are first on the list but HR experts are also frequently cited. A diversified French PE stated that: "*CFO and HR directors are scarce resources for SMEs, and we encourage our portfolio to actually share the time and costs of transition managers*".
- **3rd parties PMI resources** when they pursue build-ups and need to care for companies cultural differences.

PE models
Knee deep in the mud

They go beyond where the previous category went and have structured permanent and dedicated operational teams.

- Some PEs are dragged (beyond their will) onto the line of fire as for this UK firm saying that: "*When things have gotten harder, we have had to get more involved. management can't always see the macro issues coming, that creates problems and we had to look more at financing / problem solving / troubleshooting*."
- The internal operations department are filled with operating partners, who are active in the DD phase and develop 100 days performance plan. They usually start small like this diversified UK PE, recruiting a couple of former consultants from the Big Four to this major German PE which has transformed into a full fledge restructuring firm counting only 25 M&A professionals when their Operations team is exceeding 200 people.
- Few PEs are also delegating executives to their portfolio companies. Those firms are led by founders, who have their own entrepreneurial experiences and are seconded by a mix of operational background and traditional financial analysts. They can be substitutes to CEOs and run the company in a "*De facto management*" situation.

Many firms in this category are either focused on distressed assets (negative EBITDA, bankruptcy) or near-zero EBITDA, that would obviously require a very close operational monitoring.

This type of PE covers a wide spectrum, from small boutiques supporting SMEs to very large firms, with billions of investments and ticket size above €500m in some cases. They also show that this model applies to very diverse investment strategies.

PE models

Knee deep in the mud

Others like this PE with multiple offices in Western Europe, specializes in carve-outs of non-core activities and looks for stable businesses with a potential for differentiation. Indeed, management at these companies are frustrated with the last "no investment" years and welcome the entry of a very active investor.

> Such a deep involvement can only occur when management is willing to share their intimacy with outsiders.

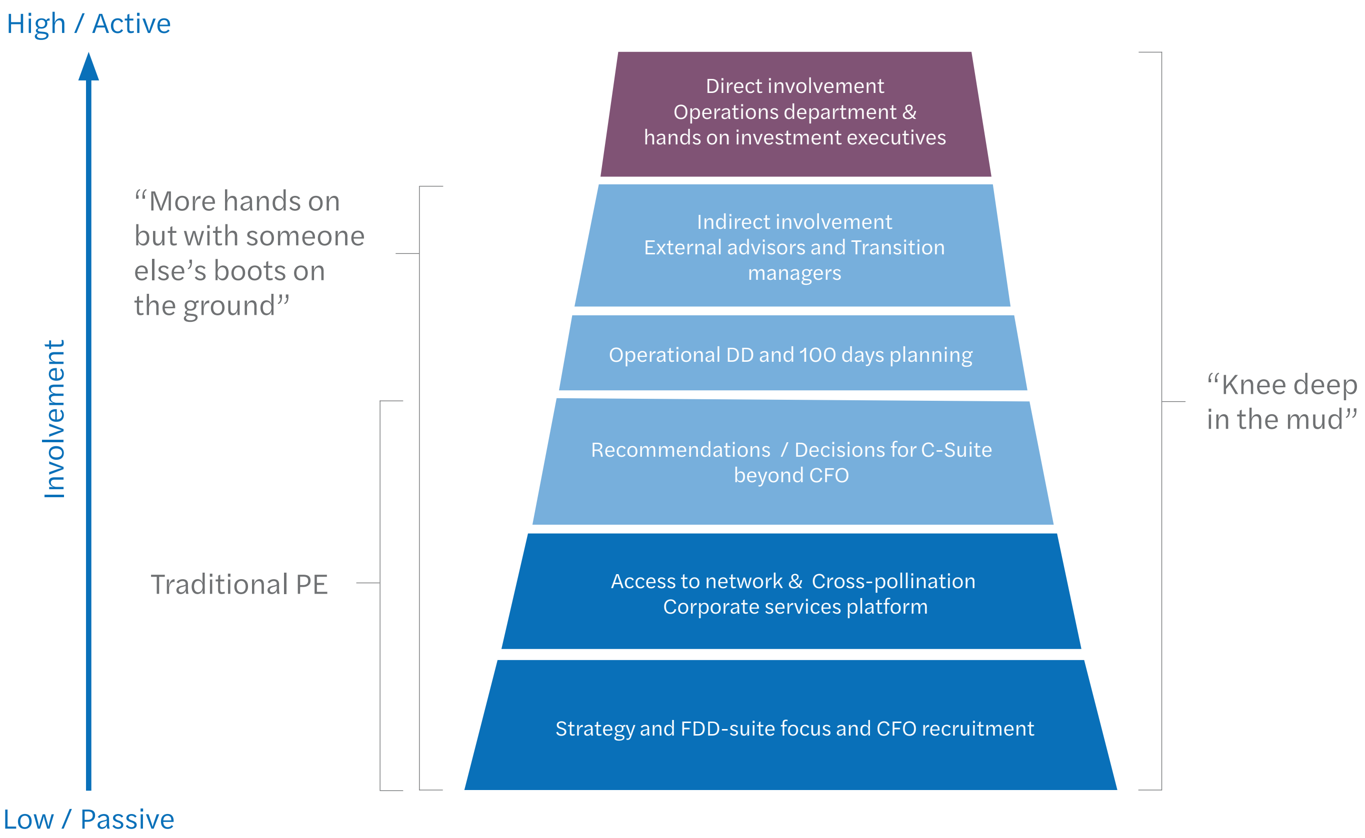
A French Medtech PE, investing in growth participations, whether they be at the early stage or already delivering revenue in the hundred million € range: "*Our golden rule for success is to be, if possible, on a daily basis side by side with our portfolio companies or at least conducting a weekly review. Close contact enables maintaining a healthy pressure and going deep into a variety of operational topics*".

