

# NHH ACPE

ARGENTUM CENTRE for PRIVATE EQUITY

## Newsletter

---

Autumn 2015.....	1
Research Focus: Performance Measurement .....	2
Centre in the Press .....	5

---

## Spring 2016

This is the third edition of the Centre’s bi-annual newsletter. The mission of the Argentum Centre for Private Equity at the Norwegian School of Economics is to deliver high quality Private Equity research. To that aim we support research projects at NHH directly and are building a pan-Nordic PE database. The main topic of this newsletter will be the impact of buyout investments on firms in Norway

**Carsten Bienz**

Centre Director



### PRIVATE EQUITY FOR LARGE INVESTORS

The Centre held a conference with the theme, “Private Equity for Large Investors” at NHH’s Jebsen Centre on December 2015. David Robinson (Duke), Berk Sensoy (Ohio State) and Thore Johnsen were among the presenters.

## ANNOUNCEMENTS

The Argentum Private Equity Centre will host its bi-annual academic conference this fall.

The Centre is an Academic Partner for the DVCA's Nordic Private Equity Summit in Copenhagen on June 21<sup>st</sup>.

## Research Focus: Buyouts in Norway

---

*In this newsletter I want to look at the impact of buyouts on portfolio companies*

How are firms changed when they are subject to a buyout? While we have a lot of evidence from outside of Norway there is not much evidence from within the country.

### WHAT CAN WE ANALYZE?

Doing research on PE is in some sense always an exercise in frustration. Most of the time the data to do the analysis we want to do just does not exist.

There are exceptions however. The PE center has invested considerable effort to build a dataset on buyout deals in the Nordics. In order to analyze the impact on Norwegian firms we merge our database with Norwegian accounting data into a comprehensive dataset. I want to now highlight some of the results from three master theses written at NHH during Autumn 2015 using the Centre's data:

- 1) Do buyout investments in Norway increase firm performance?
- 2) What are the tax consequences of buyout investments?
- 3) How does corporate governance work?

The Centre's web page also has links to all three theses.

Looking at question one, Friedrich, 2015 suggests that PE targets become more efficient in their operational and financial aspects. Table 1 presents some of the findings. All findings are relative to a comparable group of non-buyout firms. Significant improvements relative to the comparison group can be found for both EBITDA/Assets and Net Cash Flow/Assets. Over a longer horizon Net Income/Assets is negative. This last finding represents the difference between Cash Flow ( $EBIT(1-t)+Dep+\Delta NWC-Capex$ ) and Net Income ( $EBIT-Interest(1-t)$ ). The difference is telling as it hints at significant increases in leverage after the first year of the buyout. Operational performance also increases across the board.

In addition, there is evidence that being PE owned also reduces the probability of financial distress relative to comparable no-buyout firms.

*Norwegian buyout targets become more efficient in their operational and financial aspects.*

Table 1: The relative effect of buyouts on deals

Percentage Changes between Buyout Targets and Controls			
Financial Measures			
	0 to+1	0 to+2	0 to+3
EBITDA/total assets	44.30%**	32.47%**	23.60 %
Net cash flow/total assets	9.12 %	26.37 %	52.14 %
Net income/total assets	21.34 %	-16.03 %	-37.79 %
Operational Measures			
	0 to+1	0 to+2	0 to+3
Return on sales	25.36 %	-3.35 %	21.90 %
EBITDA-margin	5.29 %	9.30 %	16.37 %
Asset turnover	8.95%***	19.74%***	49.56%***
Current ratio	-4.40 %	-67.23%***	-48.14%***

*Source - Friedrich (2015). Stars indicate statistical significance.*

Roald & Roti, 2015 investigate whether some of this increased financial performance comes at the expense of tax-payers. Yet it seems that there is little evidence of such a problem. To the contrary, it seems that the increase in performance reported by Friedrich counterbalances any increase in leverage.

Finally, Farran & Lãm, 2015, investigate the channel through which buyout funds affect the companies they have invested in. Interestingly, it turns out that this channel is not the firm's board. We see almost no influence of the fund manager's presence on the firm's board.

How do these papers arrive at these results?

In general, we cannot directly compare firms that receive PE financing with non-PE financing as buyout targets are selected by their investors. That is a fallacy that most applied research falls into.

First of all, we need to realize that by being selected by a buyout fund, firms are probably somewhat different from the average firm. What could cause this difference? It might be that the firm has higher growth potential than a comparable firm or that its management is considered to be better. The problem for us is that it is difficult to find out.

However, what we can do is to compare PE funded firms with similar firms that did not receive PE financing. We can then try to see if we find differences in the future performance of firms that received PE financing and those that did not.

The data needs to be collected from several sources. The main source Information about investments is taken from NHH's Argentum Centre for Private Equity's (ACPE) database. The database is compiled by NHH and contains information on buyout deals from the late 1990s up to 2012. The database also contains information on the name of the portfolio company, the fund investing and the deal year. It is matched to SNF's accounting database,

*Just comparing buyout firms to all non-buyout firms usually is the wrong approach.*

maintained by Aksel Mjøs at NHH, using organization numbers. Organization numbers are independently hand-collected and verified by two research assistants. The SNF accounting database covers all Norwegian firms from 1997 to 2014. Historical ownership information was purchased from Bisnode and covers all Norwegian deals up to 2012. We need this information to identify past holding companies and the leverage in these holding companies.

Note: This is an excerpt from “The Impact of Buyouts on Portfolio Firms in Norway”

**References:**

Carsten Bienz, “*The Impact of Buyouts on Portfolio Firms in Norway*”, Argentum Centre for Private Equity, (2016).

Hadi Farran, and Kim Lâm, “*Corporate Governance in Private Equity: Do Boards Really Matter?*”, Master Thesis, NHH,(2015).

Tobias Friedrich, T. (2015). “*The Impact of Buyouts on Company Performance: Evidence from Norway*”, Master Thesis, NHH (2015).

Andrea Roald and Tonje Roti, “*Tax Planning in Norwegian Private Equity-Backed Companies*”, Master Thesis, NHH (2015)

## Report: Private Equity for Large Investors

---

*Based on historical returns, large LPs should be able to outperform the public market on a net-of-fee basis.*

On December 18th 2015 the Centre held a conference on “Private Equity for Large Investors” at NHH’s Jebsen Centre. Speakers were Thore Johnsen, David Robinson (Duke), Berk Sensoy (Ohio State) and Carsten Bienz. The program focused on a critical discussion of what PE can bring to the table for large investors.

David Robinson reviewed recent evidence on the returns that large investors (‘LPs’) can expect when investing into private equity. He pointed out that, based on historical returns, one should expect to outperform the market on a net of fee basis. He also emphasised the importance of using the Public Market Equivalent as a performance evaluation tool rather than the IRR.

Berk Sensoy highlighted the secondary market for private equity and discussed various ways for investors to build up a stake in Private Equity without having to rely on the primary market. Thore Johnsen discussed the limitations for an asset allocation policy that relies primarily on equities.

The Conference concluded with a panel discussion between David Robinson (Duke), Berk Sensoy (Ohio State), Benedicte Schilbred-Fasmer (DNB), and Tore Sirevaag (KLP). The presentations are available upon request.

## *Centre in the Press*

On 6 December, Carsten Bienz' feature article "Mange bekker sma" ("Many small streams") was published in Bergens Tidende. Read the article [here](#).

On 30 October, [Aksel Mjøs](#)' feature article "Staten hindrar best mogleg pensjon" ("The State curbs best possible pension") was published in Aftenposten. Read the article [here](#).

---