Flexibility in uncertain times
Private equity backed company survey 2013
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Foreword

Welcome to PwC’s 2013 survey of private equity backed companies. Our analysis is based on in-depth face-to-face interviews with private equity backed companies across a wide range of industry sectors. For the fourth year running we have increased our survey sample size to allow us to gain further insights into the trends shaping private equity portfolio companies.

The economic backdrop these companies face is a ‘new normal’ of relatively slower growth and greater uncertainty than in the past. PwC’s central forecast is for modest UK GDP growth of around 1% in 2013 rising to 2% in 2014, assuming a gradual revival in the global economy and no major accidents in the Eurozone. The risks to this scenario, however, remain weighted to the downside given the potential for further global commodity price shocks and on-going Eurozone uncertainty.

In this challenging environment the most successful companies will be those that can adapt flexibly and quickly in their pursuit of growth opportunities. Reflecting this, our survey shows that private equity backed companies are focused on the need to introduce new products or widen their service offering as the most important driver of value in their businesses. Most portfolio companies perceive that their strategy has sufficient flexibility built in to achieve their objectives and also that their private equity owners are open to amending the strategy when required.

Of course there are areas where portfolio companies could improve their operational performance. This year’s survey shows that there is room for improvement in risk management and that while the focus on working capital and cash flow management has sharpened, there remain opportunities to create value.

As well as being flexible on strategic direction, portfolio companies view their private equity owners as more willing than lenders to invest further capital to achieve growth. In an environment in which government programmes to increase bank lending to SMEs have yet to yield significant positive results, this willingness to invest is particularly encouraging. So too is the fact that while the macroeconomic outlook remains relatively downbeat, 90% of our survey respondents expect to maintain or increase their permanent staffing levels in the coming year.

Overall our survey results show that private equity backed companies display the dynamism needed to be competitive in the ‘new normal’ and underline the critical contribution the sector has to play in supporting the UK’s economic recovery.

Duncan Skailes
UK private equity portfolio company leader
Flexibility is critical to success in the ‘new normal’

As the road to recovery has proved long and arduous the consensus view of the UK economy’s prospects has shifted from ‘weaker for longer’ to a growing perception that businesses face a different longer-term growth dynamic. This ‘new normal’ is for generally slow growth amid greater uncertainty than in the past.

To survive and prosper in this new world the UK needs flexible, dynamic and competitive businesses to take advantage of growth opportunities where they arise. The first theme explored by this year’s survey is whether these characteristics, which are typically associated with private equity backed businesses, are in fact evident among portfolio companies.
The survey results substantiate the view that private equity backed companies have flexible business strategies. Slightly more than three quarters of respondents have a clear and formalised written strategy, the vast majority of which (88%) have been updated within the last year, most commonly as part of a regular planning cycle. A large majority reports that strategies are generally designed with flexibility and room for manoeuvre built in. Most also report that, while the business is performing, the private equity house is very, or quite flexible to amending the strategy.

Figure 1: Business strategy

<table>
<thead>
<tr>
<th>Has bank/equity model been transformed into clear business strategy?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes 77%</td>
</tr>
<tr>
<td>No 20%</td>
</tr>
<tr>
<td>DK 3%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Does company have formalised written strategy?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes 76%</td>
</tr>
<tr>
<td>No 19%</td>
</tr>
<tr>
<td>DK = Don’t know</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>When written strategy last updated</th>
</tr>
</thead>
<tbody>
<tr>
<td>Last 3 months 50%</td>
</tr>
<tr>
<td>Last 6 months 13%</td>
</tr>
<tr>
<td>Last 12 months 24%</td>
</tr>
<tr>
<td>Longer 13%</td>
</tr>
<tr>
<td>Last 13%</td>
</tr>
</tbody>
</table>

The survey results substantiate the view that private equity backed companies have flexible business strategies. Slightly more than three quarters of respondents have a clear and formalised written strategy, the vast majority of which (88%) have been updated within the last year, most commonly as part of a regular planning cycle. A large majority reports that strategies are generally designed with flexibility and room for manoeuvre built in. Most also report that, while the business is performing, the private equity house is very, or quite flexible to amending the strategy.
When performance issues arise, however, private equity houses tend to become both more involved in the business and more rigid regarding changes to the agreed strategy. There is also a sizable minority (20%), which do not have a formalised written strategy. This could be seen as a potential source of flexibility, but equally could present problems if, at exit or when a need to re-finance arises, the company cannot communicate a clear strategy. Taken alongside other survey findings that one in four companies finds it difficult to model different scenarios and that 36% do not have a risk register, this suggests that there is a significant minority of companies, which could benefit from greater control over their future strategy.