For these investors, delegating investment team members to operations is not just a one-way street but a way of growing the PE team's skill set: "*When our own executives are involved, they can pinpoint areas for improvement, and they can leverage the team's combined expertise to create value in the future*".

But the example of one Dutch PE tells us that this model is not always sustainable. Their portfolio used to include turn-around cases and they had to be very hands-on, spending systematically a couple of days with every company. This had proven not to be such a game changer in terms of exit value and they decided, instead, to concentrate their efforts on sourcing more deals and conducting a better selection: "*The more transactions you make, the more successful you are.*"

> Despite its advantages, "*Knee deep in the mud*" might not be the end game for the profession.

PE models
Models Comparison



Options to contribute to performance

From our survey, we have observed that PEs have different ways to help their investments and they follow a scale of low / passive to high / active involvement (see pyramid).

What about performance contribution

On average, PEs in our panel have assessed that 25% of their portfolio is below expectations. Can PE behavior according to our 3 models explain this?

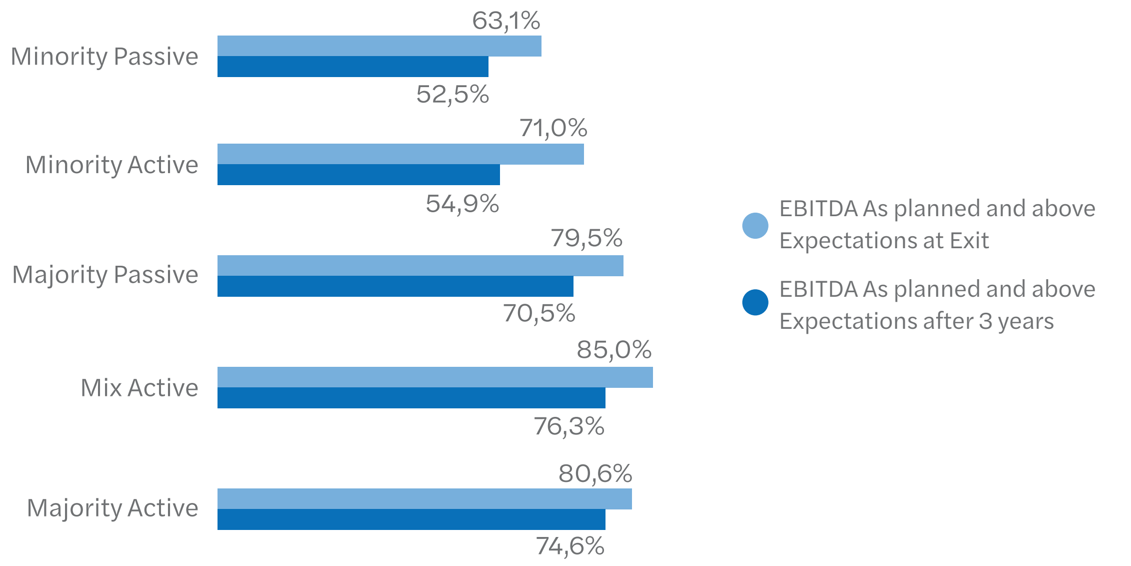
Our quantitative online survey can only bring a bundle of clues but no definitive answer, as the data collected is segmented between Majority Active, Majority Passive, Mix (majority and minority) Active, Minority Active and Minority Passive and do not strictly match the later definition of our 3 models stemming from our interviews. Is one model better than the others?

