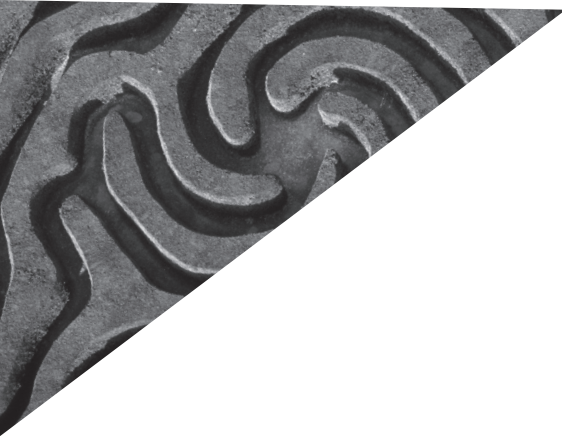


BVCA Annual Report on the performance of Portfolio Companies, III



Foreword

This is the third annual report on the performance of Portfolio Companies, a group of large private equity owned businesses that met defined criteria at the time of acquisition. Its publication is one of the steps being taken by the private equity industry to meet the Walker Guidelines.

This year's report is of particular interest as it tracks the performance of the Portfolio Companies through economic recession in 2009, a year which challenged performance and the resilience of capital structures for many businesses. The fact that there were few changes to the group of Portfolio Companies, from either new investments or exits, means that comparable year-on-year trends can be clearly presented.

The main finding is that the Portfolio Companies performed well in 2009, with positive year on year growth in revenue, profits and productivity – albeit at lower levels than in prior years of private equity ownership. On a relative basis, the Portfolio Company performance was stronger, with growth rates on these measures ahead of public company and UK economy benchmarks – many of which evidenced the effect of recession. Consistent with prior years, the Portfolio Companies improved productivity of labour and capital – in absolute terms and well ahead of benchmarks. This strong performance may benefit from business selection, as well as the distinctive governance and incentives of the private equity business model.

In next year's report, the lowering of the size criteria to be applied at acquisition will expand the group of Portfolio Companies captured in this report.

Ernst & Young, 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 on the back page.

Yours sincerely,

BVCA, Ernst & Young

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Objectives and summary findings

Objectives

This is the third Annual Report on the performance of Portfolio Companies, published by the BVCA and Ernst & Young, produced as part of the voluntary code of practice on transparency and disclosure adopted by the private equity industry that is independently overseen by the Guidelines Monitoring Group ('GMG').

This Annual Report provides aggregated data and independent review on key aspects of the performance of the Portfolio Companies, from the time of the acquisition by private equity investors through to the latest annual report. In the year under review there were few changes to the group of Portfolio Companies, with no new investments and all four exits providing a further full year of performance data prior to their change in ownership. This facilitates the understanding of how this group of companies performed in 2009, the year of the most severe UK and global recession for decades.

Consistent with prior years, there are two principal objectives addressed in this report:

1. To report on compliance by General Partners with the data collection, and profile the population of the Portfolio Companies.
2. To analyse the data set to enable a fact-based understanding of the performance of the Portfolio Companies under private equity ownership:
 - Focus on the latest trading year versus the prior year.
 - Versus economy-wide and public company benchmarks.

Summary findings

Objective 1. Compliance and data set

All private equity firms complied with the request to provide information on the performance of their Portfolio Companies, by completing the data template prepared by Ernst & Young for the purposes of this report. The data was drawn from audited annual reports, and additional company and private equity sources. 49% of the latest year ends were in the fourth quarter of 2009, 34% in the first quarter of 2010 and the remaining 17% between April and November 2009.

As at 31 December 2009, there were 43 Portfolio Companies. This figure includes 40 companies that met all criteria at the time of their acquisition by private equity investors, and a further three companies where the owner is private-equity like but is not FSA authorised. After consultation with the GMG, these three companies are included throughout this report. The decrease from 47 as at 31 December 2008 reflects four exits and no new investments, and is the first year over the past five that the number of Portfolio Companies has declined. The 43 Portfolio Companies were acquired for an aggregate £77bn in enterprise value, funded by £25bn of equity invested and £52bn of net third party debt. At latest year ends (through to latest date of March 2010), the 43 Portfolio Companies had total revenue of £47bn, EBITDA (earnings before interest, tax, depreciation and amortisation) of £8bn, and direct employment of 315,000; 64% of revenue and 78% of employment was in the UK.

Objective 2. Performance of the Portfolio Companies under private equity ownership

Despite the challenges of recession in the UK economy in 2009, the Portfolio Companies in aggregate grew revenue, profits and productivity in the latest year. Year on year growth rates in revenue and profits declined from prior years, but remained positive in the range of 3% to 4%, both on an underlying organic basis, as well as on a reported basis which includes the effect of bolt-on acquisitions that exceeded disposals. There was strong productivity growth in labour and capital: gross value added per worker grew by 3.1% and operating capital productivity (revenue over operating capital employed) grew by 8%. Reported employment fell slightly versus the prior year, by (0.6)% and, removing the effect of acquisitions and disposals, organic employment declined by (1.6)%. Capital resources declined by (3.9)% due to an (11.1)% decline in capital expenditure and tight management of working capital. Net debt was reduced in the year reflecting the growth in profits and reduction in capital expenditure and working capital. The aggregate ratio of net debt to EBITDA was 7.4 at latest year end.

On most of these metrics the Portfolio Companies performed ahead of public company and economy-wide benchmarks, which showed more clearly the effects of the recession. For example, labour productivity growth of 3.1% by the Portfolio Companies compares to a UK-wide result of (2.7)%, operating capital productivity growth of 8% compares to a sector-weighted FTSE benchmark of (0.4)%. Revenue and profits both grew more slowly in public companies in the latest year; employment falls were steeper in public companies and the economy as a whole. The area where public companies out-grew the Portfolio Companies was in operating capital employed, which grew by 5.6% versus a decline of (3.9)%.

Looking at the exits of Portfolio Companies, the returns attribution analysis shows that, on top of the sector weighted FTSE return, a component of the gross investment return is due to private equity strategic and operational improvement, calculated at 0.7x the sector weighted FTSE return. The total investment return was 3.8x the sector weighted FTSE return. This strong return to equity investors also benefited from additional financial leverage, averaging 61% in Portfolio Companies versus 18% in public company benchmarks, that contributed 2.1x the sector weighted FTSE return.

