SVCA
SVENSKA RISKKAPITALFÖRENINGEN

PRIVATE EQUITY PERFORMANCE STUDY 2011

A study of Swedish private equity owned portfolio companies 2007–2010

Content

Foreword

This study is published by the Swedish Private Equity and Venture Capital Association, SVCA. It is the seventh portfolio company study conducted by SVCA and the purpose of the study is to investigate how Swedish portfolio companies held by buyout and venture capital funds perform compared to other companies and to the general economy.

The dual focus of the study is to provide an overview of the present state of the group of private equity owned companies, as well as to examine how certain key measures have evolved over the last few years.

We study performance in terms of employment growth, turnover growth and growth in value added in portfolio companies that profited from support by private equity funds. The report first presents some key figures concerning the market for private equity investments and fundraising. The report then goes on to discuss the performance of private equity owned portfolio companies between 2007 and 2010, compared to relevant peer groups, where applicable.

The group of companies studied is based on the previous performance study, supplemented by transaction data from a pan-European database tied to the European Venture Capital Association, EVCA. Financial information about both the private equity portfolio companies and the peer group of publicly listed companies was delivered by Newsline Group.

Highlights

- *Private equity portfolio companies created SEK 75 billions of Value Added in 2010, corresponding to 2.3% of Sweden's GDP, and the average buyout portfolio company increased its Value Added by 10.1% annually compared to 3,4% for the group of listed small cap companies*
- *7.5% of private sector employees now work for private equity portfolio companies*
- *Median employment growth over the period from 2007 to 2010 was 4.1% in buyout portfolio companies and 5.1% in venture backed companies, compared to just 0.4% in listed small cap companies*
- *Turnover growth in buyout portfolio companies has outstripped peers by over 4 percentage points*
- *The venture capital industry continues to provide support to Swedish start-ups with over 600 venture backed firms, employing 18,000 people*

NB! We have shifted focus from revenue to value added. This measure is consistent with GDP.

1. Introduction

This year's Private Equity Performance Study surveys 800 portfolio companies, looking at how they have fared since 2007. Several variables are investigated, such as Value Added growth and employment statistics and where applicable comparisons are made to publicly traded companies, as well as the general economy.

Private equity comprises the equity financing of unquoted companies with an active and time limited ownership. Private equity firms supply capital and active ownership commitment in order to contribute to the development of long-term profitability and success of portfolio companies. The industry can be divided into two main areas, venture capital and buyout:

- *Venture capital* funds generally take minority positions in companies in their early stages of existence and is often further divided into seed, start-up and expansion phases.

- *Buyout* funds in general take majority stakes in mature companies that are typically restructured, refinanced and grown.

In this study, a total of 800 Swedish portfolio companies owned by Swedish and foreign private equity firms have been identified as the portfolio sample. A number of acquisitions that took place during the period were marked as confidential in the database and could therefore not be used in this study.

Private equity and venture capital funds are active owners, providing their portfolio companies with vital resources for long term growth and profitability. As a consequence, earnings and equity values should increase more than in companies with less active ownership models. In this study, we provide evidence supporting this. Active ownership can in this connection be said to comprise four main areas: *selection, financing, complementary resources* and *corporate governance.*

The *selection* role involves identifying projects that have the right growth or restructuring potential and that fit the competencies of the fund managers. The selection process usually involves a thorough mapping and design of a financial plan all the way from entry to exit, especially in the case of buyout.

Financing is paramount both during acquisition and throughout the holding period, especially in buyout where advanced financing solutions play a more important role, relatively speaking. The active ownership ensures efficient use of long term credits and a supply of follow-up investments, though it could be said that the main importance of Private Equity is not in merely supplying capital, but in the expertise, networks and financial discipline that they provide.

These competencies in fund managers can be seen as *complementary resources* in relation to portfolio companies' management groups. It may involve knowledge of markets, financial and industrial networks, strategic partners, entrepreneurial experience etc. For active owners to be able to profit from their ownership advantages, the complementarity factor is vital. Hence, many players tend to focus on investments in firms that cluster around a specific sector (e.g. clean tech or life science).

Corporate governance is normally pursued through positions on the Board of Directors. It is central for following the portfolio company closely over time. Here, management incentivisation, target alignment and implementation of milestone strategies play a central role, ensuring the owners that employees, managers and owners all focus on the same goals.

The active ownership model of private equity has proven successful over a long period and constantly evolves to adapt to changing market conditions.