PE models

Is one model better than the others in terms of contributing to the Portfolio performance?

Our theorem of PE satisfaction regarding EBITDA: (Faster reward for Majority Active than Majority Passive) and overall Majority satisfaction 10 points > Minority active, 7 points > Minority Passive.

% of PE* having an EBITDA as planned and above expectations



A trivial observation is that holding the majority (or at least having a mixed majority and minority portfolio) vs being minority, makes a significant difference in terms of (as planned and above expected) satisfaction with EBITDA both after 3 years and at Exit.

Being active when you hold the majority, is not an obvious game changer at Exit (80,6% for active vs 79,5% for passive) as being passive, you may have plenty of levers, like a decisive Board position, to impose your views on the long term.

But it does when you are in a minority stake position: there is almost 7 points difference between the active minority and the passive at Exit, and the Active Minority are able to improve their satisfaction between the 3 years hold and Exit by 16 points.

*The data analyzed here is related to 98 PEs out of the 141 surveyed. Indeed, they have provided both "After 3 years" and "Exit" EBITDA data, while the others have either not responded at all or have only provided "After 3 years" data but not for Exit, which we assume means that they have not exited yet.

PE models

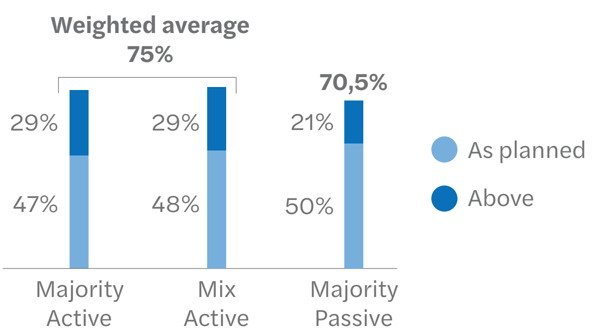
Is one model better than the others in terms of contributing to the Portfolio performance?

However, being active when you hold the majority, may have some benefits in terms of controlling the dynamic and amassing profits quicker:

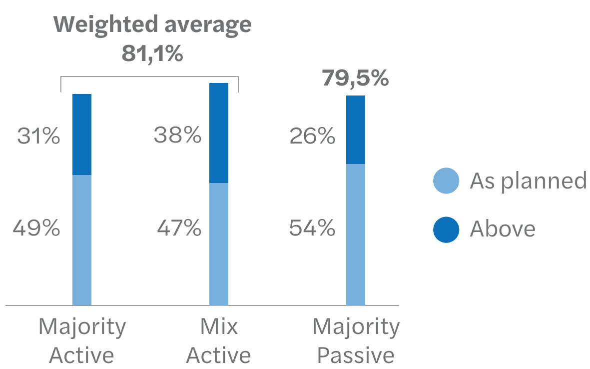
- After 3 years, for Majority Active and Mix Active PEs, the combined "As expected" and "Above expectations" performance is 4,5 points higher

- From the start until Exit, the Above Expectations performance are higher for Majority Active firms.

