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WHITEPAPER

PE Value Creation Through Digital Transformation

Can Overhauling Traditional Operating Models Yield **Big Returns**?

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Exploring value creation inside and outside of technology

Technology has delivered strong revenue growth for past 10 years. Investors have benefited from robust EBITDA margins at entry and deal pricing. Combined, both drivers supported strong value creation.

Conversely, outside of tech, there is negative value creation contribution from operating margin developments and other factors.

Yet the pandemic has accelerated a structural shift. We are experiencing significant change in digitization and technological transformation across all industries. Non-tech companies are investing in their digitization, creating opportunity for investors who benefit from lower entry pricing multiples and runway to transform the business.

In this report, we evaluate 20+ years of performance of more than 15,000 portfolio companies to derive insights to help investors maximize performance.

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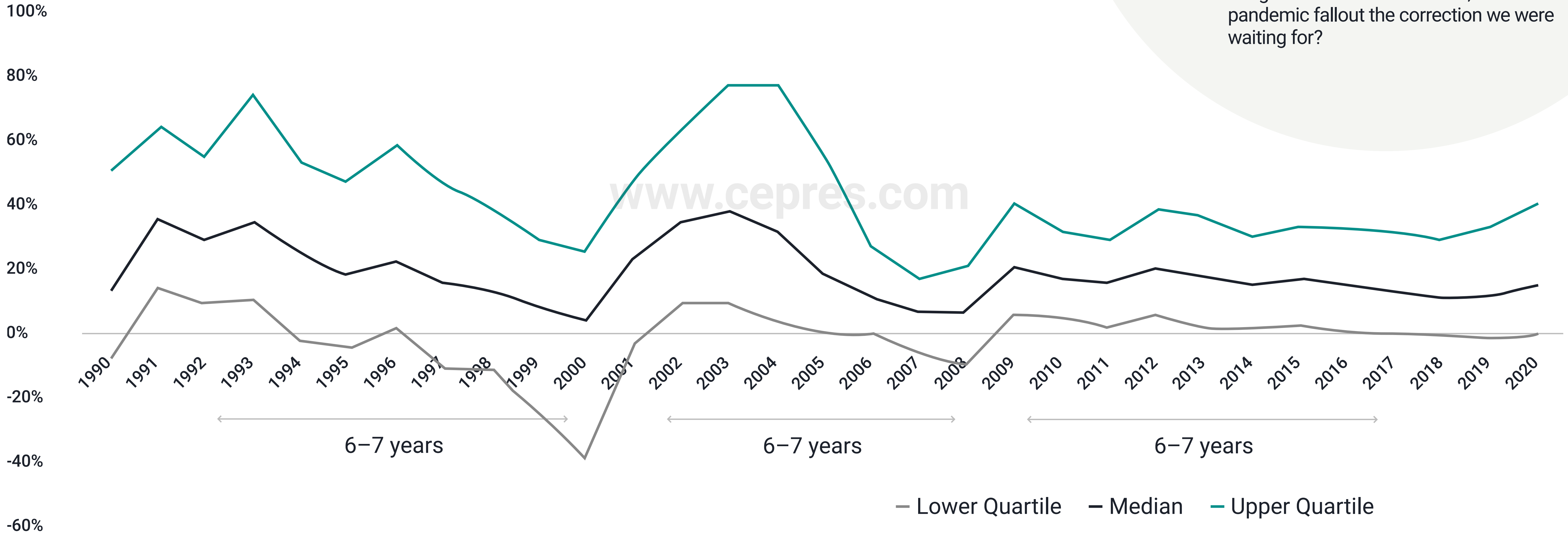
Overall gross return profile across market cycles (company level)

- Buyout & growth equity historically run on a six to seven year cycle
- Median and top quartile have moderated down from investment years 2012-2018. Where is the correction?
- Long overdue for a correction, but was pandemic fallout the correction we were waiting for?