Behind the average results, there is a wide range of performance at the individual company level. This is true of the Portfolio Companies as well as public companies. Comparing the range of performance on certain measures shows that Portfolio Companies had a lower range of performance, certainly in employment growth in the latest year, versus public companies.

While 2009 showed growth in many performance measures, the rate of growth was lower than in prior years, in aggregate due to the economic slowdown. This has reduced the growth rate measured from date of acquisition to latest date on most performance metrics, for example growth rates in reported revenue and profits are reduced from 9% to 6% and from 11% to 7% per annum respectively; most remain ahead of public company benchmarks.

Some of the differences in performance between Portfolio Companies and benchmarks is explained by industry sector mix, with the Portfolio Companies concentrated in the consumer services sector, and therefore less exposed to other sectors that experienced sharper falls in 2009. However this does not explain all of the difference. The results in this report show that the performance of the Portfolio Companies is not adversely affected by higher financial leverage or private equity ownership. On the contrary, the evidence to date suggests that the distinctive features of the private equity business model, versus other forms of ownership, translate into faster growth in Portfolio Company productivity, profits and investment returns.

Compliance and data set

Definition of Portfolio Companies and Compliance

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

The objective of this Annual Report is to present independently prepared information on the performance of Portfolio Companies during their period of ownership by private equity investors. By capturing information on all of 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 and R&D?
- ▶ 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 political, 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 GMG in April 2009, being a company (at the time of its acquisition):

- ▶ “Acquired by one or more private equity firms in a public to private transaction where the market capitalisation together with the premium for acquisition of control was in excess of £300 million, and either more than 50% of revenues were generated in the UK or UK employees totalled in excess of 1,000 full time equivalents” **or**

- ▶ “Acquired by one or more private equity firms in a secondary or other non-market transaction where enterprise value at the time of the transaction is in excess of £500 million, and either more than 50% of revenues were generated in the UK or UK employees totalled in excess of 1,000 full time equivalents”; **and where**

- ▶ Private equity firms are those authorised by the FSA that manage or advise funds that own or control Portfolio Companies.

The companies that meet the criteria were determined by the BVCA through consultation with its members, and by review of the submissions made to Ernst & Young during the course of the research. As in prior years, the investee companies that volunteered to comply with the Walker Guidelines but did not meet all of the criteria at acquisition are excluded from this report.

There are three Portfolio Companies whose private equity owners are not FSA authorised. The GMG intends to review the definition of a private equity firm in the coming year, and any changes are expected to include these firms. Therefore, after consultation with the GMG, these three Portfolio Companies have been included in this report. None of the findings are materially changed by their inclusion. It should also be noted that the GMG has already announced a lowering of the criterion of entry enterprise value that will become effective in next year's report, and will also increase the number of Portfolio Companies.

Compliance by private equity firms

Private equity firms were requested to complete a data template, specified by the BVCA and Ernst & Young, for each of the Portfolio Companies, and all complied.

Data collection entailed provision of the latest year's information, as well as additional information requested this year covering cash flow data. For the four exits in 2009, the same data template was updated for the final year of private equity ownership, as well as data required to complete the returns attribution analysis. Completion of the data template drew on information available in company accounts, and further information that was prepared from Portfolio Company and private equity firm sources. This further data enabled analysis, inter alia, of the impact of acquisitions and disposals, and movements in pension liabilities and assets.

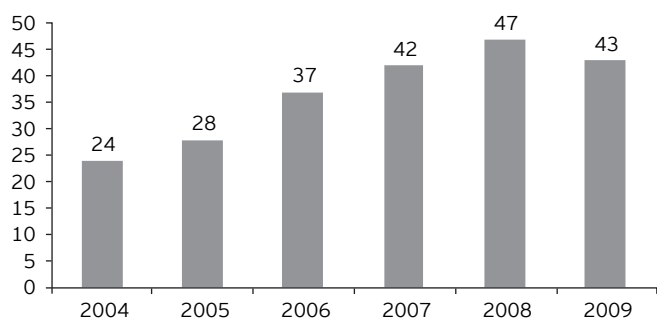
Compliance and data set (continued)

Profile of the Portfolio Companies

Size of the Portfolio

At 31 December 2009, there were 43 Portfolio Companies. In 2009, the number of companies reduced for the first time as there were no new investments and four exits. The rate of exits is consistent with prior years with the main change being the absence of new investments (see appendix A for the list of Portfolio Companies, appendix B for details on the annual movements in the number of Portfolio Companies).

Fig 1: Number of Portfolio Companies at 31 December



The 43 Portfolio Companies accounted for 315,000 jobs, of which 78% are in the UK. They were acquired for a total consideration of £77bn in enterprise value, represented by £25bn of equity investment and £52bn of net debt. This represents an average valuation multiple at acquisition of 11.5 x EBITDA and net debt multiple of 7.9 x EBITDA.

Many of the results in this year's report include the last year of performance of the four businesses exited in 2009, as the date of exit was close to the latest financial year end. The enlarged data set of 47 companies represented 351,00 jobs at latest year end, with an entry enterprise value of £82bn.

83% of the Portfolio Companies reported latest year end results to Q1 2010 or Q4 2009, with the remainder in the period April to November 2009. As a result, the latest year of performance of the Portfolio Companies largely captures a full year in the economic recession that started in the second half of 2008.

For the purposes of this report, the latest year is referred to as '2009' and prior year as '2008'.

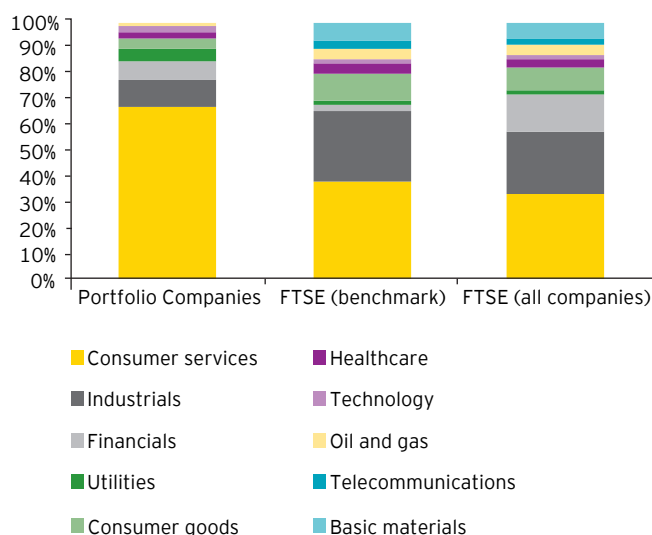
Industry Sectors of the Portfolio Companies

The industry sector profile of the Portfolio Companies helps to gauge the influence of external factors, as they vary by sector, and to align performance benchmarks.