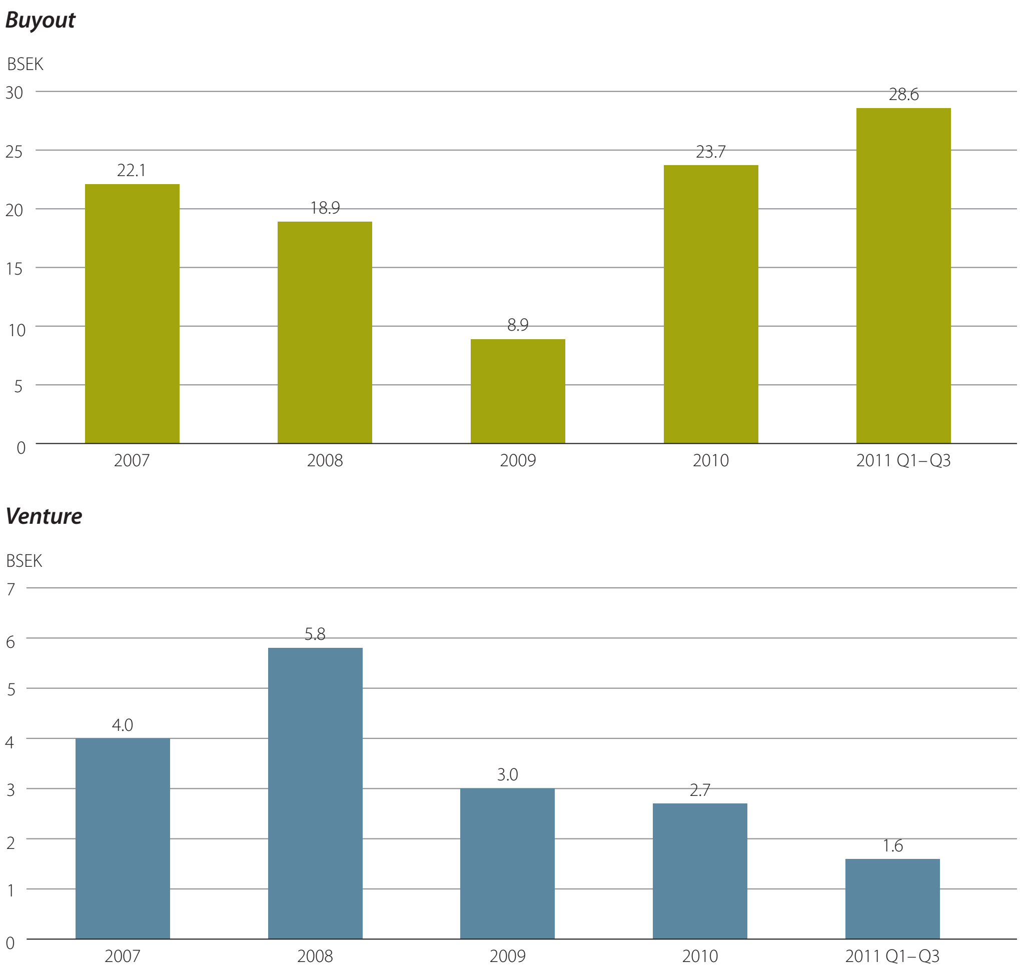
1.1. PRIVATE EQUITY ACTIVITY 2007–2011

The investment activity level in the private equity industry responded strongly to the negative effects of the financial crisis, yet buyout activity quickly recovered in 2010.

Figure 1 shows the amount invested in Swedish portfolio companies from Swedish and foreign buyout and venture funds over the period 2007 to Q3 2011. In 2010 26.4 billion SEK was invested in Swedish portfolio companies, being the highest investment volume over the last five years. In terms of investment activity, the buyout industry has largely recovered from the financial crisis, though it remains to be seen what activity levels will look like when the backlog of deals, created during the aftermath of the financial crisis in 2008, is gone through. Activity will then return to a more sustainable long-term level. Due to the present debt crisis, uncertainty over the effects of a swathe of upcoming regulation is compounded by worry over access to capital and financing. The health of the real economy also strongly affects the valuation and outlook for present and potential portfolio companies.

The venture segment is still struggling severely with low investment activity. As a consequence, early stage innovative companies have very limited access to venture capital with active ownership competencies.

FIGURE 1 AMOUNTS INVESTED IN SWEDISH PORTFOLIO COMPANIES 2007–2011Q3



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29 BSEK

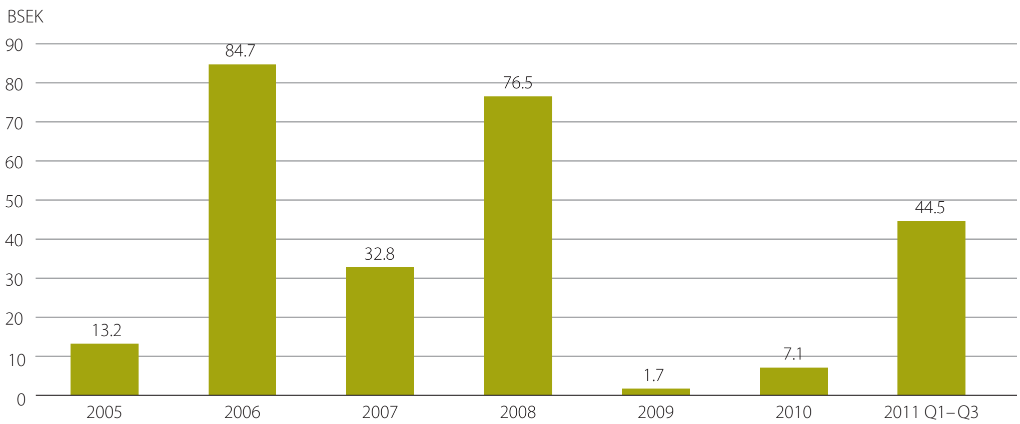
Buyout funds invested 29 BSEK in Swedish portfolio companies up to Q3 2011, making 2011 the most active year since 2006.

Note though that new fundraising in venture and buyout funds has been extremely low the last couple of years. In 2006 venture and buyout fundraising volumes were respectively 5,900 and 84,700 MSEK. In comparison, venture and buyout raised respectively 307 and 7,150 MSEK in 2010. The latest figures indicate that 2011 will show a very high volume of buyout fundraising (44,700 MSEK up to Q3 2011) with venture still languishing, though the backlog effect needs to be kept in mind.