Looking beneath the headline figures, the survey results point to very flexible decision-making within private equity backed companies, which is often driven by flat management structures. For two-thirds of companies the flexibility of the cost base is not seen as a key concern and on average half of the cost base is considered variable. While a lack of labour mobility is often perceived as an issue for businesses, only one in ten portfolio companies has problems with an inflexible workforce and three quarters report that their workforce is somewhat or very flexible in support of the business strategy.

When considering the regulatory backdrop in which companies operate, there is a wide variation in the specific rules or policies that companies would change. A dominant theme failed to emerge from the results on restrictive rules and regulations, with respondents tending to point to sector specific issues. This could in part reflect the nature of the businesses in which private equity has invested, which tend to have a narrower industry focus and are therefore perhaps less likely than a conglomerate business to have a broad view of the burdens of red tape on companies.

Tax issues are more prominent than in the previous year’s survey, but dissatisfaction is focused less on the business tax regime and more on individual taxation, which is viewed as failing to provide incentives. There is a high degree of acceptance of the business tax regime: half of companies consider the regime acceptable and a further third believe it is benign, with only 12% considering it unattractive or hostile. Taxation more generally however, has recently come under media scrutiny and tax is a potential source of reputational risk for companies. This is particularly the case with those perceived by the press or public to have taken advantage of tax planning to the detriment of the UK tax take.

“The private equity house listens and guides but doesn’t dictate”
As with other businesses, management at private equity owned businesses need to have a clear understanding of the group’s tax strategy, including where, why and how much taxation in all its forms the business contributes and to be able to clearly articulate and support the position.

Overall, the picture that emerges from the survey is that private equity backed companies do exhibit the clear but flexible strategic focus required for success in the new normal. Judged by staffing intentions, this also appears to translate into confidence in their ability to grow despite the gloomy macroeconomic outlook – almost 90% of respondents expect to maintain or increase permanent staff in the next 12 months. From a sector viewpoint there are also some surprising results given the economic backdrop: the sectors most likely to increase headcount are retail, leisure and hospitality.

“The business has outperformed plan and the private equity house has been willing to allow investment to strengthen the business. The holding period that the private equity house expects has increased so they are prepared to invest from current EBITDA to make a greater return in the longer term.”
Management of a business in uncertain times is key. Better businesses have appropriate risk management in place and have financial and non-financial information at their fingertips. The information is timely, relevant and consistent with the objectives of the business.

Boards are aware of the need for high quality management information (MI) to be able to project different scenarios and have placed greater emphasis on business drivers in the last year, with almost two thirds reporting an increased focus on pricing and profitability analysis. This finding is consistent with the need for businesses to tighten performance measurement in a tough economic climate and may also reflect greater pressure from private equity owners, which have experienced failed exits and refinancings.
Our survey results, however, show that a considerable number of companies – more than we would have expected – have room for improvement in risk management and the production of MI.

Respondents were divided roughly 50:50 between those saying MI provided all the information needed to monitor and manage the business and those saying it did not. Those voicing these frustrations say that the information can be generated, but that the process can be slow, laborious and labour intensive. Similar concerns arise regarding budgeting and planning processes, where one third are not satisfied, citing that the process is too slow and that internal systems are old or inadequate.

![Figure 2: Change in Board’s area of focus over past year](image-url)
Generally, partly as a result of system and data constraints and partly driven by a lack of analyst depth and business partnering in the finance function, MI at portfolio companies suffers from:

- An absence of clear alignment between the company’s strategy/value creation plans on the one hand and KPIs and Board/management reporting, budgeting and forecasting on the other.
- Insufficient operational depth in cash and working capital reporting.