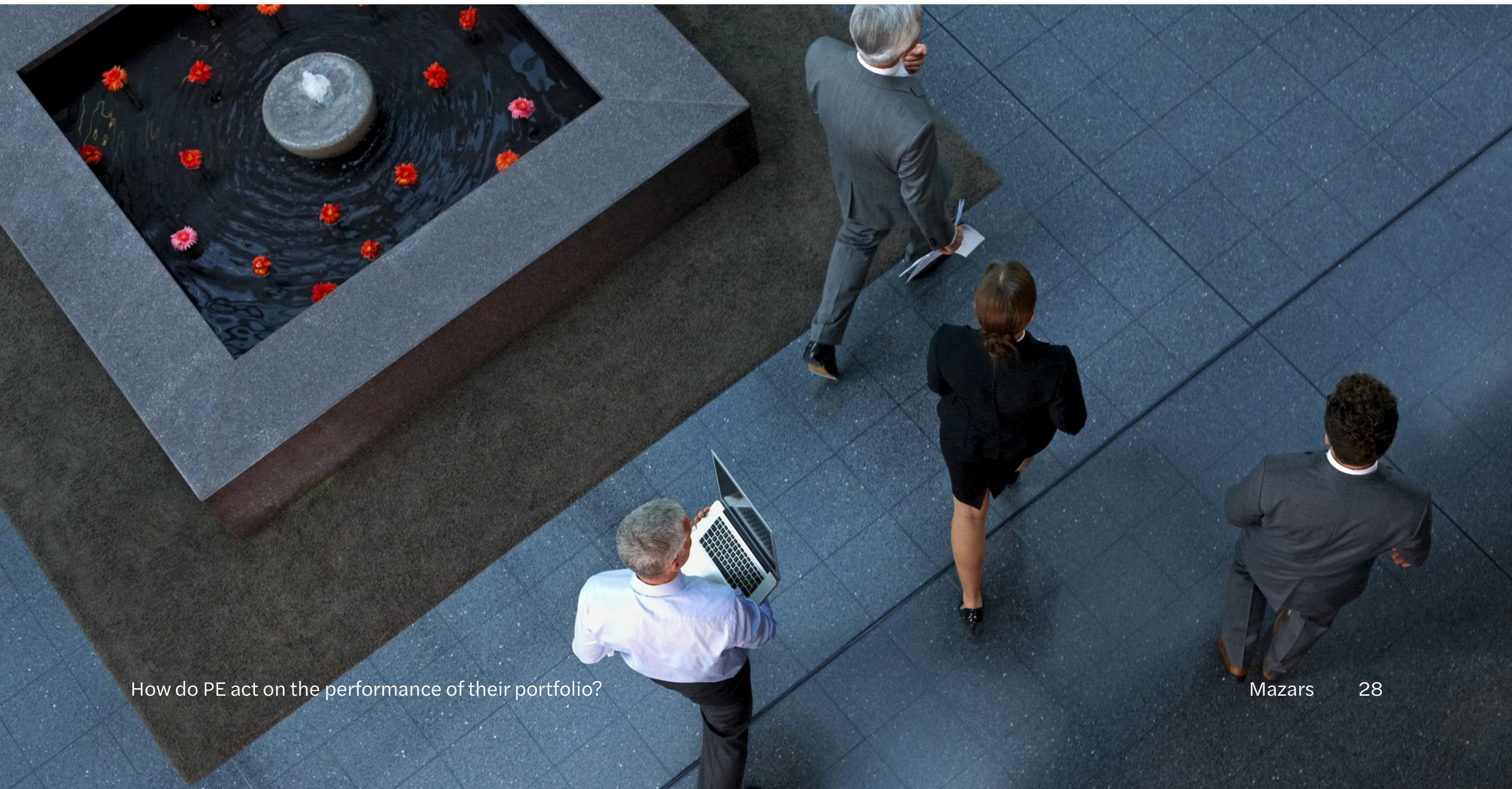
EBITDA satisfaction after 3 years



EBITDA satisfaction at exit



Based on 61 Majority Active, 8 Mix Active and 10 Majority Passive PEs



The confirmed status of ESG and emergence of cybersecurity as investment decision criteria

The confirmed status of ESG and emergence of cybersecurity as investment decision criteria

Whatever their profile is, new topics have climbed the ladder of "Must-Dos" for PE firms: ESG and cybersecurity.