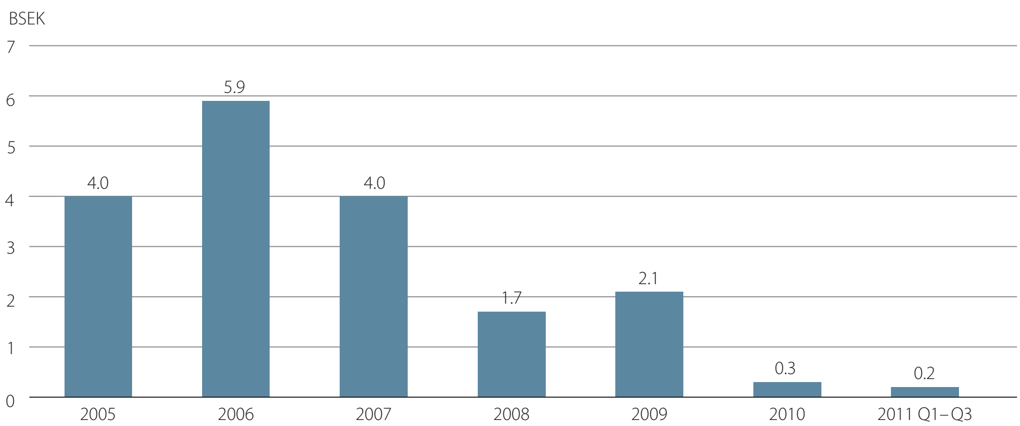
Figure 2 illustrates the strong decline in fundraising over the last two years (together with the rebound in buyout in 2011) and together with Figure 1 it clearly illustrates the important role that the buyout and venture capital industry has played, as a supplier of capital to the Swedish business sector during the financial crisis. In other words, although capital markets collapsed during the period 2008–2010 (reflected in the fundraising numbers), these funds were able to invest actively in portfolio companies using previously raised funds. One interpretation of this is that these funds, helping to balance the investment cycle.

FIGURE 2 **FUNDRAISING BY SWEDISH BUYOUT AND VENTURE FUNDS 2005–2011Q3**

Buyout



Venture



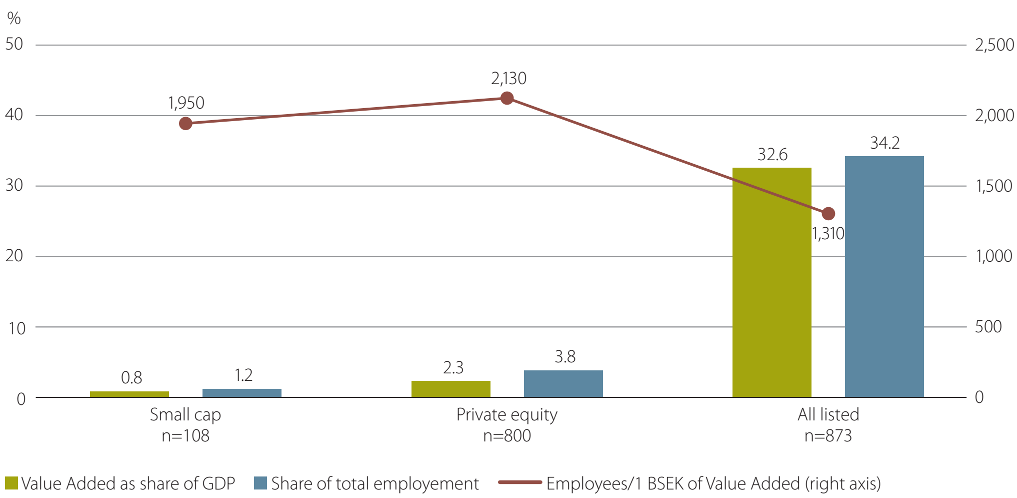
1.2. PERFORMANCE – KEY FIGURES

Below we investigate Value Added and employment in private equity portfolio companies. The term Value Added is a measure of the additional value created for society by a company's employees and capital[1]. It is directly comparable to the GDP of a country. In Figure 3, total Value Added for private equity portfolio companies is compared to the GDP of Sweden, for all publicly listed companies in Sweden as well as for Swedish companies listed as small cap companies on Nasdaq OMX Stockholm. This last group is generally considered to be the most relevant peer group for buyout portfolio companies.

The private equity portfolio companies represented a Value Added of approximately 75 billion SEK in 2010, corresponding to 2.3 percent of the GDP of Sweden (green bars below). In comparison, the 108 small cap listed companies on Nasdaq OMX Stockholm generated 25 billion SEK in Value Added.

1. Value added = EBITDA + wage costs

FIGURE 3 **SHARE OF VALUE ADDED[2] AND TOTAL EMPLOYMENT[3] IN 2010**



2. Adjusted Value Added for firms with missing data 2010 (2009-level adjusted with trimmed mean growth –2.6 percent)
3. Adjusted employment for firms with missing data 2010 (2009 adjusted with average trimmed growth 1.9 percent)

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3.8%

Of all employees in Sweden in 2010, 3.8% worked for private equity owned companies.

The figure also shows the employment level in the same three categories of companies in 2010, as a share of total employment in Sweden (blue bars). The private equity portfolio companies employed 160,000 people in 2010, representing close to 4 percent of the overall employment in the Swedish economy, which contrasts with publicly listed companies that employed 34 percent of the work force in 2010. This indicates that the portfolio companies are considerably more labour intensive with 2,130 employees per 1 billion SEK of Value Added, compared to 1,310 for listed companies and 1,950 for listed small cap companies (red line). This means that private equity investments are highly interesting for job creation and that both buyout and venture funds may thus contribute strongly to long-term employment growth.

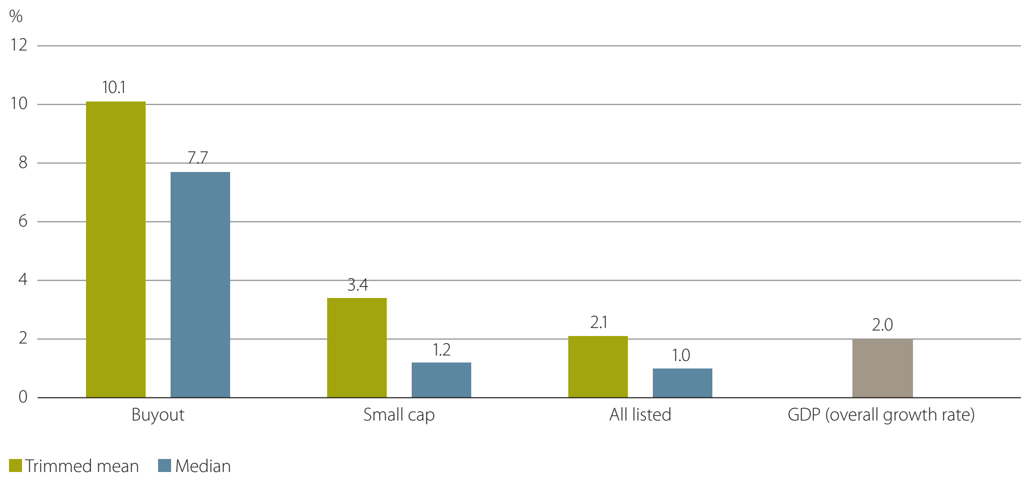
2. Buyout – comparative performance study