Looking at share of employment, as a better indication of relative scale than number of companies, 67% of all Portfolio Company employees were employed in the consumer services sector (including retail), followed by industrials, financials and utilities, collectively a further 22%.

This sector mix is different to the companies in the FTSE All Share, which has 33% of employees in consumer services, half of the share for the Portfolio Companies. Conversely, the FTSE has a greater share of employees in industrials, consumer goods, oil and gas, and basic materials.

Fig 2: Industry Sector of Portfolio Companies and FTSE All Share, by employees (see Appendix D for methodology)



Performance of Portfolio Companies – in 2009

Performance in 2009

The Portfolio Companies grew revenues, profits and productivity in 2009 versus the prior year – whether measured on a reported basis or as underlying organic growth, i.e., removing the effect of bolt-on acquisitions and disposals.

Consistent with prior years' findings, reported revenue, profit and employment growth rates are higher than the underlying organic growth rates. This shows that Portfolio Companies were net acquirers of businesses in the latest year. Reported revenue growth of 3.8%, and organic revenue growth of 3.0%, were slightly faster than the respective profit growth rates indicating that profit margins declined slightly in the year, in contrast to prior years.

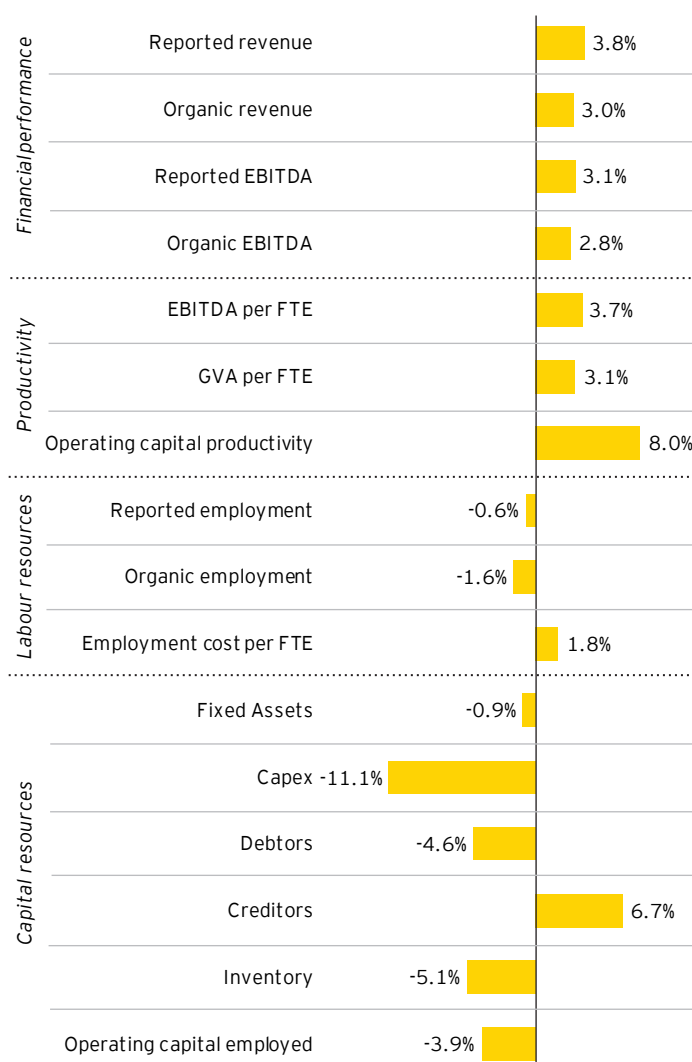
With faster growth in revenue and profits than labour and capital resources, 2009 saw an improvement in productivity. Labour productivity grew by 3.1% as measured by gross value-added per employee, and 3.7% measured as EBITDA per employee. Operating capital productivity, defined as the ratio of revenue to operating capital employed, increased by 8.0% in the year.

Organic employment fell by 1.6% in the year as costs and employment levels were controlled going into the recession. Employment cost per FTE rose by 1.8%.

There is also evidence of improved cash management in the year, in response to the recession. Fixed assets also reduced slightly as capital expenditure was reduced by 11.1% versus the prior year. Each of the three components of working capital moved in favour of improved cash flow for the Portfolio Companies, by 5% to 7%. In total, operating capital employed fell by 3.9%.

Fig 3: Performance of Portfolio Companies in 2009 versus 2008, year on year growth

n = 46



Performance of Portfolio Companies – compared to benchmarks

Performance in 2009 versus benchmarks

A further test of the performance of the Portfolio Companies in 2009 is to compare them to relevant public company and other economy-wide benchmarks. As this activity cannot be precise, we have compared performance against three types of benchmark in figure 4 (see also appendix D):

- FTSE benchmark: all companies in the FTSE All Share index, excluding equity trusts, the largest banks and insurance companies.
- Sector weighted FTSE benchmark: the same companies in the FTSE benchmark but grouped by industry sector and weighted according to the sector mix of the Portfolio Companies.
- UK economy-wide labour statistics.

The Portfolio Companies, in aggregate, outperformed public companies and economy-wide metrics in 2009. This is true of financial performance, and productivity measures of both labour and capital. The outperformance in labour and capital productivity was also noted in last year's report.

In terms of resources, compared to FTSE benchmarks, the Portfolio Companies reported a smaller reduction in employment, and a tighter control of cash and operating capital. By contrast, the FTSE benchmarks show greater reduction in employment and continued growth in operating capital employed.