Only two out of three companies have a risk register and only one out of three report that it is at the heart of their decision-making processes. (This latter result is correlated to size of company). The significant proportion of companies without a risk register raises questions over the ability of these companies to assess risk effectively and to conduct proper scenario testing. For organisations and boards charged with managing risk in the new economic reality, the fact that fundamental changes are underway is relatively easy to spot.

**Figure 3: Has the requirements for and capabilities of the finance team in the following areas increased, decreased or stayed the same under PE ownership?**

<table>
<thead>
<tr>
<th>Area</th>
<th>Increased</th>
<th>Same</th>
<th>Decreased</th>
<th>Unknown</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pricing and profitability analysis</td>
<td>70%</td>
<td>29%</td>
<td>1%</td>
<td></td>
</tr>
<tr>
<td>Cash and working capital management</td>
<td>70%</td>
<td>27%</td>
<td>1%</td>
<td></td>
</tr>
<tr>
<td>KPI/Driver based budgeting and reporting</td>
<td>61%</td>
<td>37%</td>
<td>2%</td>
<td></td>
</tr>
<tr>
<td>Trading performance</td>
<td>59%</td>
<td>39%</td>
<td>2%</td>
<td></td>
</tr>
<tr>
<td>Cost management</td>
<td>49%</td>
<td>47%</td>
<td>2%</td>
<td></td>
</tr>
<tr>
<td>New business pipeline/churn</td>
<td>47%</td>
<td>48%</td>
<td>3%</td>
<td></td>
</tr>
<tr>
<td>Taxation</td>
<td>34%</td>
<td>56%</td>
<td>6%</td>
<td>4%</td>
</tr>
</tbody>
</table>
But it’s much harder for organisations to define both what’s driving this reshaping and how they should respond. By understanding, documenting and regularly reviewing the risk landscape we believe private equity backed companies can be better positioned to deal with risks as part of an exit process.

Boards’ increased focus on business drivers is being met by greater efforts from finance teams rather than investment in systems. Consequently, finance teams, particularly outside London, are feeling the pressure across many areas of their work. Almost three quarters report that under private equity ownership the finance team faces an increased workload with regard to pricing and profitability analysis and cash/working capital management analysis. The unexpected finding that finance teams are feeling the pressure less in London could reflect various factors, such as the specific sectors the businesses surveyed operate in. It may also reflect the broader talent pool available in London – anecdotally respondents note the difficulty in finding talent to fill roles located further out in the regions.

The speed of producing MI varies significantly with most companies taking 16-20 days to produce management accounts after month end. A significant proportion of companies (37% of respondents) also have concerns about whether their finance team has sufficient depth of ability to focus on analysis.

Overall, the survey suggests that in a rapidly changing world in which exit and refinance windows of opportunity open and close very quickly, a significant number of companies may be underinvested in the critical support systems needed to realise value.
Innovation is critical to value generation and the realisation of a growth strategy

“Our current strategic priority is to continue winning profitable market share in the UK, where we only have a 10% share, through innovation and service linked to good people and technology solutions.”

The ability to generate value is fundamental to the success of a private equity backed portfolio company. The third theme in this year’s survey considers the areas of value generation that management teams are most focused on.

**Value generation drivers**

Awareness of the need to innovate to drive growth emerges clearly from the research. Broadening the service offering or introducing new products has increased in importance to be the key driver of value for private equity backed businesses and this is reinforced by the high level of importance attached to reputation and brand management. The speed at which companies are able to innovate is also perceived as critical, as other markets, specifically Asia, catch up and improve the quality of their products.
However, there may be a gap between awareness of the importance of innovation and the extent to which companies are actually innovating. The 16th PwC Annual Global CEO survey highlighted that only 50% of UK chief executives intend increasing R&D activity. Instead they want to grow their existing customer base and drive operational effectiveness. This suggests that there may be a need for UK companies to take a longer-term view about the value, which can be added to the business through investment in R&D. This includes gaining a better understanding of the government incentives available to businesses engaged in R&D including the new patent box and above the line R&D credit regimes which come into effect in 2013. In a private equity environment, this raises the question of whether there is a willingness to invest for the long term, because there may be a need to show value enhancement before the full benefits of innovation have had time to show through.