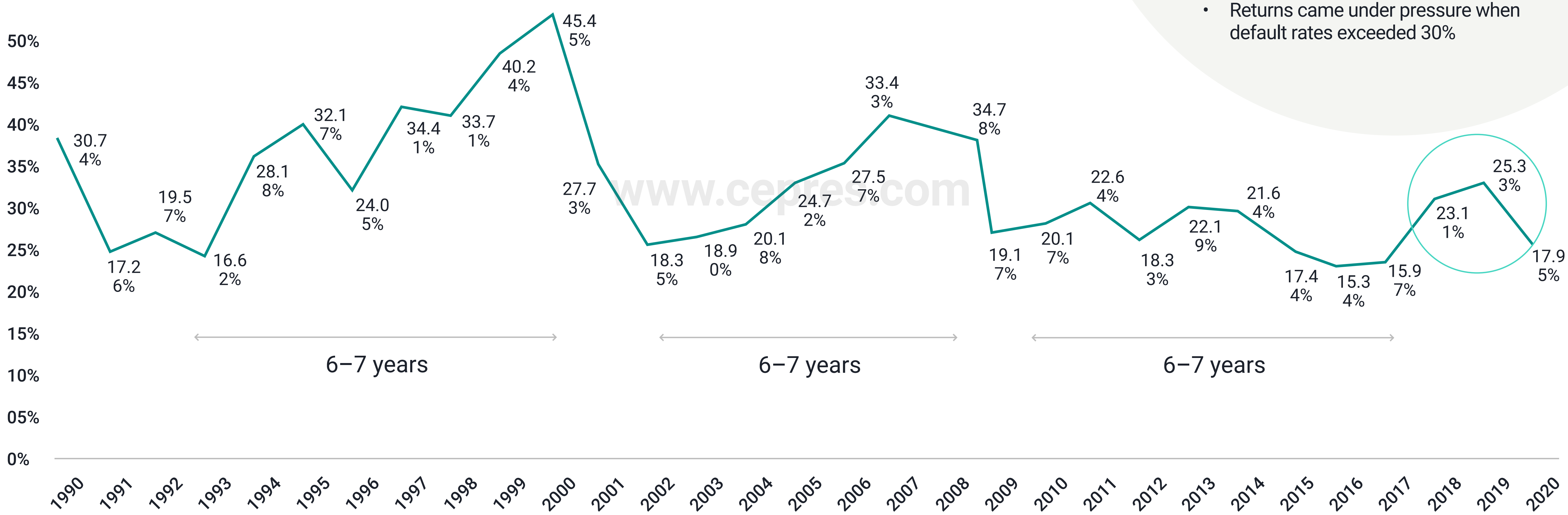


Source: CEPRES Market Intelligence

Private Markets Growth & Buyout Company Level Gross IRR Return Spread by Investment (USD)

Overall downside risk developments (company level)

- Default rates run on a six to seven year cycles, but there was an extended period of low defaults between 2009 & 2017
- Incremental rise for investment year 2018 and 2019 deals
- Returns came under pressure when default rates exceeded 30%



Buyout & Growth Deal Default (TVPI<1x Rate by Investment Year)

Source: CEPRES Market Intelligence

Not all value creation is created equally: drivers of tech vs. non-tech industries