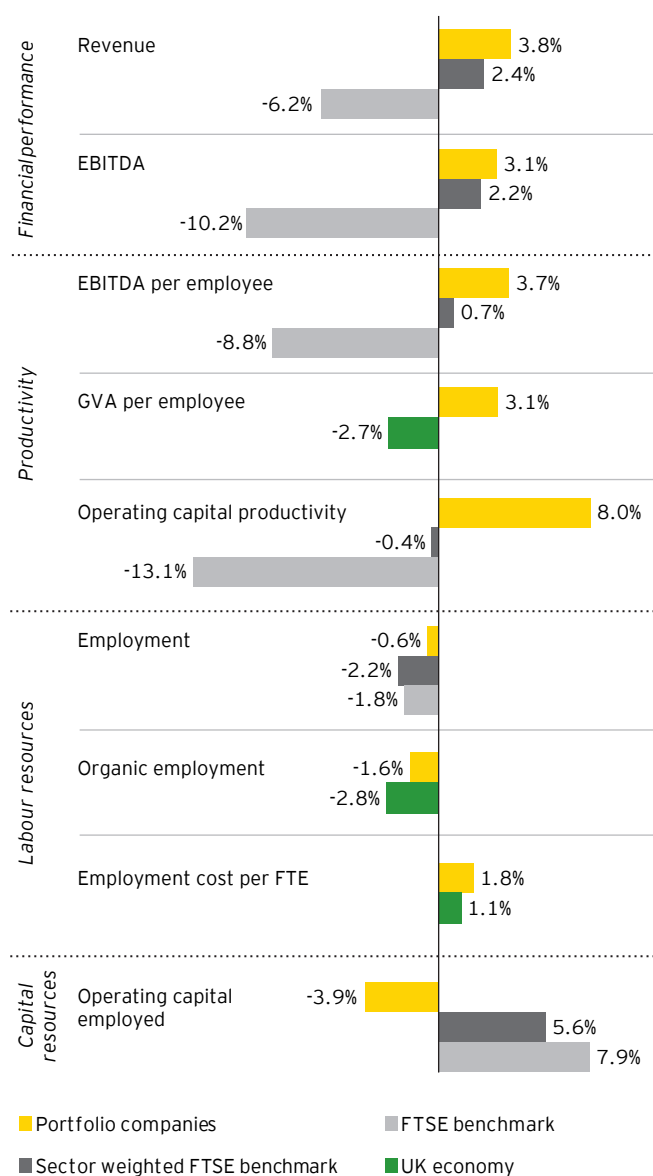
In part these results reflect differences in sector mix, as shown by the significant variances between the FTSE benchmark and the sector weighted FTSE benchmark for public companies. This largely reflects declines in the few, large public companies in the oil & gas and basic materials sectors (commodity price and volume related) – sectors that have relatively low weighting in the Portfolio Companies. The sector weighted FTSE benchmark is closer to the performance of the Portfolio Companies in revenue and profit growth, albeit slightly lower. However the pattern of employment and operating capital employed is not changed by sector weighting.

Comparing the Portfolio Companies to UK economy-wide labour statistics shows that employment declined faster in the economy as a whole, (2.8)% for all private sector employment¹ versus (1.6)% for Portfolio Companies. Portfolio Companies also improved labour productivity in the year (as measured as Gross Value Added per employee) whilst the economy as a whole experienced a decline of (2.7)%².

¹ Source: UK Employee Jobs, Quarterly, Office of National Statistics. Quarterly result calculated on LTM basis and weighted to the year-ends of the Portfolio Companies.

² Source: Output per, Worker Office of National Statistics. Quarterly result calculated on LTM basis and weighted to the year-ends of the Portfolio Companies.

Fig 4: 2009 growth rates, Portfolio Companies vs. FTSE benchmark, sector-weighted FTSE benchmark and relevant UK economic metrics (see appendix D for methodology and limitations)



Range of 2009 performance

Behind the aggregated results, there is a wide range of performance at the individual company level.

To illustrate this, figures 5 and 6 show the distribution of growth in 2009 versus 2008 for two metrics: reported profit growth and reported employment growth.

For the Portfolio Companies, which had an underlying average of 3.1% reported profit growth in 2009, 27% of companies saw profit growth of more than 10% in 2009 versus 2008, whilst 20% saw a decline of more than (10%). The range of results for employment shows a different distribution, with most companies (37%) reporting employment growth in the range of 0-5% in the year, against an average for all Portfolio Companies of (0.6)%.

This analysis shows the range of performance at the individual Portfolio Company level – and the importance of developing a consistent population to avoid selection bias. It also shows that the average result is not being swayed by just a few exceptional performers – either up or down.

For comparison, figures 5 and 6 also show the distribution of results for the public companies in the FTSE benchmark. The public companies show a wider range of performance on both of these metrics, and a lower weighted average profit growth due to few, large companies in the oil & gas and basic materials sectors. While 34% of public companies in the FTSE benchmark reported profit growth of more than 10%, 40% reported a profit decline of more than (10)%. Similarly, the reported employment growth rates also show a wider range of performance in 2009 than the Portfolio Companies. Weighting the results by sector to match the Portfolio Companies does not change the findings.

While the comparisons of groups of companies may be influenced by other factors including size, this analysis shows that the range of performance of Portfolio Companies is narrower than public companies in the period under review.

Fig 5: Distribution of 2009 reported profit growth, Portfolio Companies vs. FTSE benchmark (% of companies)