ESG

A Spanish PE told us that their role has evolved from "*being profit centric to prioritizing investment with positive impacts*". So ESG is more and more present in the official speech at least. Let's see if it is fully at the center of PE decision making.

And ESG entails many dimensions.

1. Environmental care and Decarbonation

Decarbonation is critical for PEs Go / No Go assessment when they see it as core for the business. It is especially true with industrial portfolio companies where lack of action ends up bearing more costs or even paying penalties with the tightening of regulations in the EU for example. A European diversified fund reported such an example with one their transport and logistic investment: "*ESG is not just a constraint, it is actually at the center of their differentiation strategy*".

A French regional fund reported that "*Putting in place an ESG reporting in a B2C gifts company pushed them to rethink their textile supply, a major part of their procurement and product design and a priority target of environmental regulations*".

For those PE convinced with decarbonation efforts, gains in that area may even become measures of their own performance. Another French PE, claiming its ESG impact vocation, systematically develops an extra-financial business plan for its portfolio companies and its achievement contributes to 50% of the fund compensation.

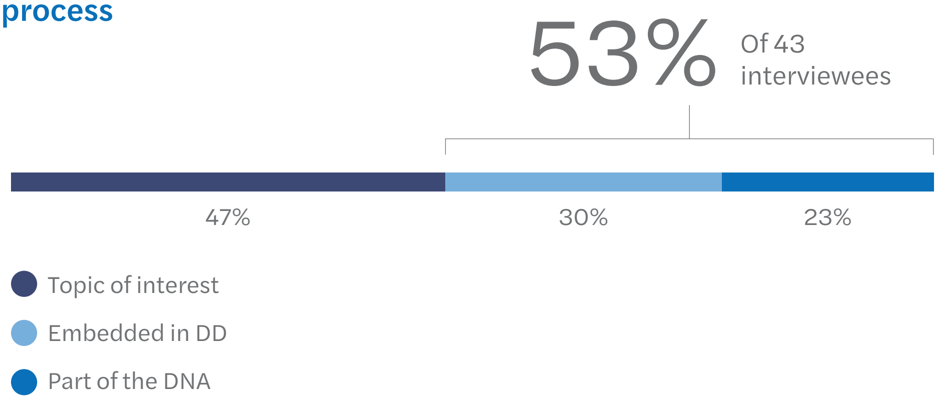
> Decarbonation investment: a key differentiation criterium, a required cost with no impact on valuation?

But for the rest of PEs, views on decarbonation benefits are still divided.

Few consider decarbonation as a cost that you have to consent to but, for which there is no gain. "*Making all necessary investment in decarbonation to make one company compliant does not bring the valuation up*" said one investor and another one confirms in a different manner: "*For sure ESG factors impact the entry valuation, especially when there are troubles to fix. However, you do not see any real impact of resolving ESG challenges on the exit valuation*".

On the other side of the aisle, small PEs perceive that decarbonation investment provides a return especially when they sell to larger PE firms, which tend to use an ESG provider during their assessment.

ESG becomes a prominent aspect of the investment process



Q: What is the role of ESG in your investment process (DD and action plan)?

The confirmed status of ESG and emergence of cybersecurity as an investment decision criteria

2. Social considerations

Social considerations are paramount for PE firms convinced that people are key assets.

Designing compensation packages for all employees and not just management has become a major focus. One French PE is proposing innovative packages using all the room given by local regulations: "*We share value creation with employees through a mix of FCPE (mutual fund), Profit-sharing above legal requirements and the advantages of the new Loi Pacte (collective retirement plan, unilateral contribution of employer to the purchase of shares for the benefit of employees...)*".

Depending on the industry, specific functions with no managing responsibilities may garner special attention and get customized retention / compensation packages. For instance, in Technology companies, the loyalty of programmers is critical while this population is often wooed by competitors and a M&A transaction can be perceived as a risk on their career.

ESG: Growing focus on employee satisfaction through packages and societal issues.

This PEs focus on the compensation issue also stems from a reputational concern: "*We must bring value to all and not just being seen as helping managers and ourselves getting richer*".

