Master Thesis

Master of Science in Finance and Strategic Management

Copenhagen Business School

The Business Model of Private Equity Funds and Its Drivers of Value Creation

An Empirical Case Study of Joe & the Juice

Authors:
Alexandra Rosenberg, 93925
Milena Hakanpaa, 116284

Date of submission: May 15, 2019
Supervisor: Daniel Wekke Probst
Number of pages and characters: 117 pages, 272.872 characters

Executive Summary

The private equity industry has grown significantly since its emergence and continues to attract increasing capital from investors year after year. However, despite a considerable amount of research conducted on private equity, there still exists little understanding of the private equity business model regarding how private equity funds generate returns for the investors. In particular, investors have limited insight as to how value is actually created on the portfolio company level rather than at the private equity fund level. Nonetheless, it is this value creation process that eventually translates into returns. Hereby, the purpose of this thesis is to answer the following problem statement:

What is the business model of private equity funds and how does it drive value creation for its investors, both in theory and in practice?

To shed light upon the first aspect of the problem statement, a theoretical framework has researched the business model of private equity funds and identified three key drivers of value creation, namely, financial leverage, multiple expansion, and operational improvements. The research finds that while financial leverage and multiple expansion still contribute to the returns generated by private equity funds, operational improvements now represent as much as 50% of total returns. This value driver has shown to exceed the conventional emphasis on driving revenue growth and margin improvements in the portfolio companies to also involve improvements within human capital and strategy. Thus, it appears private equity funds take an active role in the value creation on the portfolio company level.

To research this in practice, the thesis has conducted an empirical case study of Swedish private equity fund Valedo and its investment in Joe & the Juice. Since the investment, Joe & the Juice has grown from a Danish company with 52 stores in 2013, to a multinational company with 210 stores in 15 countries worldwide in 2017. Through a holistic analysis of the Joe & the Juice, the thesis has examined how Valedo has employed the identified key value drivers to enhance value creation. The analysis indicates that Valedo has mainly implemented operational improvements with emphasis on driving revenue growth. To quantify the potential value creation, an LBO model has been built based on forecasting and underlying assumptions. The model estimates a gross IRR of 36% for Valedo and its investors if the investment is exited in 2020 with an exit multiple of 8x. Hereof, considering the consensus that private equity investments should yield a gross IRR of 25%, the findings suggest that Valedo has successfully created value on the portfolio company level and hereof for its investors.

Table of Contents

1. Introduction

Since the early 1980s, the private equity (PE) industry has grown tremendously. On a global level, the PE industry grew from $870 billion in 2004 to $2,5 trillion in 2016, in which year PE funds invested an equivalent of $60,3 billion into almost 6000 companies in Europe (Preqin, 2017; Caselli & Negri, 2018). Hereof, it is evident that PE has come to play a significant role in today's financial markets, fostering the investment ecosystem and helping economies to flourish by providing investors with investment opportunities and companies with sources of funding, knowledge, and skills.

Nonetheless, over the last decades, the regarded superior performance of PE relative to public equity has been questioned by several academics and practitioners (e.g. Ilmanen, Chandra & McQuinn, 2019; Harris et al., 2016) investigating the risk-adjusted returns. These state that the performance gap between PE over public equity is narrowing, suggesting that the value created by PE funds for its investors relative to public equity markets may be declining. Despite this, PE funds continues to fundraise increasing amounts of capital from investors year after year.

In this regard, PE has become a focal point of financial research investigating the value creation of PE funds (Braun et al., 2015). However, as a considerable amount of research investigates returns on the PE fund level, investors have limited insight as to how PE funds create value on the portfolio company level to generate returns. Consequently, a research gap currently exists in relation to the PE business model and its drivers of value creation. Hereof, this thesis intends to narrow the identified research gap by investigating how PE funds drive value creation on the portfolio company level, both in theory and in practice.

To investigate the research gap in practice, the thesis examines the case of Swedish PE fund Valedo and its investment in the Danish juice bar brand Joe & the Juice. In 2002, Joe & the Juice was founded by Kaspar Basse and has established itself as a "go-to place for health-conscious people who like their fresh-pressed juice served with a side of edgy" (Raphael, 2018). The company has grown from a single store in Copenhagen in 2002, to 210 stores in 15 countries worldwide in 2017 (Joe & the Juice, 2017). In 2013, Valedo entered Joe & the Juice with a majority stake and has thus been the majority owner of the company for the past six years. Hereby, this investment case is used for an empirical case study to examine to what extent Valedo has assisted Joe & the Juice in achieving its experienced growth and hereof created value for investors.