The buyout portfolio companies have displayed remarkable resilience in the face of the crisis, showing annual growth rates that are often significantly higher than for listed companies, and outstripping Sweden's GDP growth.

The period from 2007 to 2010 has been marked by a strong economic downturn and this has affected the financials of companies throughout the economy. Despite this, buyout portfolio companies showed strong growth during the period. As shown in Figure 4, the median buyout portfolio company exhibited a growth of 8 percent in Value Added during the period – considerably higher than the growth rate in the Swedish economy as well as both small cap companies on Nasdaq OMX Stockholm and the group of all publicly listed companies. The strong performance figures are maintained if we instead look at averages.[4]

4. The averages are applied to a trimmed dataset leaving out the top and bottom 10 percent companies in order to exclude extreme outliers.

FIGURE 4 **ANNUAL GROWTH RATE IN VALUE ADDED 2007–2010**

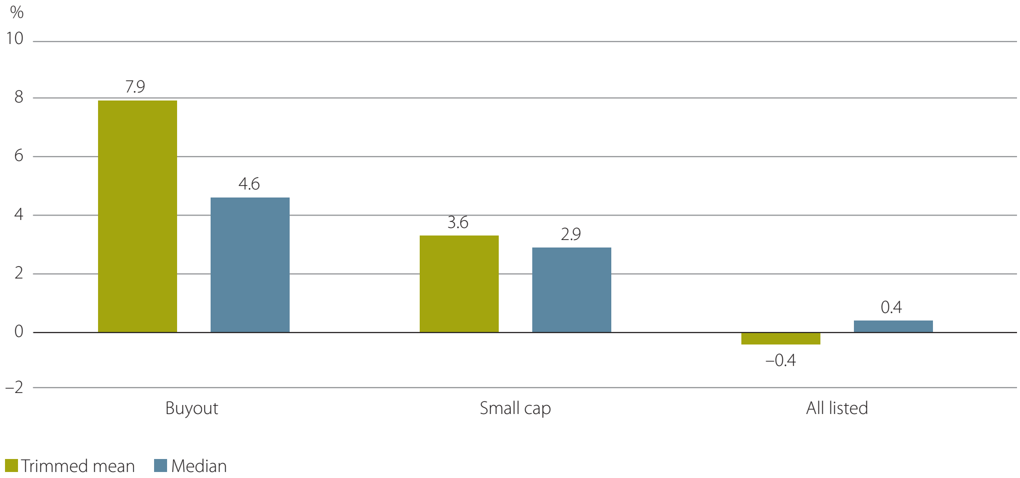


7.7%

The median growth in Value Added in buyout owned companies between 2007 and 2010 was 7.7%, which compares favourably with an annual GDP growth of only 2.0%.

The picture that emerges from Figure 4 is verified in Figure 5 where turnover growth is considered. Note that turnover growth has been lower than growth in Value Added, indicating that firms have become more efficient during the period, by producing more value for each SEK in revenues.

FIGURE 5 ANNUAL TURNOVER GROWTH 2007–2010



The performance advantage of buyout portfolio companies is also present when considering employment growth. This is illustrated in Figure 6, where these companies display an annual growth of around 4 percent, compared to growth rates close to or below zero in the two groups of listed companies.

FIGURE 6 ANNUAL EMPLOYMENT GROWTH 2007–2010

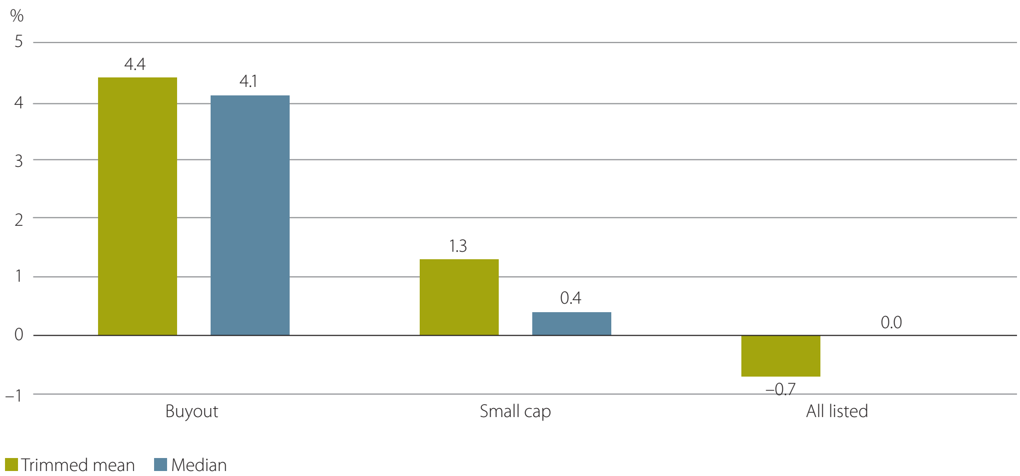


Figure 7 shows wage growth per employee. This figure indicates that wages do not grow faster in buyout portfolio companies. The difference from other comparable companies is relatively small, however.