A few PEs also focus their ESG attention on another "*S topic*"; that is diversity and inclusiveness. One PE firm stated that they have been applying their own standards in the evaluation and selection of investment like gender ratio, respect for sexual orientation and ethnic background. Another Dutch PE puts it straightly: "*It is crucial for us to contribute to improving the world, both morally and financially... Some business models are no longer sustainable and defensible*".

With ESG concerns rising to the forefront of their evaluation analysis and improvement plans, PEs are not only demonstrating that they are one of the market invisible hands, but one that cares for societal changes.

3. ESG in DD and embedded in PEs organization

Our survey confirms the interest of PEs in ESG. The topic is top of mind and has penetrated DD in Western and in Eastern Europe like this CEE PE: "*Additionally, we track operational efficiency, innovation metrics, and adherence to ESG principles, on top of talent retention as critical indicators of a company's ability to achieve sustained growth... We actively encourage and support our portfolio companies in integrating ESG practices into their business operations*".

PEs firms also tend to strengthen their internal capabilities.

In Western Europe, some PEs have internalized ESG specialists. "*They participate to our investment meetings and their voice weigh on Go / No Go decision*" said one firm, while another explained "*Our ESG team drives an ESG DD and designs a compliance plan that we execute after the transaction*". One firm also said that they had recruited for the first time a Chief Climate Officer to complement their Senior advisors' team.

In CEE, one PE says that, as part of their support to portfolio monitoring: "*We contribute to reporting improvements with a dedicated team in the fund which works with companies to improve financial reporting and another for non-financial reporting (ESG reporting)*".

With their newly established ESG internal capabilities, PE firms are developing their own reporting framework with detailed KPIs that are not just there to meet regulations. Thus, at the crossroad of ESG and compensation, a French fund has created 5 ESG KPIs that play into how company management are rewarded.

The confirmed status of ESG and emergence of cybersecurity as an investment decision criteria

Cybersecurity

Cybersecurity has often been cited as a potential DD topic. However, few firms are conducting it on a systematic basis. From our sample, we estimate that less than 15% of PE firms have enforced it.

Cybersecurity not yet on top of DD priorities, however, practice of regulatory audits may fade into DD adoption.

As one can expect, PE firms investing in technology or in companies owning patents will be more sensitive to these kind of topics.

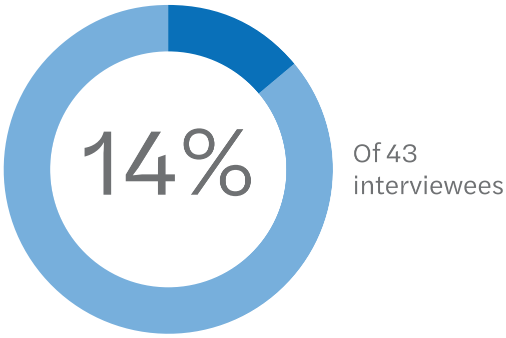
On one hand, a large European PE carrying developed its own IT department, is used to carry regular cybersecurity evaluation on their whole portfolio which is made up of lots of telco investments. Their assessment includes performing hacking simulations through company websites, email phishing...

On the other hand, another European PE with a diverse portfolio beyond Tech (industry, textile, transport...) has also systematized IT audits with a mix of internal and external resources. They cover websites inviolability, E-reputation of their brands and key people, E-commerce (transactions) security and cyber risks.

Incidentally, firms having been hacked or having investments that have been cyberattacked are also keener to assess cyber vulnerability and threats. A French regional fund explained: "*One of our portfolio companies had been attacked, since then our consciousness has grown and we are now partnering with a cybersecurity specialist and promoting their services to our portfolio*".

In the future, we can foresee that cybersecurity will gain traction very quickly with the development of AI and the volume of data that it requires. Such data / cybersecurity audits are already becoming mainstream in regulatory audit works and this should permeate into the transactions to do list soon. For Mazars UK, the majority of DD works already includes IT DD for example.