1.1. Problem Statement

In the context of the research gap identified above, the problem statement that the thesis seeks to answer is:

What is the business model of private equity funds and how does it drive value creation for its investors, both in theory and in practice?

–

An Empirical Case Study of Joe & the Juice

In order to provide a thorough answer to the problem statement, the thesis has been broken down into two parts. The first part relates to the theoretical aspect of the problem statement for which the following sub-questions will guide the theoretical framework to be built:

1. *What are the main characteristics of private equity funds and, historically, how have the practices of the industry developed over time?*
2. *How are different frameworks and tools utilized by private equity funds to identify, analyze, and guide potential investments?*
3. *What are the key value drivers of the business model of private equity funds, and how does each play a role in the value creation process?*
4. *How do private equity funds evaluate the performance of their investments from entry to exit where a potential return is realized?*

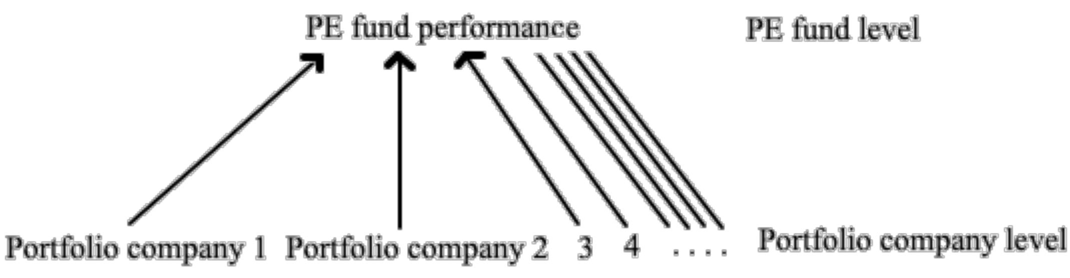
In regard to the second part of the thesis, the theoretical framework will be employed to analyze the empirical case study of Valedo and its investment in Joe & the Juice. For this part of the paper, the following sub-questions will guide the analysis:

1. *How has Joe & the Juice proved fit as an investment case for the business model of Valedo given its investment objectives and criteria?*
2. *To what extent has Valedo improved the performance of and created value for Joe & the Juice by employing the key value drivers?*
3. *What could be a potential exit strategy for Valedo concerning its investment in Joe & the Juice, and what might its implications be?*

Hereof, the first part of the thesis will provide the theoretical framework to obtain an understanding of the PE business model and its drivers of value creation, whereas the second part will consist of the empirical case study analysis. Prior to the research section of this paper, the methodology section outlines the adopted research philosophy, the research process, as well as delimitations and limitations of the thesis.

2. Methodology

This section outlines the research process that has laid the foundation for the thesis, and explains what is intended to be researched, how the research has been planned, and what is the underlying justification of the research. For this research, the form of questions is *what* and *how* concerning the PE business model and its value creation for investors. This is further explored through an empirical case study of Valedo and its investment in Joe & the Juice and thus takes form as a qualitative research, using the design of a case study to explore this specific situation. Whereas the theoretical framework sheds light on the problem statement mainly on the macro level, that is the PE fund level, the empirical case study examines it on the micro level, that is the portfolio company level. Thus, by analyzing the specific investment case of Joe & the Juice, the research moves from investigating the more general practices of PE funds to the specific practices of Valedo. This is done in order to obtain a deeper understanding of how value creation can take place within the individual portfolio companies that aggregated result in PE fund performance. Therefore, the focus of this research is to investigate how PE funds create value on the portfolio company level rather than on the PE fund level (see Figure 1).



(*Figure 1:* own creation)

The research presented in this thesis is the outcome of a two-parted process and the paper is thus structured accordingly with both parts culminating into a final discussion and conclusion. The first part constitutes a critical literature review on the given topic, which, in turn, provides the context and theoretical framework for the second part of the research that consists of an empirical case study. More specifically, the case study will investigate to what extent Valedo has employed different value drivers to create value in Joe & the Juice and what are the potential prospects for exiting the investment. These findings will then be placed within the provided body of knowledge and will form part of the final discussion and conclusion. Both parts of the thesis share the same reason of research, namely, to investigate how PE funds generate returns for investors through driving value creation on the portfolio company level.