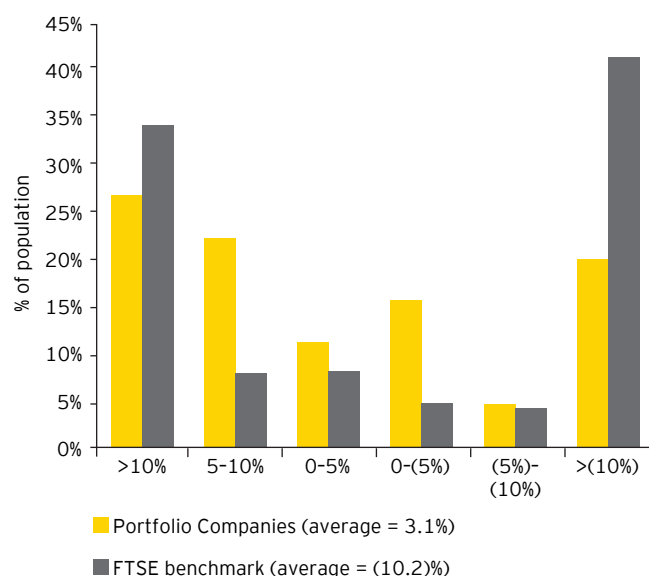
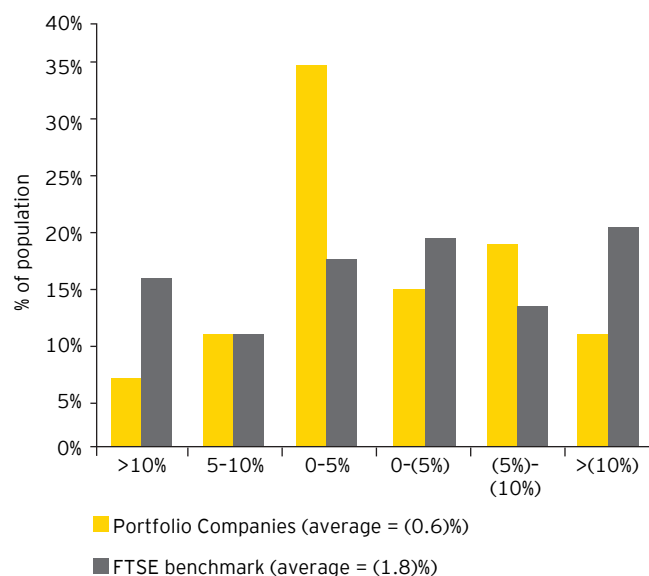


Fig 6: Distribution of 2009 reported employment growth, Portfolio Companies vs. FTSE benchmark (% of companies)



Performance of Portfolio Companies – acquisition to latest date

Comparison to last year's report

The growth rates published in prior years' reports were largely based on a calculation from the date of acquisition to the latest date, i.e., capturing the performance of the business over the entire period of private equity ownership, often more than one year.

Figure 7 shows most of the performance metrics as in figure 3 but on this revised basis, i.e., compound annual growth of the Portfolio Companies measured to the latest year end from the year of acquisition rather than the prior year. The 2009 data includes the four exits in the year, and five businesses which reported year on year growth figures for the first time. This explains the different number of companies in each sample (2008: n=41, 2009: n=46).

The main finding is that while 2009 saw positive growth on many of the key metrics, as already reported, the rate of growth was lower than in prior years and as a result the measure of growth from start to latest date has slowed versus last year.

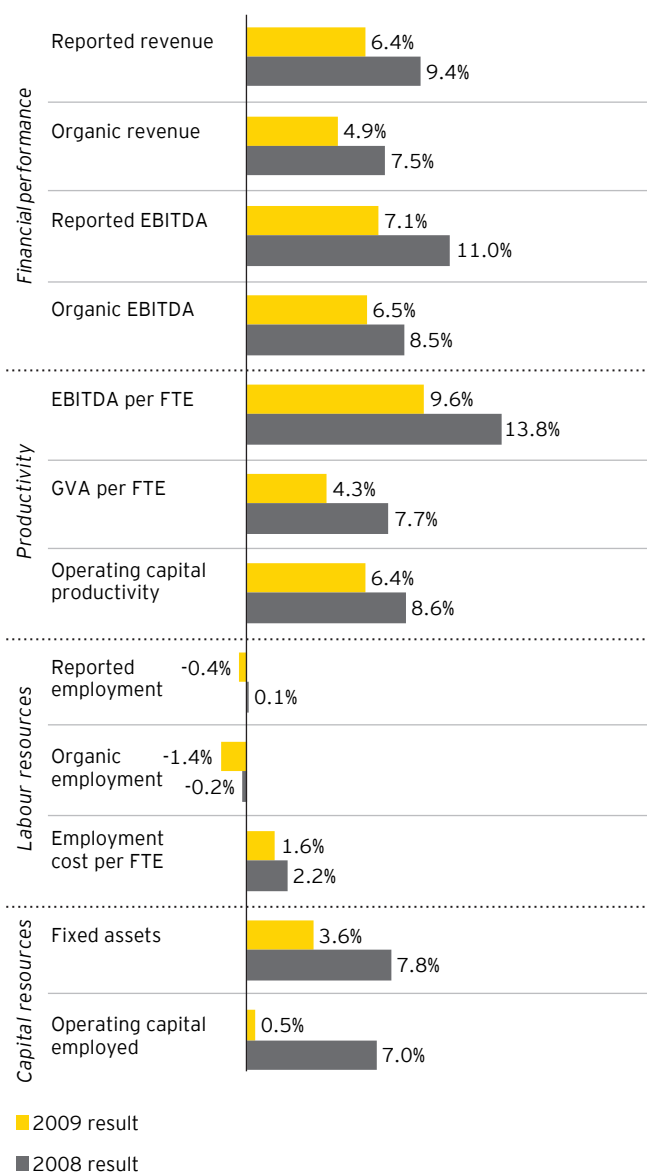
Revenue growth since acquisition is now, on average, 4.9% organic and 6.4% reported, a decline of about 2.6% and 3% respectively versus 2008 findings. There is a similar result for profit growth.

Organic employment growth which was (0.2)% per annum now averages (1.4)% per annum. This compares to an annual decline in total UK private sector employment of (0.7)% between 2006 and 2009¹.

The average growth in total employment cost per employee grew by an average annual rate of 1.6%. This figure is slightly below last year's result of 2.2% and the UK economy as a whole, where average earnings grew by 2.8% per annum from 2006 to 2009².

Productivity growth (measured as gross value added per worker) has declined from 7.7% growth in last year's report to 4.3%. However, UK-wide productivity growth has fallen by (0.6)% per annum from 2006 to 2009³.

Fig 7: Performance of Portfolio Companies since year of acquisition, 2009 vs prior year report
2008 n = 41; 2009 n = 46



¹ Source: UK Employee Jobs, Quarterly, Office of National Statistics. Quarterly result calculated on LTM basis and weighted to the year-ends of the Portfolio Companies.

² Source: UK Average Earnings Index, Office of National Statistics.

³ Source: Output per Worker, Office of National Statistics.

Performance of Portfolio Companies – productivity

Productivity

One of the consistent findings in this work is the strong productivity growth achieved by Portfolio Companies, in absolute terms and relative to benchmarks.