![Figure 4: Importance of the following to the company's three year growth strategy in 2012](image_url)

<table>
<thead>
<tr>
<th>Service Offering or Intro New Products</th>
<th>2012</th>
<th>2011 Mean +/-</th>
</tr>
</thead>
<tbody>
<tr>
<td>Broadening service offering or intro new products</td>
<td>4.0</td>
<td>3.6 0.4</td>
</tr>
<tr>
<td>Working capital and cash flow management</td>
<td>4.0</td>
<td>3.5 0.5</td>
</tr>
<tr>
<td>Reputation/brand management</td>
<td>3.9</td>
<td>n/a n/a</td>
</tr>
<tr>
<td>Staff development, retention and motivation</td>
<td>3.8</td>
<td>3.8 0.0</td>
</tr>
<tr>
<td>Improving margins</td>
<td>3.8</td>
<td>3.6 0.2</td>
</tr>
<tr>
<td>Hiring talent</td>
<td>3.8</td>
<td>n/a n/a</td>
</tr>
<tr>
<td>Reducing costs and seeking efficiencies</td>
<td>3.7</td>
<td>3.6 0.1</td>
</tr>
<tr>
<td>Data security/IP protection</td>
<td>3.5</td>
<td>n/a n/a</td>
</tr>
<tr>
<td>Managing risk</td>
<td>3.4</td>
<td>3.4 0.0</td>
</tr>
<tr>
<td>Tax planning</td>
<td>2.8</td>
<td>2.8 0.0</td>
</tr>
<tr>
<td>Seeking and making acquisitions</td>
<td>2.8</td>
<td>2.6 0.2</td>
</tr>
<tr>
<td>International expansion (Europe)</td>
<td>2.7</td>
<td>2.4 0.3</td>
</tr>
<tr>
<td>International expansion (North America)</td>
<td>2.6</td>
<td>2.1 0.5</td>
</tr>
<tr>
<td>International expansion (Asia)</td>
<td>2.5</td>
<td>2.3 0.2</td>
</tr>
<tr>
<td>International expansion (Australia)</td>
<td>2.0</td>
<td>1.8 0.2</td>
</tr>
<tr>
<td>International expansion (South Australia)</td>
<td>1.8</td>
<td>1.9 (0.1)</td>
</tr>
<tr>
<td>International expansion (Africa)</td>
<td>1.5</td>
<td>1.4 0.1</td>
</tr>
</tbody>
</table>

Mean importance scores (1 = low importance; 5 = high importance)
While the pursuit of growth remains vital, the most marked increase in focus over the last year has been on working capital and cash flow management. This reflects the toughness of the economic environment as companies are under pressure to manage their liquidity and debt repayments as effectively as possible. This finding is consistent with the results reported above on the increased pressure being placed on finance teams to provide analysis and MI to support cash flow and working capital management.

The importance of finding and keeping the highest calibre managers and staff is also very clear from the survey results. Hiring talent and staff development, retention and motivation were considered among the most important factors in following the company’s three-year growth strategy.

The calibre of staff and management is by far the most important staffing issue, with 73% of respondents rating its importance as 5 out of 5. Last year’s survey highlighted a drop in the number of management teams that felt sufficiently incentivised, but our latest findings show that this proportion has now recovered to 2010 levels (69%).

Management incentives are also closely aligned with business objectives: in 83% of cases incentives are either well or very well aligned. This greater satisfaction with incentivisation may reflect the re-setting of management equity plans (37% of companies have reset plans in the last year). However, it may also reflect a more realistic assessment by management of incentives relative to the prospects of the business in a tough environment.

Overall, international expansion is not considered to be critical to value generation. However, there has been a marked increase in the consideration of expansion into North America and Europe compared with the 2011 results. Expansion into faster growth emerging markets is considered a lower priority than Europe and North America, which is perplexing given the outlook for slow growth in developed markets. These results mirror PwC’s 16th Annual Global CEO Survey, which found that UK CEOs lag behind their counterparts in Germany and France, for example, in pursuing growth opportunities in faster growing emerging markets.