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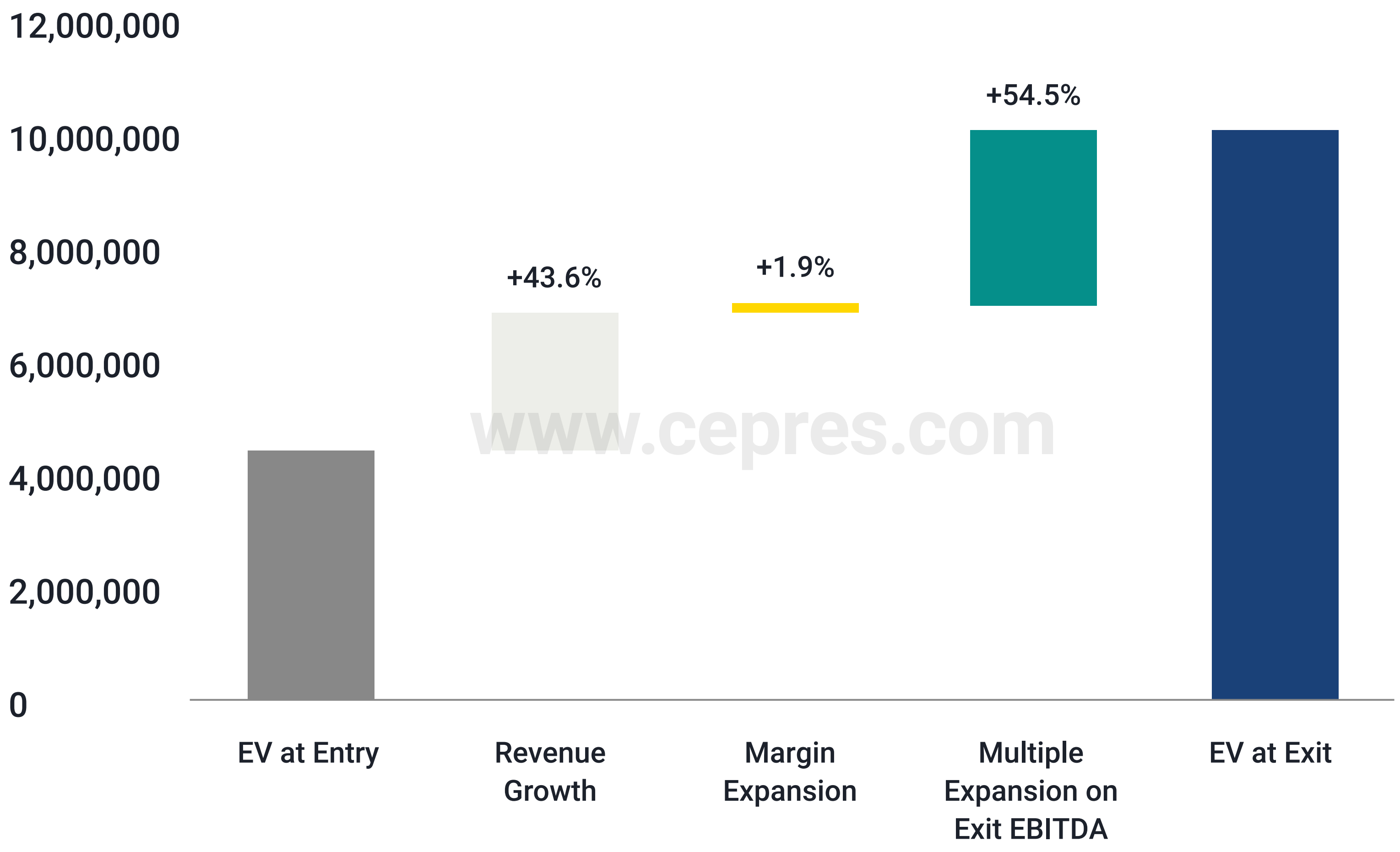
Tech industry value creation, deal investment years 1997-2020