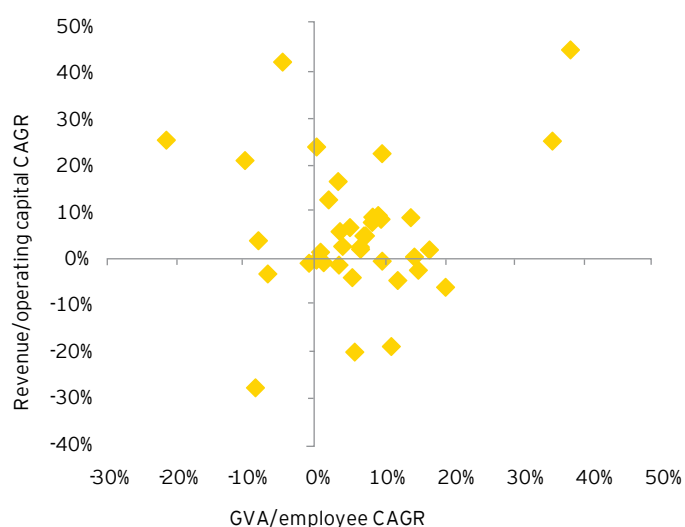
Figure 8 shows the distribution of productivity growth in labour and capital from acquisition to latest date by Portfolio Company. As with other results at the company level, this shows a wide range of performance that aggregate to deliver average performance well above public company and economy-wide measures as previously described.

While these results evidence a spread of performance at company level, it also shows that productivity growth is widespread across the Portfolio Companies, and not overly concentrated or influenced by a few outliers.

- 22 Portfolio Companies have improved both labour and capital productivity since acquisition. This group also reported strongest growth in revenue and profit, and growth in employment.
- 9 Portfolio Companies improved labour productivity, but saw flat or declining capital productivity. This group saw lower revenue and profit growth, and an increase in capital resources as well as a slight decline in total employment.
- 7 Portfolio Companies improved capital productivity but not labour. Revenues were broadly stable while capital resources were reduced through working capital management and other programmes.
- 4 Portfolio Companies saw declines in both labour and capital productivity, with flat revenue and profits.
- Note that a further 4 Portfolio Companies were excluded as they had negative operating capital in either the opening or closing year, preventing meaningful comparison.

Fig 8: Labour and capital productivity growth by Portfolio Company, acquisition to latest date.

n = 42; 4 outliers not shown



Performance of Portfolio Companies – capital structure

Debt ratios

The ratio of debt to EBITDA is a key measure of a company's ability to service its debt from cash flow. The Portfolio Companies had an average net debt to EBITDA ratio of 7.9 at acquisition. In aggregate, this has reduced by 0.5 from acquisition to latest date. This is due to the fact that growth in third party debt was slower than the level of growth in reported EBITDA.

16 Portfolio Companies are asset intensive businesses (defined here as having a ratio of Tangible Fixed Assets to EBITDA of greater than 5). For these businesses, the extent of asset backing is also an important debt ratio; the ratio of debt to assets of 1.0 was unchanged at the latest date.

Composition of net debt

At latest year end, the Portfolio Companies reported aggregate cash balances of £6.2bn, and third party debt of £64.6bn, giving a net debt of £58.4bn.

Change in net debt

Net debt increased from acquisition to latest date by £6.9bn. The main reason for the increase in third party debt was to fund bolt-on acquisitions, representing £6.4bn of the increase. Debt-funded equity withdrawals were £1bn.

The net of operating cash flow less all other investing and funding cash flows was positive £0.5bn, i.e., slightly reducing net debt. This figure would have been larger but for Portfolio Companies in the utilities sector that have funded capital expenditure programmes with additional third party debt.

In 2009, net debt fell by £1.8bn due to a surplus of operating cash flow over investing and funding costs.

Fig 9: Change in net debt – acquisition to latest date
n = 42

Opening net debt at acquisition	51.5
Debt-funded acquisitions (net)	6.4
Debt-funded equity withdrawals	1.0
Operating cash flow post investing and funding charges	(0.5)
Change in net debt since acquisition	6.9
Net debt at latest date	58.4

Fig 9a: Change in net debt – movement in latest year
n = 42

Opening net debt at prior year end	60.2
Debt-funded acquisitions (net)	–
Debt-funded equity withdrawals	–
Operating cash flow post investing and funding charges	(1.8)
Change in net debt in year	(1.8)
Net debt at latest date	58.4

Performance of Portfolio Companies – returns attribution

Overall investment returns

There were 18 exits of Portfolio Companies between 2005 and 2009, four of which were in the last year (one of which was achieved by corporate merger with no cash realisation, this exit is excluded from the analysis until the stake is realised).

Overall, the gross investment return (IRR), i.e., pre transaction fees and payments to fund managers, is 3.8x the return earned from investing in public stock markets, set at 100% in fig 10. Returns on the FTSE All Share over the period were strong, and above the historical average. This highlights the strong returns that have supported the rapid growth of investing in private equity by pension funds, life insurance funds and other investors.

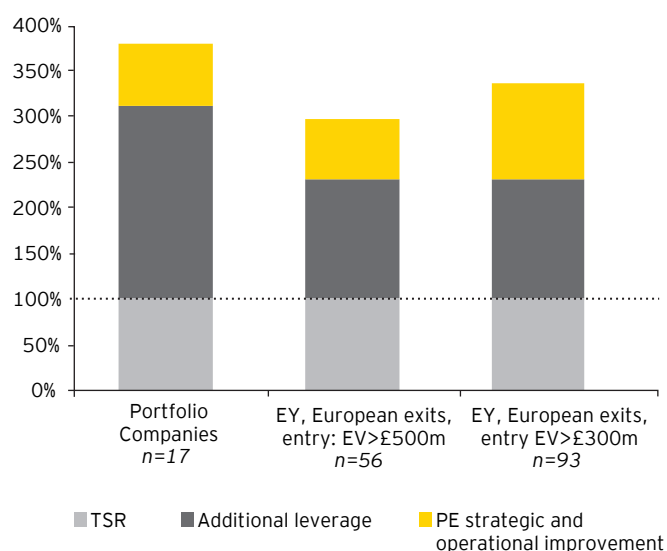
Returns attribution

While it is the absolute return that is the only certain fact and measure of private equity investing performance, the returns attribution analysis seeks to test whether private equity returns are more than achieved by public stock markets plus additional financial leverage. See appendix D for a description of the methodology.