In this year’s survey we asked companies for the first time to rank the importance of data security and the protection of intellectual property. The results show that companies consider these issues to be of similar importance to the pursuit of cost reductions and efficiencies. This result is consistent with the on-going trend towards enterprises using software as a service and the migration to cloud-based solutions and the resulting potential reputational risks associated with data loss.

Tax planning is generally not seen as a key driver of exit value and fewer than one in five companies has a written tax strategy agreed by the Board. Nonetheless at least one third of companies actively manage corporation tax and a meaningful proportion also try to manage other tax costs, such as payroll and sales taxes, which are more often considered compliance burdens rather than a potential source of value generation.

“Management team stability is seen as a key risk, therefore leading us to focus on motivation.”
Company size is also a parameter in the extent to which companies need to consider active tax planning. Larger multinational businesses need to factor in transfer pricing and where it is most cost effective to pay corporation taxes, which are less of an issue for smaller domestically focused businesses. Given recent media debate regarding companies’ tax planning, the issue is likely to rise up the corporate agenda in future.

Only half of the companies surveyed have agreed an ATCA with HMRC, which is perhaps surprisingly low. There is, however, variation depending on company size – with larger corporations more likely to have reached an agreement – and also variation depending on deal vintage, with two-thirds of more recent deals having an ATCA. This may be a reflection of the different views between gaining certainty on exit at an increasingly large negotiated ‘cost’ in obtaining the agreement of HMRC compared with the confidence businesses may already have in the robustness and defensibility of their debt position, particularly on refinancing events.
Figure 5: How do you rate the following in terms of a) importance and b) how your PE house performs?

<table>
<thead>
<tr>
<th>Service</th>
<th>2011 Performance mean</th>
<th>+/-</th>
</tr>
</thead>
<tbody>
<tr>
<td>How to plan for successful exit</td>
<td>4.2</td>
<td>3.5</td>
</tr>
<tr>
<td>Providing good quality challenge</td>
<td>4.1</td>
<td>3.9</td>
</tr>
<tr>
<td>Strategic direction</td>
<td>4</td>
<td>3.4</td>
</tr>
<tr>
<td>Advice on acquisitions</td>
<td>3.3</td>
<td>3.5</td>
</tr>
<tr>
<td>Introducing new contacts</td>
<td>3.1</td>
<td>2.8</td>
</tr>
<tr>
<td>Advice on reducing costs</td>
<td>2.4</td>
<td>2.5</td>
</tr>
<tr>
<td>Help with moving into new territories</td>
<td>3.2</td>
<td>2.3</td>
</tr>
<tr>
<td>Assisting with contract negotiations</td>
<td>2.2</td>
<td>2.3</td>
</tr>
<tr>
<td>Advice on emerging markets</td>
<td>2.4</td>
<td>2.1</td>
</tr>
</tbody>
</table>

Mean importance/performance scores (1 = low; 5 = high)
Support provided by the private equity house

When considering the on-going contribution to value generation provided by private equity owners to their portfolio companies, the view of management teams is that performance falls short of expectations in a number of important areas.

Private equity backed businesses look most to the houses for exit advice, strategic direction and good quality challenge. Among these factors, management’s assessment of the gap between expectations and private equity house performance is most marked in the help provided with strategic direction and exit planning. Help with moving into new territories, while a lower priority, is also an area in which portfolio companies perceive their private equity owners to fall short.

These results may reflect the changing landscape for deal making where vendors may not have the luxury of many competing bids and a strong secondary buy out market. This change can lead to less competitive tension and greater risk that deals are not concluded successfully. The observation that the performance of private equity houses only exceeds expectations when providing advice on acquisitions tends to support the perception that private equity owners add more value on the way in than on the way out. Longer holding periods may also be a contributory factor in portfolio companies’ disappointment. With private equity houses in the current climate tending to hold onto the parts of their portfolios that have the best growth prospects for longer, company management teams may perceive that exit opportunities have been missed.

Our survey also shows that private equity houses could do more to promote the sharing of best practice amongst portfolio companies. Only 48% of those surveyed say that their private equity owners encourage the sharing of best practice. Where sharing of best practice is encouraged, the support and services offered by the private equity house tends to be ‘light touch’ only.