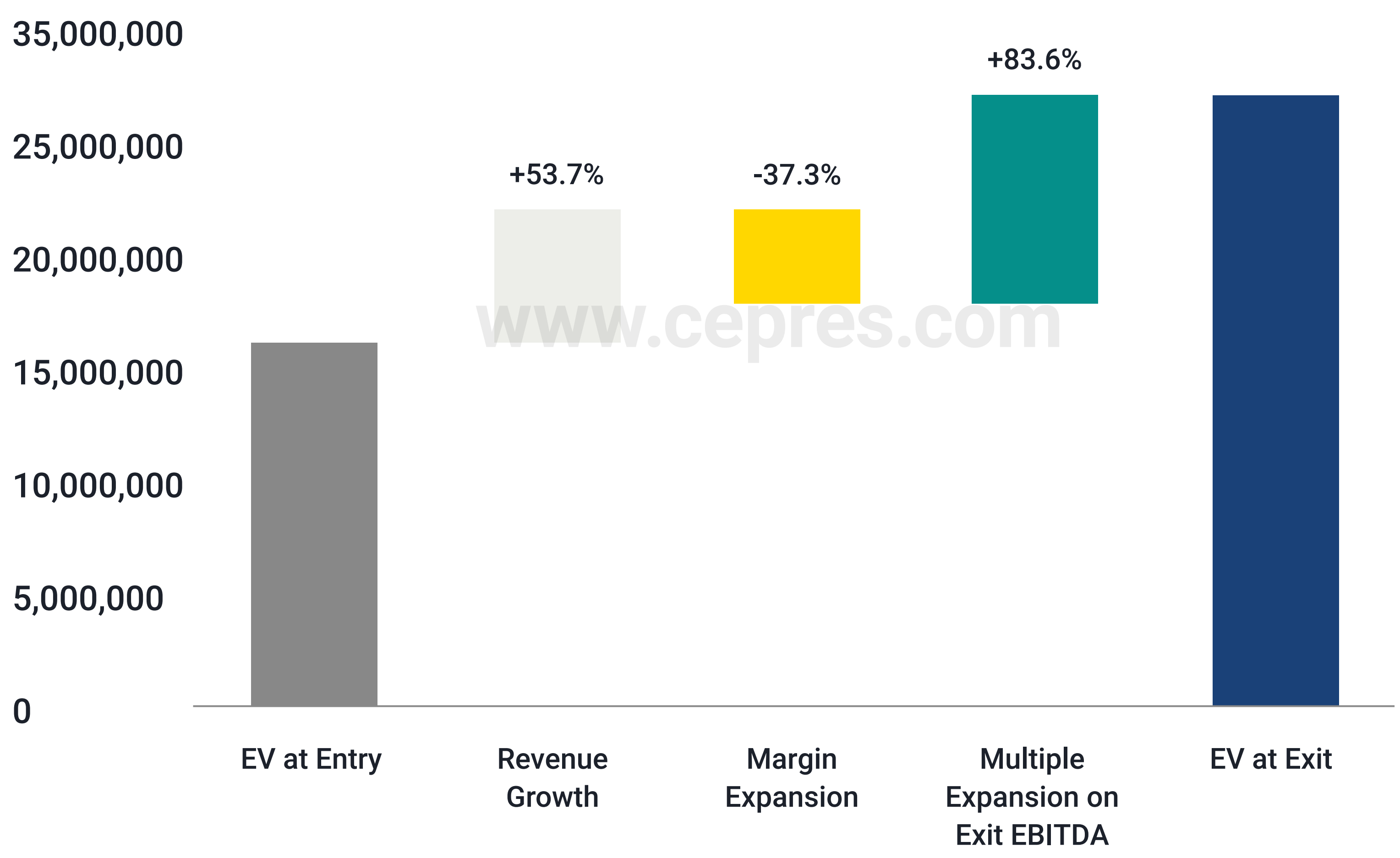


Source: CEPRES Market Intelligence

Within tech, there is proportionate balance between revenue growth & multiple expansion value drivers with minimal positive contribution from margin expansion.

This dynamic suggests that the PE value proposition to tech companies is more about growing the business and less about operational improvements.