Setting the market return at 100%, as in figure 10, the amount of private equity strategic and operational improvement is a further 70%, or close to double the level of public market return. It includes the incremental benefit, over and above public company performance, of a wide range of actions taken under private equity ownership related to productivity, investment, growth and cash flow improvements, as separately evidenced earlier in this report.

Another aspect of the private equity business model is to increase financial leverage in the Portfolio Companies, with an average leverage ratio of 61% compared to a sector weighted FTSE benchmark of 18%. The increased financial leverage acts both as incentive to use capital more productively (as earlier evidenced) and to increase the return on invested equity. Considering the latter effect only, the financial benefit of the additional leverage increases the underlying market return by 210%. The effect of additional leverage is that less equity achieves the same increase in enterprise value, thereby boosting its return. As the data set grows, it will become possible to test whether, at the Portfolio Company level, there is any correlation of additional leverage with increased range of investment performance, relative to public companies.

Fig 10: Returns attribution analysis, Portfolio Company exits 2005-09



Comparison to other studies

Figure 10 also shows a comparison of the returns attribution result for other larger populations of private equity exits over the same timeframe, calculated with the same methodology, from separate research undertaken by Ernst & Young.

The two other studies show absolute levels of return between 3x and 3.4x the return from investing in public stock markets (and in absolute terms the returns are more comparable than the chart may suggest).

The other studies also show a significant source of return attributed to private equity strategic and operational improvement – in the range of 65% to 105% of the market return. Both of these findings are similar to the results of the smaller sample of Portfolio Company exits.

The main difference between the samples is the attribution of return to additional leverage, which is higher for the Portfolio Companies than for the other Ernst & Young samples. The main reason for this is that the leverage ratio of the public company benchmark is higher for the European samples (23% and 22%), whilst the leverage ratio of the deals is very similar.

Appendix A – List of Portfolio Companies

Portfolio Companies (at 31 December 2009)

- ▶ Acromas
- ▶ Airwave Solutions
- ▶ Alliance Boots
- ▶ Annington Homes
- ▶ Associated British Ports
- ▶ Biffa
- ▶ Birds Eye Igloo
- ▶ Brakes Group
- ▶ British Vita
- ▶ CenterParcs
- ▶ Domestic & General
- ▶ Doncasters *
- ▶ DX Group
- ▶ Emap
- ▶ Enterprise
- ▶ Equiniti
- ▶ Expro
- ▶ Findus Group
- ▶ Fitness First
- ▶ Gala Coral
- ▶ Gondola Holdings
- ▶ John Laing
- ▶ Merlin Entertainments Group
- ▶ Moto
- ▶ National Car Parks
- ▶ NCP Services
- ▶ New Look
- ▶ Northgate Information Solutions
- ▶ Odeon & UCI Cinemas
- ▶ Osprey (AWG)
- ▶ Partnerships in Care
- ▶ Phones4U
- ▶ PHS
- ▶ Queens Moat Houses
- ▶ Spire Healthcare
- ▶ Thames Water
- ▶ Trader Media Group
- ▶ Travelex
- ▶ Travelodge *
- ▶ United Biscuits
- ▶ Viridian Group *
- ▶ Wales & West Utilities
- ▶ Weetabix

Exits of Portfolio Companies during 2009

- ▶ Arqiva
- ▶ Baxi
- ▶ LINPAC
- ▶ Somerfield

** Companies where the private equity owner is not FSA authorised; after consultation with the GMG it was decided to include these as Portfolio Companies for the purposes of this report.*

All Portfolio Companies were included in the BVCA Annual Report on the performance of Portfolio Companies, 2009.

Appendix B – Movement in the number of Portfolio Companies, 2005–09

Number of Portfolio Companies	2005	2006	2007	2008	2009
At 1 January	24	28	37	42	47
Exits of Portfolio Companies	(5)	(5)	(5)	–	(4)
Acquisitions of Portfolio Companies	7	12	8	5	–
Acquisitions of new Portfolio Companies, that were formerly part of existing Portfolio Companies	2	2	2	–	–
Total acquisitions of new Portfolio Companies	9	14	10	5	–
At 31 December	28	37	42	47	43
Memo: exits to existing Portfolio Companies or as new Portfolio Companies	2	2	4	–	–

Exits of Portfolio Companies

The effect of private equity ownership of a business is evaluated from the date of acquisition to the date of exit. The date of exit is defined as the date of completion of a transfer of shares which means that the private equity fund no longer has control, or in the case of IPO onto a public stock market, the date of first trade.

Acquisitions of Portfolio Companies

Acquisitions of new Portfolio Companies represent all companies entering the group of Portfolio Companies, as acquisitions of businesses from other companies, private shareholders or take-privates. This group includes a number that were also exits (see opposite).

Acquisitions of new Portfolio Companies, that were formerly part of existing Portfolio Companies

This defines new stand-alone businesses that were disposed of by Portfolio Companies, and that meet all Walker criteria at acquisition and therefore become new Portfolio Companies.

Exits to existing Portfolio Companies or as new Portfolio Companies

As some exits by private equity investors are to new private equity investors, and meet all Walker criteria, or are bolt-on acquisitions by existing Portfolio Companies, these companies remain within the group of Portfolio Companies.

Appendix C – Pensions

Pension provision

In the latest year there was no change in the pensions benefits offered by the Portfolio Companies. 30 Portfolio Companies offered defined benefit ('DB') pensions for their employees at acquisition. One DB scheme has been discontinued since acquisition and three have been set up. 27 companies from the 29 which offered a DB throughout the period continue to pension the service of existing employees through the DB scheme, with 5 companies also offering a DB pension for new joiners.

41 Portfolio Companies offered defined contribution ('DC') pension benefits at acquisition and all these schemes continued. Two Portfolio Companies introduced DC schemes after acquisition.

Financial position of DB pensions

In aggregate, the financial position of the DB schemes has remained relatively stable since acquisition. Looking at the accounting data at the latest year end, there was a net deficit equal to 11.2% of the value of liabilities, a level that has increased since acquisition. This trend is seen across the portfolio and is largely a result of the fall in long-term interest rates in the year under review leading to a higher valuation of liabilities. Similar patterns have been seen in public companies.