FIGURE 7 **ANNUAL WAGE GROWTH PER EMPLOYEE 2007–2010**

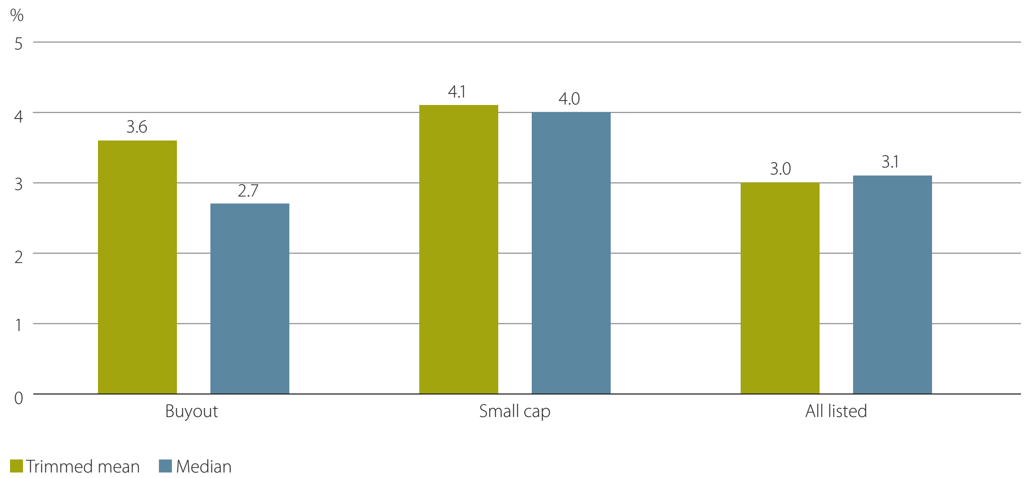


Figure 8 (next page) describes the spectrum of industries represented by buyout portfolio companies. About 23 % of the portfolio companies operate in the consumer goods and retail space. Business and industrial products and services are also strongly represented among the portfolio companies, together making up 37 % of the companies. Notice that within buyout, the share of companies sorting under life science and energy/environment is still relatively limited, although these sectors receive much attention.

FIGURE 8 DISTRIBUTION OF PORTFOLIO COMPANIES BY INDUSTRY 2010

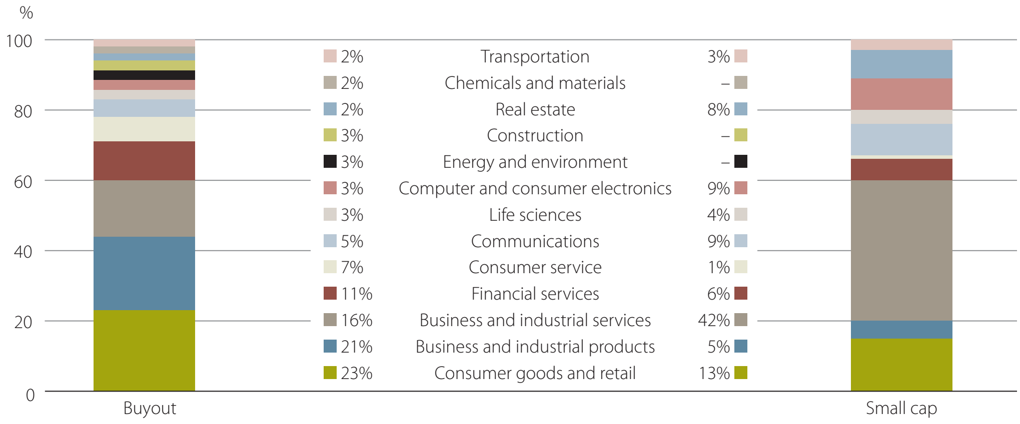
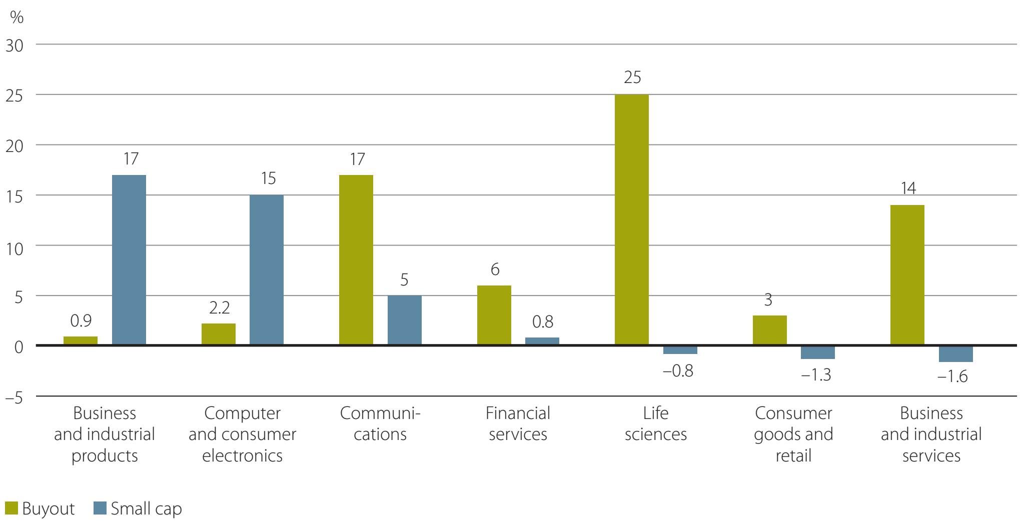


Figure 9 shows Value Added median growth rates in several different industries for buyout and small cap. The growth rate varies greatly from industry to industry within the two peer groups. The industries where small cap lacks observations are left out of the comparison. Overall, buyout performs better, but there are industry areas such as *Business and industrial products* where small cap performs significantly better than buyout.