2.1. Research Philosophy

As stated by Saunders et al. (2016), every step of the research process involves making philosophical assumptions. Such assumptions inevitably shape our understanding of the stated research question, the methods used, and how to interpret the findings. Additionally, Johnson and Clark (2006) stress the importance of recognizing the philosophical commitments researchers make through the choice of research strategy, as it significantly affects how research is conducted and the understanding of what is researched. Taking this into account, we find it relevant to clarify the research philosophy adopted in this paper, as it points to the assumptions taken to support the chosen research strategy and methods. As we consider it wrong in principle and unrealistic in practice to decide on only one particular point of view, we have adopted the research philosophy of the pragmatist. According to Saunders et al. (2016, p. 143):

> "Pragmatism asserts that concepts are only relevant where they support action. [...] It strives to reconcile both objectivism and subjectivism, facts and values, accurate and rigorous knowledge and different contextualized experiences."

In accordance with the pragmatist view, we find the most crucial determinant for research strategy is the problem statement and the relevant research questions, as specific assumptions adhere to specific purposes and thus vary according to the aim of the research. Yet, we recognize that as researchers our own values and beliefs inevitably affect our interpretation of research materials and data, and thus plays an important role in the research process.

Hence, the adopted pragmatism philosophy leans towards the interpretivist view, acknowledging that to a certain degree, the findings will be researcher dependent. This is especially the case within business and management research, as organizations are both complex and unique, especially in terms of the specific context. Thus, organizations reflect a particular set of circumstances and interactions involving individuals and groups of individuals coming together in a specific setting.

2.2. Two-Parted Research Process

In order to arrive at a comprehensive answer to the problem statement, we will examine the interactions between the more general theoretical framework and the specific situation of Valedo and Joe & the Juice. Thus, following the research design of a case study, data collection and analysis are conducted using the methodological approach of triangulation. Employing the triangulation method will heighten the validity of the research as it allows us to use multiple methods to collect data on the same area. As a result, we are able to utilize the most suitable approaches for each part of the paper, and thus, also able to capture different dimensions of the case study research.

2.2.1. Part 1: Theoretical Framework

For the first part of the thesis, the research has taken a deductive approach where the literature reviewed has assisted in the development of the theoretical framework. According to Saunders et al. (2016, p. 74), the critical literature review on which the theoretical framework is built can be characterized as a systematic review:

> "which uses a comprehensive pre-planned strategy for locating, critically appraising, analyzing and synthesizing existing research that is pertinent to a clearly formulated research question to allow conclusions to be reached about what is known."

The systematic review is based on both primary and secondary data. As secondary data, the research is grounded on a search of relevant academic and practitioner literature from sources such as books, articles, and online sources. This provides the foundational knowledge of the PE industry, its historical development, and the PE business model, for the research of this paper. With the specific focus on the PE business model and its drivers of value creation, the literature review is conducted to achieve a thorough understanding of the important elements interacting with and influencing the value creation process that takes place at the portfolio company level.

We acknowledge that various views and opinions exist regarding PE, and therefore, the chosen literature to be reviewed will shape the research lens of this paper. Hence, changes to the theoretical framework could potentially shift the focus of the research and therefore lead to alternative findings.

To support the knowledge acquired from the literature review, while at the same time obtaining in-depth insights into the PE business model, primary data has been collected through one-on-one interviews with professionals working in the PE industry. Two one-hour long interviews were conducted with two professionals from Danish PE funds. One of the interviews was with J. Breitenstein who is working as an investor relations officer and the other was with N. Retbøl who holds a partner position. Both interviews took place at the premises of the PE funds to accommodate the interviewees and to ensure a neutral and relaxed environment. The primary data has been obtained solely from one geographic area, Denmark. Thus, it is important to acknowledge that these findings cannot be claimed representative of PE funds in general as this would require more extensive data collection, both in terms of the number of interviews conducted and the geographical diversity. Additionally, while both interviewees can be considered subject matter experts due to their extensive careers within the PE industry, we acknowledge that primary data is subjective by nature in the sense that views and opinions are influenced by personal biases and experiences. Thus, interviewing two other PE professionals could have yielded slightly differing findings. With this in mind, we have chosen to use the interviews solely for the purpose of complementing the literature review with practical examples which together constitute the theoretical framework. Additionally, one one-hour follow-up interview was conducted with J. Breitenstein with the purpose to obtain the secondary opinion of a professional on the case of Joe & the Juice.