Non-tech industry value creation, deal investment years 1997-2020



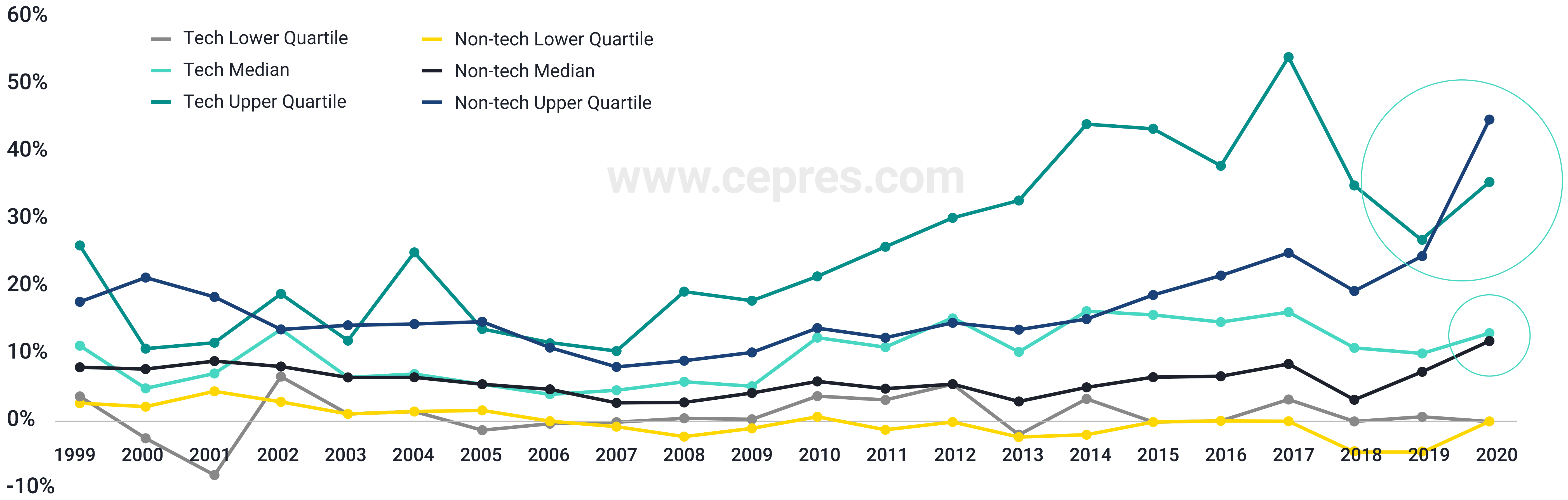
Source: CEPRES Market Intelligence

Within non-tech industries, revenue growth and multiple expansion are core drivers while margin expansion is a negative driver.

Companies are investing more in their operating business and digital transformation to propel growth. This dynamic drives multiple expansion as there are higher multiples paid for digital business models.

Is there a different PE model for different industries?

Impact of revenue growth: revenue CAGR by deal investment year



Source: CEPRES Market Intelligence

After years of accelerated growth in tech, more moderate growth rates are upcoming

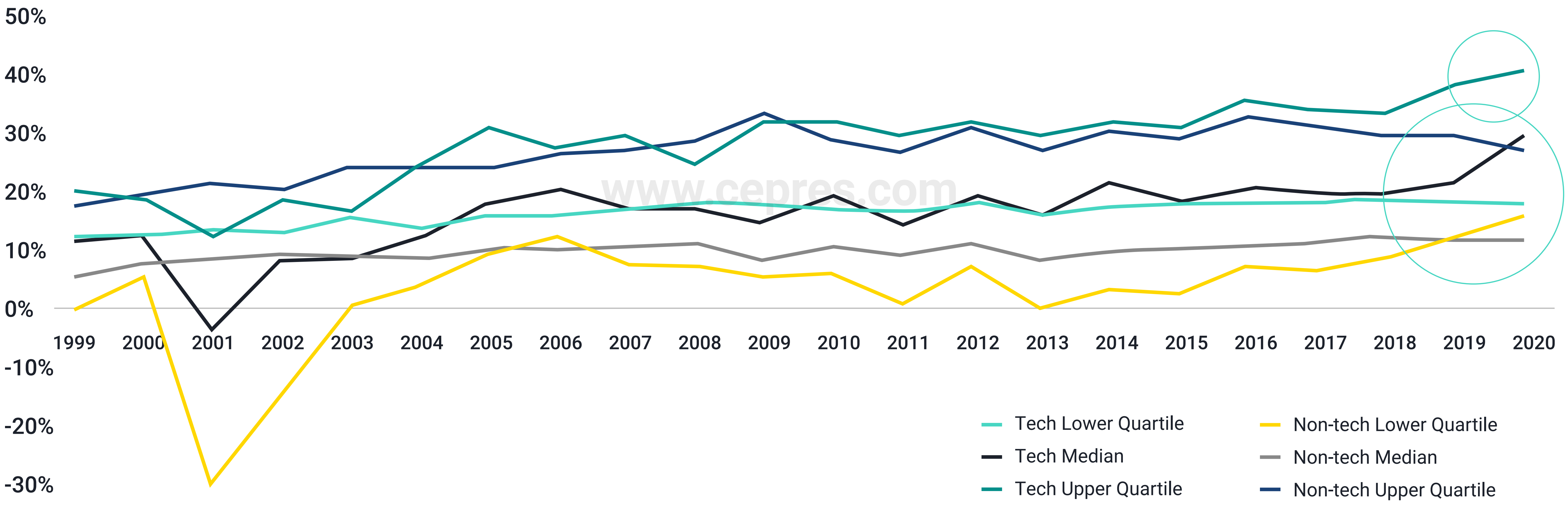
Is non-tech transformation a driver of revenue growth based on low entry?

From 2008-2018, tech revenue growth was the leader in upper quartile. Non-tech upper quartile and median are quickly catching up. The 2019 and 2020 performance of non-tech vs. tech suggests there is more headroom for non-tech industries — especially consumer and real estate — to digitize their business to grow revenue.

This approach played out in public markets with successful transformations at many tier one businesses who successfully pivoted into a digital-first operating model leading into and out of the pandemic.