While related risks are growing, cybersecurity is still a topic in the starting blocks



% of PE mentioning cybersecurity as important topic in investment process during interviews

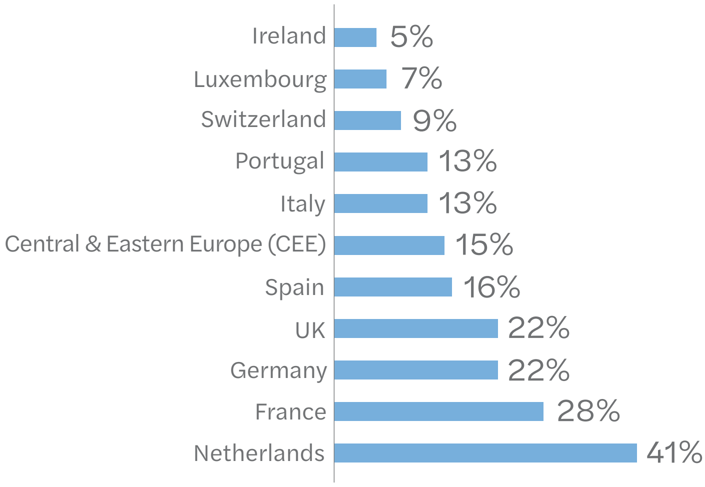
Profiles of respondents and Declared performance

Profiles of respondents and Declared performance
Quantitative Online Respondents Profiles

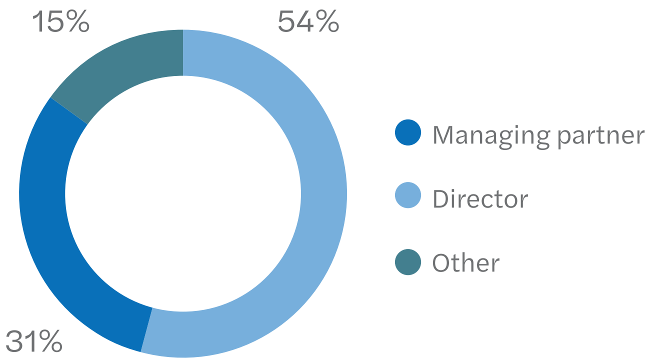
Number of participants

141

Area covered in Europe



Position of respondent



Portfolio company type

Small 40%

Medium 55%

Large 5%

Average ticket

0-10 €m 47%

10-25 €m 28%

25-50 €m 15%

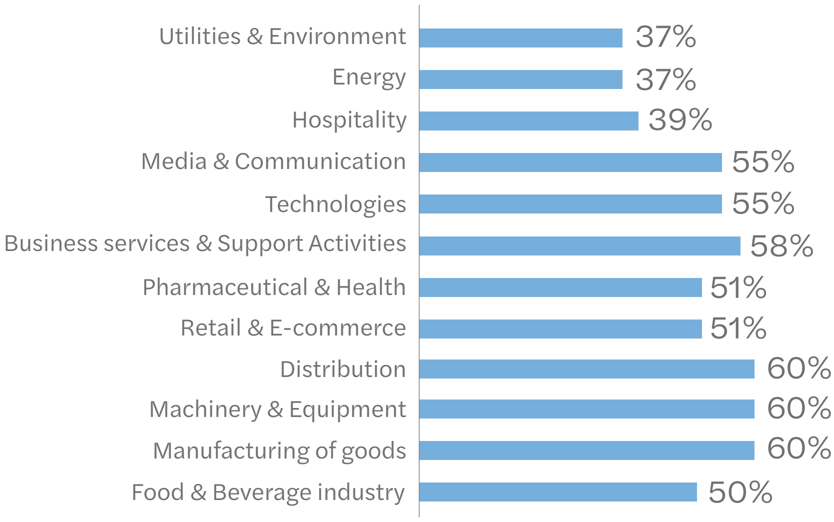
50-100 €m 9%

>500 €m 1%

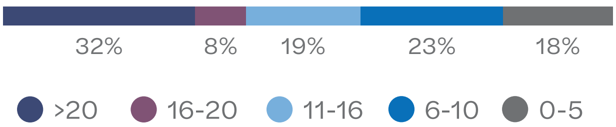
Profiles of respondents and Declared performance

Quantitative Online Respondents Profiles

Main sector repartition (multiple choice)