2.2.2. Part 2: Empirical Case Study

As the problem statement of this thesis takes form as *what* and *how*, accordingly, we found it appropriate to follow the design of an exploratory case study research. According to Yin (2014, p. 15):

> "The essence of a case study, the central tendency among all types of case study, is that it tries to illuminate a decision or set of decisions: why were they taken, how they were implemented, and with what result."

Also, as researchers, we have no control over the behavioral events related to the research, which is distinctive for a case study. Yin (2014, p. 16-17) argues that a case study involves a twofold definition:

> "A case study is an empirical inquiry that investigates a contemporary phenomenon (the 'case') in depth and within its real-world context, especially when the boundaries between the phenomenon and context may not be clearly evident.
>
> A case study inquiry copes with the technically distinctive situation in which there will be many more variables of interest than data points, and as one result relies on multiple sources of evidence, with data needing to converge in a triangulation fashion, and as another result benefits from the prior development of theoretical propositions to guide data collection and analysis."

The twofold definition indicates that case study research is an all-inclusive method, taking into consideration both the design of the research, as well as the data collection techniques and the data analysis procedures. In relation to data collection, one of the strengths of a case study research design is its ability to draw on several types of data. Particularly, for this case study, we employed interviews, observations, and relevant documents such as books, articles, and journals. However, case study research also carries weaknesses that are concerned with, for example, lack of rigor, unmanageable levels of effort, and generalizations based on single case contexts. In order to diminish the weaknesses of the case study design, we have followed interview protocols and interview guides (see Appendix 1), have scheduled a strict research plan, have made sure to note our considerations, and have checked off the milestones of our research as it progressed.

Furthermore, it is important to underline that this research is not intended to be generalizable, but rather attempts to explore in-depth how PE funds can drive value creation on the portfolio company level. Additionally, as previously stated, we acknowledge that the findings of our research may be affected by personal bias. Finally, we are aware that other relevant methods and approaches exist, however, we have chosen the aforementioned methodological approaches and research design as most appropriate for our problem statement and research questions. Furthermore, the scope of our paper is an outcome of the delimitation and limitations, which we will set out in the following section.

2.3. Delimitation and Limitations

To provide a thorough and in-depth answer to the problem statement of this thesis, the scope and delimitations of the research ought to be clarified. This is especially important due to the complexity of the PE industry and the perplexity of the used terminology.

Firstly, the term *private equity* (PE) is widely used by academics and practitioners in the industry with often varying definitions and denotations. In this paper, the term PE is employed to denote enterprise capital investments into companies in the later stages of development. Thus, we have chosen to focus the research on PE funds that primarily take part in buyout investments, that is, investments where PE funds buy a majority stake in the companies (Invest Europe, 2018). The chosen definition and the extent to which we have applied the term PE will be explained in detail in the first part of the thesis. Here, a distinction between PE and the closely related venture capital (VC) will also be made.

Secondly, in addition to the first delimitation, we have chosen to limit the scope to only concern buyout investments, and, more specifically leveraged buyouts (LBOs). The reasoning for this being that firstly, we find this type of PE investment particularly interesting, and secondly, in the case of the European market, buyout investments tend to represent more than the majority of total PE investments (Caselli & Negri, 2018). Additionally, such buyout investments usually take the form of LBOs where the investment is financed with a combination of equity and debt.

Thirdly, we acknowledge that the structure of a given PE fund can vary and consequently can have a significant impact on the business model and, thus, the value creation processes taking place on the portfolio company level. With that in mind, the research of this paper strictly focuses on the business model employed by PE funds that follow the limited partnership model, as defined by Braun and Schmidt (2014). Hence, we will not investigate the value creation processes of PE funds that are established with a different structure.

Fourthly, it is important to stress that the theoretical framework examines the PE business model in a general matter and thus does not consider the potential differences across market segments in terms of regions, industries, and sizes of investments. In this regard, the thesis does not aim to account for and explore possible variations in the value creation processes taking place in different PE markets.

Rather, the theoretical framework draws upon a general body of knowledge to be utilized for the exploration of the specific case study of Valedo and its investment in Joe & the Juice.