FIGURE 9 VALUE ADDED MEDIAN GROWTH FOR BUYOUT AND SMALL CAP 2007–2010



3. Venture capital – market performance study

Portfolio companies in the venture segment are very diverse in terms of growth rates, but overall numbers are encouraging, especially turnover growth. However, the growth in the number of venture backed portfolio companies has slowed significantly.

The group of venture capital portfolio companies consists of 591 companies in the seed, start-up or expansion phases. Figure 10 describes the development in total turnover, Value Added, wage costs with and number of employees in these companies.

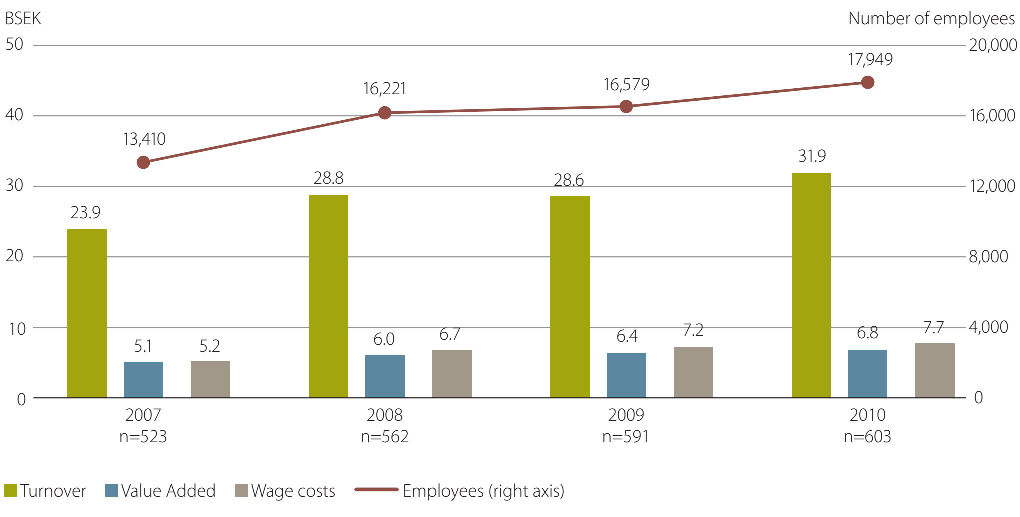
From 2007 to 2008 all four variables show very healthy overall growth (around or above 20%), which slows down considerably between 2008 and 2009 to a still respectable 7–8% for Value Added and wage costs with employee numbers and turnover remaining still or sliding slightly backwards. Growth in the latter two variables then revived to around 10% in the year to 2010, while Value Added and wage cost growth remained largely unchanged.

Naturally, since all these numbers are calculated based on the (expanding) universe of venture owned portfolio companies, part of the growth is attributable to the increased number of companies and Figure 10 should be taken as a measure of the venture industry as a whole. To be precise, the number of venture portfolio companies grew by 7% to 2008, 5% to 2009 and 2% to 2010. In Figure 11 below we look at growth from the perspective of individual companies.

The data also shows that there is no significant difference in performance between the companies that entered a venture portfolio before 2007 and those that entered after 2007. This is to some extent surprising since one would expect performance to be affected by maturity. On the other hand, since the effects of the financial crisis mainly show up in the growth figures for older venture portfolio companies, this may act to cancel out the maturity effect.

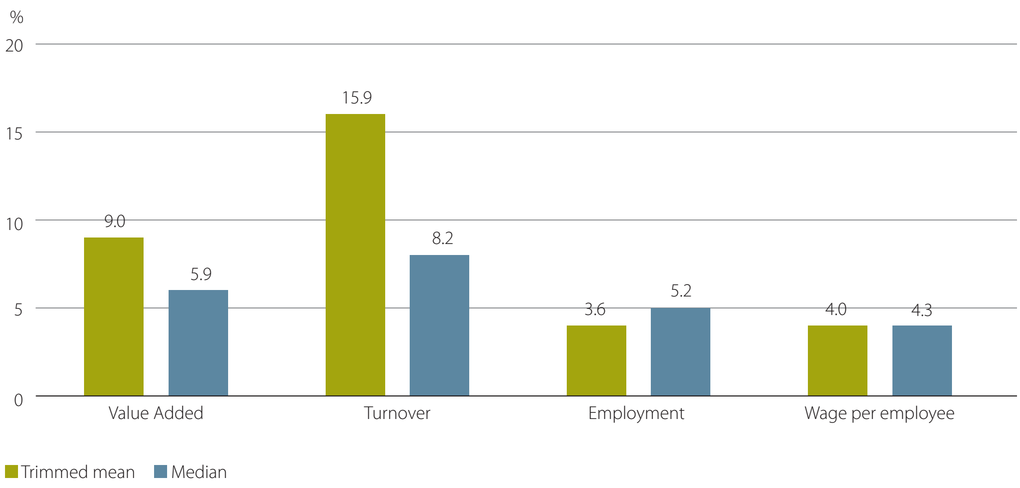
The median venture portfolio company has six employees and a turnover of 3.6 million SEK, illustrating that many venture investment cases are small companies in very early stages.

FIGURE 10 PERFORMANCE OF VENTURE CAPITAL PORTFOLIO COMPANIES 2007–2010 (TOTAL VALUES)



The venture portfolio companies have withstood the crisis years rather well, managing healthy annual growth rates over the period 2007 to 2010 (Figure 11). Yet growth rates are not significantly higher than in the more mature buyout companies. Still, one clear difference stands out, relating to turnover growth. Even after removing the top 10 percent growth performers (as well as the bottom 10 percent), the average turnover growth is still close to 16 percent, showing that a significant proportion of the companies in this group are high growth performers.