The opportunity for non-tech portfolio companies to digitize to grow revenue is tremendous.

EBITDA margin at entry by investment year



Source: CEPRES Market Intelligence

From 2019, margins rose sharply for tech deals and revenues have grown faster than costs

Margin expansion: is the PE model of operational improvements still valid?

In many portfolio companies, operational improvements no longer focus on cost cutting. Instead, they center on building new digital channels of revenue generation and a digital-first operating model, commanding higher multiples and revenue growth.

These investments happen in traditional businesses, and the PE company is seeking to maximize impact and margins.

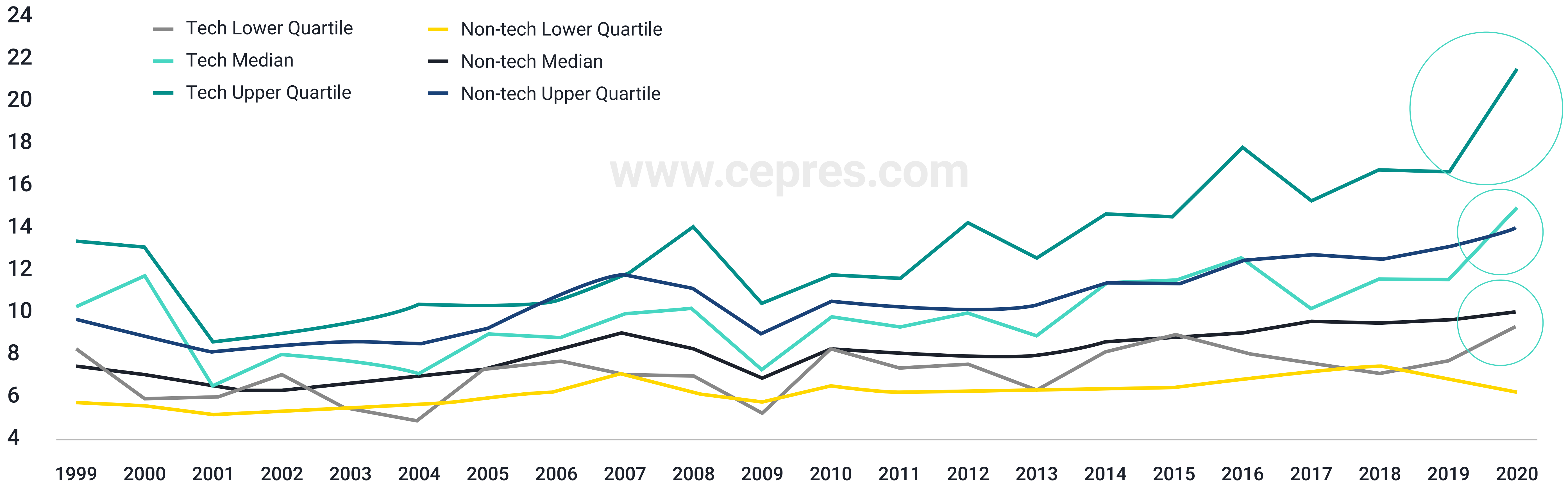
Tech businesses — including traditional businesses now operating as a tech business — will show higher margins in the future, potentially creating opportunities.

EBITDA margins: tech companies on the rise, non-tech decline. Is this the new PE opportunity?

Valuation multiple growth has more impact on EV-generation in non-tech areas due to new valuation principles that can be applied after digital transformation and a repositioning of the business model as a digital one.

Pandemic-driven digitization impacts tech bottom-line while non-tech margins are in steep decline during the same period. This situation suggests an opportunity for PE investment in low margin non-tech companies and transforming the business to drive value creation.

Deal pricing EV to EBITDA at entry, by investment year



Source: CEPRES Market Intelligence

Tech median now exceeds non-tech upper quartile, & tech lower quartile is approaching non-tech median

Value generation from entry to exit by multiple expansion

Investors are paying a significant premium for tech's high EBITDA margins at entry, impacting potential returns and exit multiples. With tech upper quartile and median taking off, this dynamic appears unlikely to decelerate anytime soon.

Rather, as more money chases increasing multiples, it appears that the typical private equity value creation play still holds water. As the playbook moves from buy and hold to buy and transform, traditional businesses appear to be undervalued, especially from a revenue growth perspective, creating opportunity for outsized returns.

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