Finally, in regard to the empirical case study, a crucial limitation involves the limited access to internal information from Valedo and Joe & the Juice. Consequently, the research will only be based on publicly-available information and thus the findings will be dependent on the quantity and quality of the external data obtainable about the case. That being considered, access to internal information from the companies could have enabled us to arrive at a more holistic and precise answer to the problem statement. With this limitation in mind, the research adopts the perspective of a potential external investor as they need to make investment decisions with often limited access to internal company information. Accordingly, the analysis involves several assumptions that are clarified throughout the second part of the thesis.

Having outlined the methodology employed for the purpose of this thesis, the paper now progresses to the actual research. As mentioned, the thesis is divided into two main parts as a consequence of the two-parted process. The first part provides an understanding of the basic characteristics of PE funds and the historical developments of the industry in regard to the use of value drivers. Additionally, the PE business model is explored by examining the PE business cycle and analyzing the different value drivers as to how they can enhance value creation. This part of the thesis concludes with a discussion reflecting upon the findings culminating in a conclusion of the theoretical framework. The second part of the paper thus dives into the analysis of the empirical case study for which the theoretical framework will be utilized. This part begins with an introduction to Valedo and its investment case of Joe & the Juice. Subsequently, the portfolio company will be analyzed from both a strategic and financial perspective before investigating to what extent Valedo has employed the identified key value drivers in this specific investment case. At last, a discussion will take place to evaluate the potential value created by Valedo in Joe & the Juice, as well as to explore the prospective exit strategies and implications before the final conclusion is provided.

Theoretical Framework

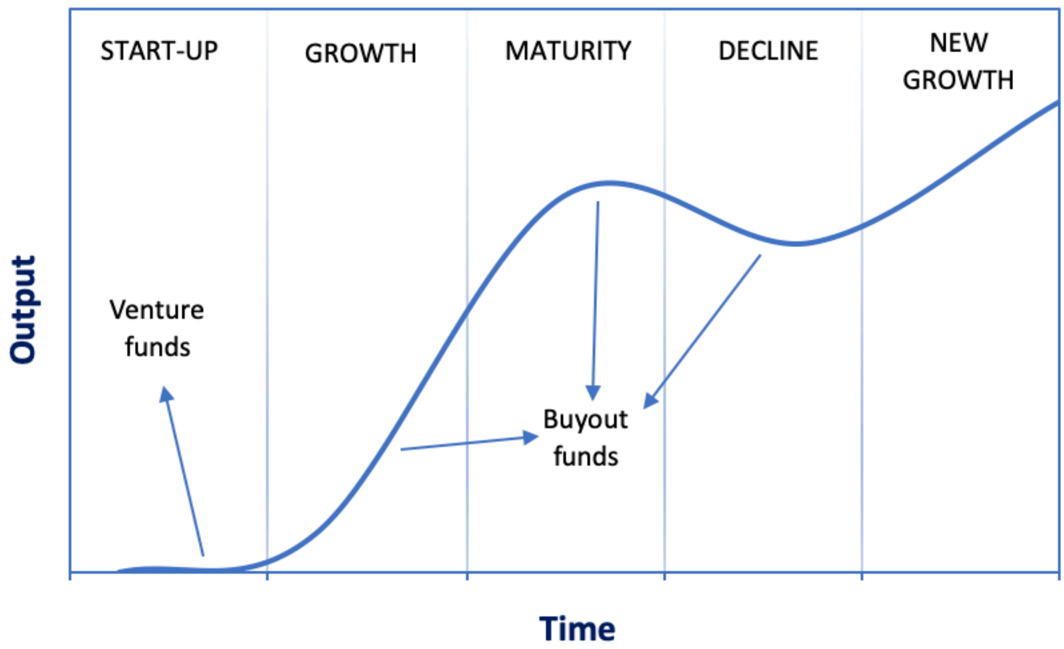
3. Private Equity Funds

3.1. Characteristics of Private Equity Funds

PE is an asset class and consists of capital that is not listed on a public exchange. Therefore, the exchange of PE is realized between buyers and sellers outside the marketplace where investors, also known as limited partners (LPs), allocate capital to PE funds that directly invest in private companies or engage in delisting of public equity (Caselli & Negri, 2018). As PE is widely used with varying definitions and denotations, it is important to outline what PE denotes when used for the scope of this thesis. The term PE will be used within this research context to define enterprise capital as "[PE] investment into more established businesses that want to internationalize, professionalize, or develop their products and services." (Invest Europe, 2018, p. 10) Thereby, this paper will not consider PE in relation to the closely-associated and sometimes intertwined area of VC. To establish the difference between PE and VC, we use the notion of Caselli and Negri (2018, p. 5) who state that:

> "According to the American approach, [VC] is a cluster of [PE] dedicated to finance new ventures. Therefore, [VCs] fund companies in the initial phases of life, whereas [PE] operators finance companies that have completed at least their first growth process. The European definition proposes that [PE] and [VC] are two separate clusters based on the life cycle of the firm. [VCs] provide the funding for start-up businesses and early stage companies, whereas [PE] operators are involved in deals with firms that find themselves in their mature age of the life cycle."