FIGURE 11 ANNUAL GROWTH IN VENTURE PORTFOLIO COMPANIES 2007–2010



Business and industrial services is the dominant industry area in venture portfolio companies and within this group 113 of 170 companies are defined as *Other science or technical research and development*. Companies in this category are typically highly R&D intensive. Other important investment sectors are *Computer and consumer electronics, Consumer goods and retail, Communication* and *Life sciences*.

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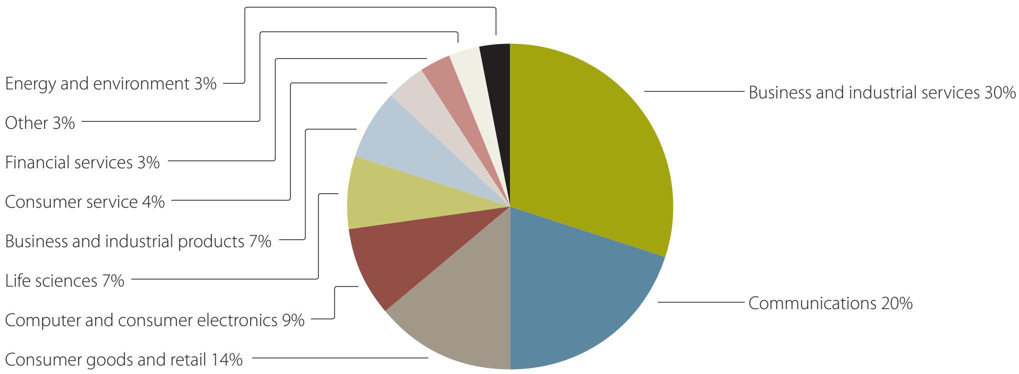
18,000

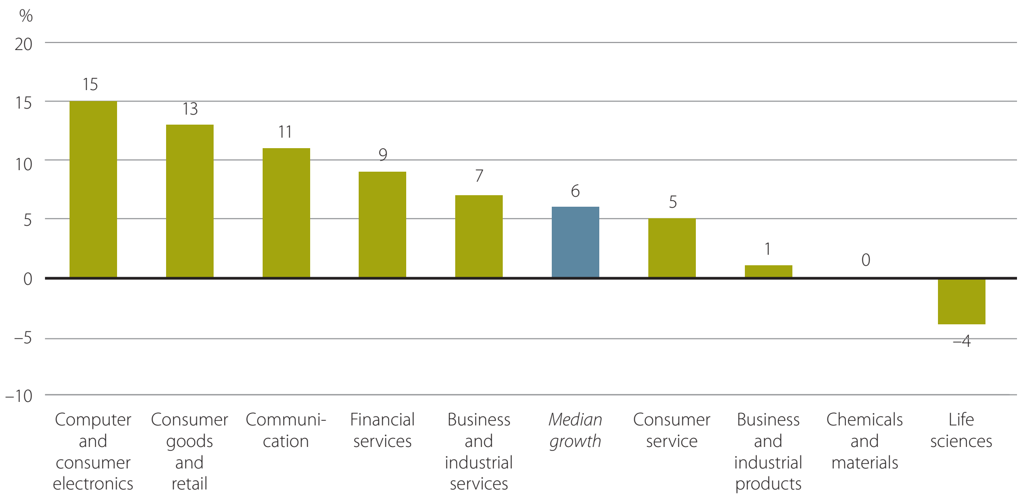
In 2010 nearly 18,000 people worked for the 603 venture backed companies covered in this study.

FIGURE 12 **INDUSTRY DISTRIBUTION BY NUMBER OF COMPANIES IN THE VENTURE PORTFOLIO**



An equally interesting pattern is the development in different industries between 2007 and 2010 (Figure 13). The venture median annual growth rate was six percent. As shown in Figure 13, venture cases in *Computer and consumer electronics* and *Consumer goods and retail* have the highest annual growth rates. Industries with fewer observations *(Real estate, Agriculture, Chemistry and materials* and *Transportation)* are not included in this figure.

FIGURE 13 **MEDIAN TURNOVER GROWTH FOR VENTURE 2007–2010**

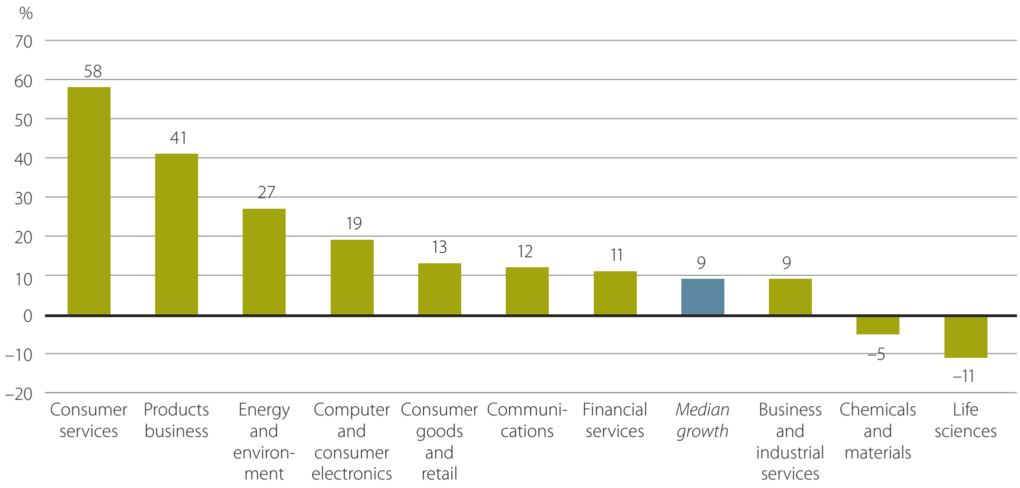


The portfolio companies in venture funds represent widely differing stages of business development. Consequently, figures for seed, start-up and expansion are reported separately below. The overall median growth rate between 2007 and 2010 is 9 percent for seed and start-up (Figure 14). *Consumer services* and *Business and industrial products* had the highest growth for seed and start-up companies. *Life science companies* are not able to produce positive turnover growth for the median company.