This result may partly reflect a size issue. Larger private equity houses may have the resources available to promote better sharing of best practice, which may not be the case for a smaller house.

This suggests there is an opportunity for private equity houses to do more and potentially to secure better value. There appears appetite to do more: our experience with private equity clients is that they are often interested in the services we can offer in benchmarking and market analysis. In a similar fashion, there may also be scope for banks to bring more of their insights into customers’ businesses to bear in their relationships. Of those surveyed 84% do not think that lenders bring their own operational experience to bear. Doing so could provide a way for banks to rebuild trust rather than just selling products.
Financing and working capital management is a key focus for PE backed businesses.

The increased focus on cash flow and working capital management as a value generator illustrates our fourth theme, which is that financing remains a key issue for all private equity backed businesses, particularly where leverage is high and maturity is imminent.
Our research shows that 60% of companies have sufficient flexibility in their financing model to facilitate growth, although a significant minority (27%) believe that their financing structure and facility headroom is either somewhat or very inflexible.

Two in five companies have recently been through a refinancing, largely to replace shareholder debt or to replace maturing, inflexible and expensive debt. A larger number of companies consider that lenders have become more helpful compared with a year ago than those who believe they have become less helpful. The majority, however, consider lenders’ attitudes to be the same as the preceding year.

Private equity owners are perceived by portfolio companies as being more willing than lenders to invest further capital to achieve growth. Three-quarters of houses are either quite or very willing to invest further. The relationship between private equity houses and lenders, however, is perceived to be less positive. While half of portfolio companies say that the relationship is good, about a quarter say the relationship is either bad or could be better. The remaining quarter say that there is no relationship between the private equity house and lenders at all.

The relative lack of focus on working capital in recent years is starting to be addressed and it is becoming an increasingly important priority for companies. As more companies start to focus on working capital, this is also having a knock on effect on others, increasing the drive to treat it as a priority in finance teams.

Virtually all respondents have cash flow and working capital metrics in place, which are reviewed at Board level. The metrics companies use most frequently to measure their performance are cash flow/cash levels and cash forecasts as well as debtor days and debtor ageing. Companies gave few details beyond these generic examples and, similarly, the steps companies have taken to improve working capital management are fairly standard and largely focused on credit control.
While individual actions can improve performance, for example, better demand forecasting, our experience is that companies often have a tendency to take one action, such as recruiting a credit manager and hope that this will optimise performance. To drive better performance working capital should be seen as a continuum – a cash conversion cycle – covering the three areas of receivables, payables and inventory. The steps the survey respondents report they have taken to improve working capital, however, make no reference to accounts payable. Instead of honing in on individual items, which may not be meaningful and may not be being used to drive performance companies need to take this broader view of how they pay their suppliers, how much stock they hold and how they get paid.

When negotiating contracts 85% of respondents said that they actively consider working capital, but, unusually, creditor management was not mentioned as a means of improving working capital. The survey results also differ from our experience of working with clients, which shows that rigorous trade off calculations between terms and margin are rarely undertaken.

Common steps taken to improve working capital

- Improved credit control
  - Tighten/formalize process
  - New team
  - Bigger team (more credit controllers)
  - Change debt collection agency/supplier
  - Change commission plan so paid on collection rather than on sale
  - Centralisation of credit control function
  - Move customers to paying quarterly in advance instead of in arrears
- Improve relationships with customers so that they pay quicker
  - Move transparency so they understand consequences of late payment
- Improved planning/forecasting process
- Improve stock management
  - More scientific, more algorithms etc.
  - More discipline in removing excess/discontinued stock
Over the last 12 months 60% of the companies in our survey reported an increase in working capital in proportion to revenue growth, while a separate PwC review of UK companies indicated that 46% had experienced an increase. However, when asked about their performance relative to their peers, 95% of companies believe that their working capital performance is as good as or better than their peers. This suggests that companies may have poor visibility of relative performance. There may also be scope for greater realism with regard to working capital. With only 5% of companies admitting that working capital performance is worse than their peer group, some companies may not be facing up to the need to improve working capital performance and are therefore missing an opportunity to generate additional value.
A successful exit needs to be supported by a value story, a plan for exit, good preparation and aligned thinking between the private equity house and the management team. Overall, portfolio companies perceive some improvement in exit conditions and also their own readiness for exit.