Regardless of the American or European approach, VC refers to investments in companies who are in the early stages of development, whereas PE refers to investments in the later stages of a company's development (see Figure 2).



(*Figure 2*. Company Development Stages. Adapted from Demaria, 2010)

At the later stages of development, PE funds tend to engage in buyout investments where PE is invested in more established companies with the objective to continue strengthening the companies through restructuring, consolidation, and/or expansion (Demaria, 2010; Invest Europe, 2018). Such buyout investments tend to be LBOs.

In a classic LBO, a PE fund normally acquires a majority stake in the portfolio company, financing the investment with a relatively small amount of equity and the rest of the balance with debt (see Figure 3). The PE fund may utilize the assets of the acquired portfolio company as collateral for the raised debt, as well as use the future generated free cash flows (FCFs) for debt repayment (Caselli & Negri, 2018; Robertson, 2009). Usually, as a result of the highly leveraged capital structure of the portfolio company, interest expenses tend to be so significant that the formerly quite profitable company may report a reduced net income in the following years as an LBO (Fridson & Alvarez, 2011). Nonetheless, as can be seen from the cash inflows and outflows in the classical LBO example below, it can still turn out to be a profitable investment.

LBO Forecast - Base Case (mln DKK)						
Capitalization						
December 31, 2014						
Senior debt	900	45%				
Subordinated debt	500	25%				
Total debt	1.400	70%				
Common equity	600	30%				
Total capital	2.000	100%				
Projected Income Statement						
	2014 (act.)	**2015**	**2016**	**2017**	**2018**	**2019**
Sales	1.429	1.543	1.667	1.800	1.944	2.100
- Cost of sales	800	864	933	1.008	1.089	1.176
- SG&A	286	309	333	360	389	420
- D&A	100	108	117	126	136	147
Operating income	243	262	284	306	330	357
- Interest expense	45	108	100	91	80	68
Income before taxes	198	154	184	215	250	289
- Taxes	65	51	60	71	83	95
Net income	133	103	124	144	167	194
Projected Cash Flow						
		2015	**2016**	**2017**	**2018**	**2019**
Net income		103	124	144	167	194
D&A		108	117	126	136	147
Cash from operations		211	241	270	303	341
- property and equipment additions		100	108	117	126	136
Cash available for debt reduction		111	133	153	177	205
Projected Capitalization						
	2014 (act.)	**2015**	**2016**	**2017**	**2018**	**2019**
Senior debt	900	789	656	503	326	121
Subordinated debt	500	500	500	500	500	500
Total debt	1.400	1.289	1.156	1.003	826	621
Common equity	600	703	827	971	1.138	1.332
Total capital	2.000	1.992	1.983	1.974	1.964	1.953

(*Figure 3*: own creation adapted from Fridson & Alvarez, 2011)

In the above example, from 2014 to 2017, net income increased by only 8% despite a 26% advance in sales. However, within the same period, the company is generating cash and has reduced its borrowings (Fridson & Alvarez, 2011). In an LBO, equity investors usually agree not to receive dividends, but rather dedicate any generated FCFs towards the debt reduction. Additionally, as shown in the example, the continuous debt repayment causes interest expenses to decrease, and thus net income increases over time. With depreciation and amortization (D&A) rising as well, cash flows from operations outride the growing capital expenditure (CAPEX) requirements (Fridson & Alvarez, 2011).