Over the period since acquisition, the holding of equities by Portfolio Company DB schemes has fallen from 44% to 35% of total assets. This is partly due to market movements and partly due to changes in investment strategy towards lower risk assets.

The decline in the net debt to EBITDA ratio evidences a slight strengthening of the balance sheets of the Portfolio Companies since acquisition, and a corresponding improvement in their ability to fund future pension commitments.

Fig 11: Value of Defined Benefit pension assets and liabilities* – acquisition to latest date

*n = 29***

£bn	At acquisition	Prior year	At latest date
Value of assets	12.8	12.0	14.0
Value of liabilities	(12.9)	(12.1)	(15.7)
Net deficit	(0.2)	(0.1)	(1.7)
Deficit as % of liability	-1.4%	-0.4%	-11.0%

Fig 12: Mix of Defined Benefit pension assets – acquisition to latest date

*n = 29***

£bn	At acquisition	Prior year	At latest date
Equities	44.3%	32.6%	34.9%
Fixed interest	49.7%	56.1%	54.5%
Cash and deposits	3.2%	2.5%	1.7%
Alternative investments	0.5%	4.1%	4.1%
Other	2.2%	4.6%	4.7%
Total	100%	100%	100%

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

** Relates to companies which offered DB throughout the period from acquisition.

Appendix D – Methodology – process and measuring performance

Process

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

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

Ernst & Young contacted the private equity firms in June 2010 and requested a standard data template to be completed for each Portfolio Company.

The data returned to Ernst & Young was checked for completeness, and iterated with the private equity firms as required. Ernst & Young undertook independent checks on c10% of the returns against published company accounts. This found no material discrepancies.

Data gathering was completed in October 2010. Ernst & Young submitted its statement of compliance to the GMG on 5 November 2010.

Measuring performance

The data set is built up from the individual companies under their period of ownership by private equity investors. For the 47 Portfolio Companies that have submitted templates, the data set extends from the date of acquisition to the date of the latest annual report (8 companies reported in Q2-Q3 2009, 23 in Q4 2009, and 16 in Q1 2010).

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

- Change in the value of point-in-time measures, including employment, fixed assets and capital structure are analysed from the date of acquisition to the latest year end in the company accounts/date of exit.
- Change in the value of trading measures, including revenue, profit, capital expenditure and cash flow, require full year comparison to full prior year (to avoid the error inherent in annualising partial year figures). Given the dates of acquisitions and company year ends, these measures can be determined for 46 of the 47 Portfolio Companies. One Portfolio Company had negative EBITDA at acquisition and in the prior year meaning that an annualised growth rate cannot be calculated. Therefore, for profit growth the number of companies is 45.

Each Portfolio Company dataset has been analysed as part of this study. Variations in performance have been identified and explained by GPs. The views in this report reflect the results of both analysis of the datasets and this additional review, and represent an aggregated view of what has happened to these businesses under private equity ownership.

However, as in prior years, we recognise that the total number of data points is relatively small. Whilst the data accurately reports on the Portfolio Companies themselves, it may not be an accurate guide to the future development of Portfolio Companies under private equity ownership, nor other businesses owned by private equity investors.

Next year's report will capture a larger group of companies following a decision announced by the Guidelines Monitoring Group in March 2010 to lower the criterion of enterprise value at acquisition to £350m (and £210m for take-privates), and the review in the coming year of the definition of a private equity firm.

FTSE benchmarks

The FTSE benchmark and sector weighted FTSE benchmark are drawn from the companies listed on the London market in the FTSE Allshare index – as they are large, UK based, and data is readily available from Thomson Datastream.

- There were 628 companies listed as members of the FTSE All Share at the 7th October 2010. From this list, 223 companies are excluded:
 - 9 companies which are on the list twice for different share classes.
 - 164 Equity Investment Trusts.
 - 50 other financial entities (see below).
- The starting number of companies used for benchmarking throughout this report across all metrics is therefore 405. Due primarily to companies listing this year or in the prior year some trend data is not available through Datastream (e.g., 14 companies do not have data for YoY revenue benchmarking).

There are two FTSE benchmarks used in this report, both of which used averages weighted by the relevant metric:

- FTSE benchmark, aggregated result over all 405 public companies.

Appendix D – Methodology – process and measuring performance (continued)

Sector-weighted FTSE benchmark: public company data is aggregated at an industry group level – as defined in the FTSE classifications – and then matched to individual Portfolio Companies. The aggregate result is then weighted by the sector mix of the Portfolio Companies. Certain activities classified within the 'Financials' industry are not comparable to any of the Portfolio Companies, so non-comparable sectors (Real Estate Investment & Services, Real Estate Investment Trusts, Banks, Equity and Non-Equity Investment Instruments) were excluded from the benchmark population to improve comparability.

Issues with approach to benchmarking

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

- ▶ Reported figures include the effect of acquisitions and disposals, which for public companies in aggregate, it is not possible to separately analyse.
- ▶ The mapping of companies to FTSE industry 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., profits, employment, the definitions captured in the FTSE All Share company databases may not be wholly consistent with the definitions adopted in our data gathering. In particular, the Plc benchmark for profit relates to operating income and not EBITDA, as this appears more reliable data. To confirm that this is not a misleading comparison, analysis shows that there is little difference between EBITA and EBITDA trends of the Portfolio Companies.
- ▶ The FTSE All Share data has survivor bias (the ranking being defined at end point rather than at the outset).

Returns attribution

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

1. Additional leverage: the effect on Gross IRR of the additional leverage PE firms place on a company above the average sector levels.
 - Adjusted deal returns are calculated by adjusting the capital structure to match average leverage levels of FTSE Allshare 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 IRR and the adjusted IRR is the benefit of additional leverage.
2. Market returns: the total shareholder return earned in the FTSE Allshare sector over the same timeframe as the private equity investment.
 - The TSR is calculated using Datastream indices. TSR captures the effects of sector earnings growth, multiple changes and dividend payments.
 - The market return TSR is applied to a deal IRR that has equivalent capital structure after the adjustment for additional leverage.
3. Strategy and operational improvement: the component of Gross IRR that relates to above benchmark performance.
 - The component of the Gross IRR for strategy and operational improvement is calculated by subtracting the market return from the Gross IRR adjusted for additional leverage.

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