Our survey results show that current expectations for an exit have slipped relative to the time frame anticipated when the deal was struck by an average of 0.9 years. However, the gap between original and current expectations was significantly wider in 2011 at 1.5 years, while average current expectations for an exit have fallen to 5.3 years from 5.5 years the previous year. Expectations for exit multiples are little changed compared with the 2011 survey, but there has been a slight improvement in expectations for total valuation at exit.
The combination of adverse market conditions and a lack of growth, which are obviously linked in many cases, is responsible for most exit delays, while several respondents also note that it has taken longer than anticipated to make the changes necessary to maximise value and prepare for exit.

With regard to the type of exit, trade sales are the main option being pursued, but secondary deals also continue to gain in popularity as management teams and private equity houses consider the full range of exit options.

Over the past few years IPOs have been perceived as an increasingly unlikely exit route, with less than a fifth of companies viewing a listing as their most probable exit. However, two PE-backed companies, Countrywide and HellermannTyton, have recently announced their intentions to float in London. If these listings are successful and stock market indices continue to rise, IPOs may become an increasingly viable option.

“The margin environment is tougher, the operational environment is tougher and international expansion is tougher.”
Two out of three companies believe that their private equity owners would exit now if they could and there is close alignment between management teams and private equity houses on the timing, type and valuation of their potential exit. Supporting the idea that exits may be more imminent than last year, a larger proportion of companies claim they are either quite or very ready for exit if an offer came in immediately (72% versus 66% the previous year), while 60% have drawn up a list of potential purchasers.

“The IPO route looks less attractive for various reasons. We have had increased interest from trade buyers”
However, when the level of preparedness is considered in more detail, it is clear that work remains to be done in a number of areas. Given the importance of communicating the value story, it is notable that the ranking for a well-established equity story is a relatively low 3.5 out of 5 (with a score of 5 indicating the company is very well-prepared). On the 10 measures that companies feel most prepared on, levels of preparedness range from 65% to 75%, which suggests that while a growing number of companies feel ready for exit there is still a significant amount of work to be carried out on the detail.
Interest in Environmental, Social and Governance (ESG) issues is increasing and it is becoming more of a focus in fund raising. Private equity backed companies recognise that the importance of ESG factors has grown and 70% expect the influence of ESG issues on business operations to continue to increase over the next three years. However, companies are generally only embracing ESG issues if the law requires it, or if there is a commercial advantage to be gained.

Companies may be missing an opportunity to create value, as ESG issues are becoming an issue for private equity sellers on exit. Our recent PRI/ESG survey focused on the attitudes of trade buyers and found that they will often seek warranties or indemnities over ESG matters that PE sellers are not in a position to provide, which are then removed at the end of the deal process, subject to a price reduction. Trade buyers also report that they have walked away from deals where they have been unable to sufficiently satisfy themselves with regard to ESG risk.
Our survey shows that companies see the potential to gain competitive advantage from ESG factors that are specific to their business, such as customer satisfaction, supply chain management and anti-bribery and corruption measures. Broader environmental concerns, such as climate change are perceived as having less potential to deliver competitive advantage.

The law requires companies to track and report certain corporate sustainability KPIs, including sickness absence rates, numbers of fatalities and the number of net jobs created or destroyed per annum. Compliance with these requirements is high, but the proportion of companies tracking and reporting additional sustainability KPIs not required by law, such as energy intensity and water consumption, drops off markedly. Company size is a factor, with larger companies tending to track more metrics.
This report draws on analysis of market trends and a survey of management teams from 94 private equity backed companies.

The companies were surveyed between October and December 2012 and represent a cross-section of sectors, company sizes and date of original deal.
Other publications of interest

16th Annual Global CEO Survey

Supporting UK growth – Private equity backed company survey 2012

IPO Watch Europe Survey – Q4 2012

Dealing with disruption
Adapting to survive and thrive

1,330
36%
82%

16th Annual Global CEO Survey
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