58%

Early stage venture backed companies in the *Consumer services* sector managed a median annual growth of 58% from 2007 to 2010.

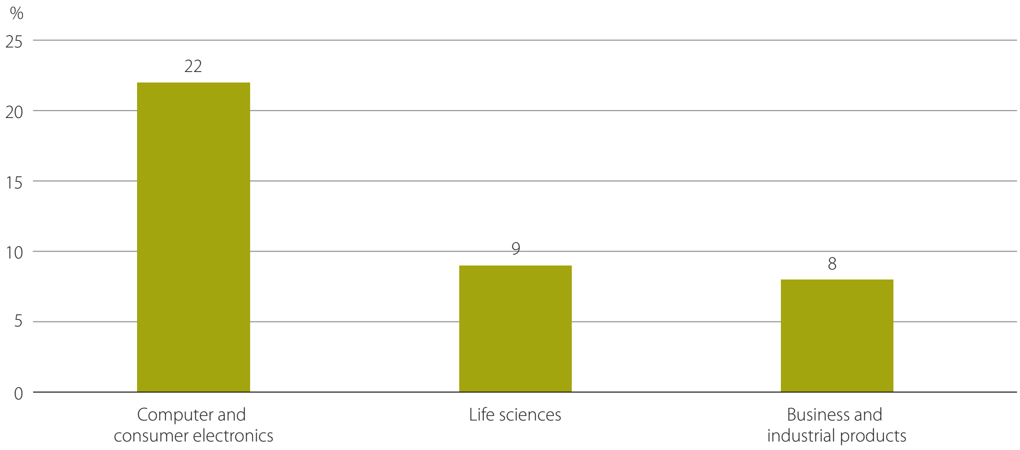
FIGURE 14 **MEDIAN TURNOVER GROWTH FOR SEED AND START-UP COMPANIES[5] 2007–2010**



5. In this figure all industries with less than 10 observations are left out.

Employment growth in the seed and start-up segments is largely driven by growth in the three industries in Figure 15, *Computer and consumer electronic industry, Life sciences* and *Business and industrial products*. The highest growth rate by far is found within the first of these.

FIGURE 15 **ANNUAL EMPLOYMENT GROWTH 2007–2010 – SEED AND START-UP**



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22%

In *Computer and consumer electronics*, the median early stage venture company grew employment by 22% annually from 2007 to 2010.

In the expansion segment (141 companies), Value Added reached a total of 6.6 billion SEK in 2010 (approximately 10 percent of Value Added in the buyout segment). The dominant industries in the expansion segment are *Consumer goods and retail* together with *Communication*. Close to 12,000 workers were employed in expansion portfolio companies, over half of which work in the areas *Communication, Consumer goods and retail* and *Business and industrial products*.

4. Methodology

This report uses a population of companies derived from the previous Performance study, supplemented with new observations from a pan-European database called PEREP. The group of all publicly listed Swedish companies, as well the subgroup of listed small cap companies, is used as a reference.

The population of companies in this study is based on the portfolio of companies in all private equity funds as of December 2010. Companies that entered a portfolio before 2007 are taken from the same population as the 2009 performance study by SVCA and Ernst & Young. From 2007, all investments and divestments in these funds are reported in a pan-European data platform managed by PEREP Analytics on behalf of The European Venture and Private Equity Association (EVCA). New initial investments from 2009 and 2010 are added to the existing previous population, and companies exited after 2008 are deleted. Using PEREP's database makes it possible to also include investments in Swedish portfolio companies carried out by investment funds located outside Sweden.

The performance study is based on financial data from 2007 to 2010 delivered by Newsline Group. Since this study was completed in November 2011, about 20 percent of the companies were still missing financial data because of delays in data reporting routines. This is perfectly normal and does not affect the comparative performance study, but it affects the key figures in this study such as total number of employees. Consequently, we have estimated the overall employment and Value Added level in 2010 based on growth in the 80 percent of companies that have reported their data.

All publicly listed companies located in Sweden are used as a peer group to study relative performance for buyout portfolio companies. The financial information for these peer group companies is also provided by Newsline Group.

Buyout portfolio companies are a group of well established companies that often share many characteristics with publicly listed companies. This is the reason for our choice of reference or peer group. We have also separated out Swedish small cap companies listed on Nasdaq OMX Stockholm since the larger listed companies tend to be significantly larger than companies in buyout portfolios. Small cap companies are companies that have a market capitalization smaller than 150 million euros.

Venture portfolio companies are smaller, early stage companies. It is a group where it is harder to find a comparable group of companies because companies of this size are not publicly listed in most cases. Hence, we have chosen to focus on a market study of the performance of this group of portfolio companies, without an explicit peer group comparison.

The industry definitions are based on SVCAs own industry definitions. Each firm has a reported SNI-code, and these codes are used to place each firm into one of SVCAs industries.

In the comparative study both trimmed mean and median growth rate from 2007 and 2010 are reported. Trimmed mean is an adjusted mean where the top and bottom 10 percent of the sample are excluded. This is often a better measure than straight averages over the whole sample because outliers in the top and bottom of the distribution can distort the data.

For calculating the growth rates between 2007 and 2010 for each company in the study, the Compound Annual Growth Rate (or CAGR) is used. This is a standard way of calculating growth averages over several years, and it essentially entails taking the geometric mean, which is more suitable in cases where growth is compounded over several years.

PRODUCTION: SVCA, MENON, ADLER MARKETING. **GRAPHIC DESIGN**: ELLI PRODUCTION.
PRINT: ORION TRYCKERI, DECEMBER 2011.

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