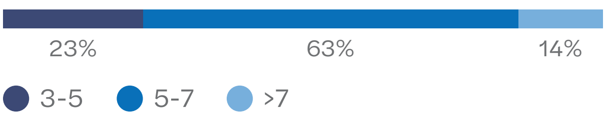
Number of companies in portfolio



Investor profile

Majority Active	63%
Majority Passive	10%
Minority Active	13%
Minority Passive	6%
Mix Majority / Minority Active	8%
Total	**100%**

Average tenure policy (years)



Top 3 type of investment (multiple choice)

LBO 33%

Growth Capital 31%

Mix Investments 25%

Pre-Exit 11%

Declared performance

We have asked our online respondents to evaluate the portfolio, they personally manage, in terms of IRR and EBITDA. Data collected are neither audited nor a precise analysis of their portfolio.

Notes below table detail the response rate by question.

IRR at exit by PE profiles

Ticket €m	[0% – 5%]	[5% – 10%]	[10% – 15%]	[15% – 20%]	[20% – 25%]	Sup. 25%	Total
>500			1				**1**
0-10	1	2	12	12	13	20	**60**
10-25			5	7	8	17	**36**
25-50			3	2	6	9	**20**
50-100				3	3	4	**10**
Total	**1**	**2**	**21**	**24**	**30**	**50**	**128**

128 respondents of the total panel of 141

EBITDA after 3 years vs expectations by ticket size

Ticket €m	# of responses	As planned	Above	Below	Total
0-10	55	48%	30%	23%	**100%**
10-25	30	42%	30%	28%	**100%**
25-50	19	48%	26%	27%	**100%**
50-100	12	43%	29%	28%	**100%**
>500	1	20%	30%	50%	**100%**

117 respondents of the total panel of 141

Profiles of respondents and Declared performance

Declared performance

EBITDA at Exit vs expectations by ticket size

Ticket €m	# of responses	As planned	Above	Below	Total
0-10	44	47%	22%	31%	**100%**
10-25	25	45%	23%	32%	**100%**
25-50	17	48%	19%	33%	**100%**
50-100	14	41%	22%	37%	**100%**
> 500	NA	NA	NA	NA	**NA**

128 respondents of the total panel of 141

EBITDA after 3 years vs expectations by portfolio type

Portfolio	# of responses	As planned	Above	Below	Total
Small cap	7	36%	29%	34%	**100%**
Mid cap	64	44%	29%	27%	**100%**
Large cap	46	48%	29%	23%	**100%**

117 respondents of the total panel of 141

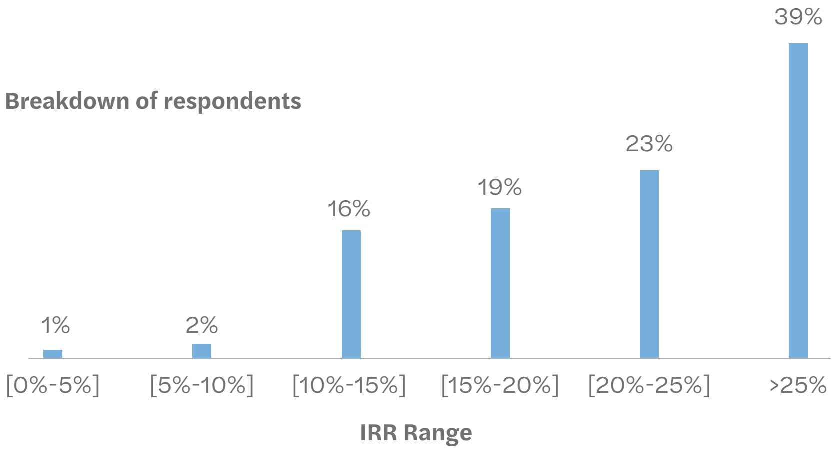
EBITDA at Exit vs expectations by portfolio type

Portfolio	# of responses	As planned	Above	Below	Total
Small cap	7	45%	21%	34%	**100%**
Mid cap	5	46%	21%	32%	**100%**
Large cap	36	48%	22%	30%	**100%**

100 respondents of the total panel of 141

Declared performance

Average IRR at exit



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