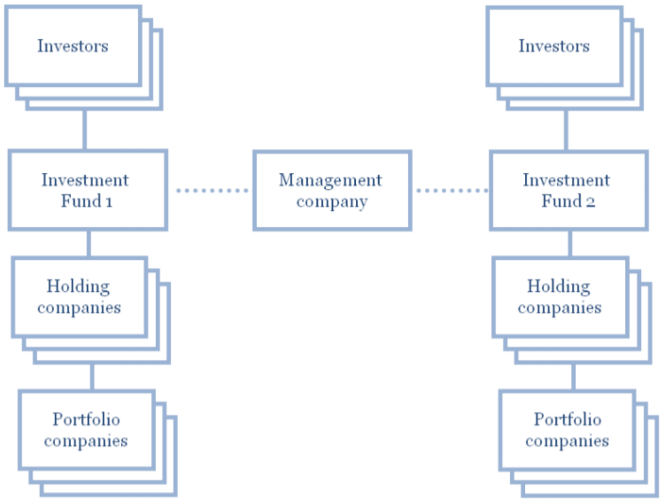
Despite being a potential profitable investment, an LBO also carries significant risk for its equity investors, which in this case represent the PE fund and its LPs. One risk is that the portfolio company defaults resulting in a loss of the entire investment made. For example, there is a risk that revenues and operating earnings will fall short of expectations or that the high interest expense turns disappointing operating income into a substantial loss (Fridson & Alvarez, 2011). This loss may be so large that even after D&A is added back, the portfolio company may still experience a significant net loss. Hence, a risk associated with LBOs is the risk of default due to financial distress and, thus, using less debt to finance the investment could reduce these risks. Nonetheless, the higher levels of debt may improve the internal cash flows and provide interest tax shields as a result of increased leverage and thus higher debt-to-equity ratio (Kaplan & Stein, 1990). Given the crucial importance of generating FCF to debt repayment and the fact that PE funds do not expect dividends, showing an accounting profit does not provide any benefits to the investment. Hereof, the cash flow statement is the most useful tool for examining LBOs as it reflects the ability of the portfolio companies to generate cash flows rather than to maximize reported income (Fridson & Alvarez, 2011)

PE investments, such as LBOs, are usually much bigger than VC investments. This can partially be explained by the difference in the size of equity that is bought in the portfolio companies. Applying this logic, whereas PE funds acquire majority stakes in companies to obtain control, VC funds typically acquire minority stakes leaving the control and ownership to the portfolio company. These differences in ownership structure have important implications for the strategic objectives of the investments. On one hand, majority ownership is required for PE funds to have the decision-making power to implement the intended operational and strategic improvements in the portfolio company to enhance value. On the other hand, for VC investments, the remaining ownership of the founder ensures her or his commitment to continue pushing the development of the business forward (Arundale, 2010).

As a result of the different strategies of PE and VC funds, the related investment risks between the two also differ significantly. For PE funds, the potential risks of financial distress and/or default are significantly higher due to the increased levels of debt in the portfolio companies. Consequently, the higher levels of debt increase not only the risk within the portfolio companies, but also the entire portfolio of the PE fund (Kaplan & Stein, 1990). Contrarily, VC risks are often associated with the mere survival of the company that is apparent because as many as 90% of startups fail (Marmer et al., 2011). With that being said, the difference between PE and VC has been established and the denotation of the term PE for this thesis has been clearly defined. Hereof, the research will now continue with the sole focus of PE funds, the related business model, and its drivers of value creation.

3.2. The Structure of the Limited Partnership Model

To analyze the PE business model and its drivers of value creation, it is essential to first understand how PE funds are set up. In practice, a PE fund can consist of multiple investment funds, which the management company uses to build portfolios of acquired target companies. For the sake of clarity and consistency, the term *PE fund* is used throughout the paper to refer to the core of the structure, that is, the management company with its one or more investment funds (see Figure 4).



(*Figure 4*: Structure of Limited Partnership Model. Adapted from J. Breitenstein, 2018)

In the limited partnership model, a PE fund is essentially a management company run by a relatively small number of professionals, referred to as general partners (GPs). GPs raise external capital from the LPs, in order to invest in or acquire target companies that after the investment become part of the portfolio of the PE fund, hereby known as portfolio companies. After a specified holding period, the investment will be exited with the objective of realizing the potential returns generated. After subtracting management fees and other costs, the realized returns will be distributed to the LPs, who, in turn, again can allocate the capital to PE funds (Caselli & Negri, 2018). Hereby, the activities and incentives of PE funds are focused on increasing the value of the portfolio companies during the holding period in order to achieve a capital gain that will only be realized at the time of exit.

The structure of the limited partnership model involves various actors including the management company (GPs), investment funds, investors (LPs), holding companies, and portfolio companies, as shown in Figure 4. These actors will now be described to provide a thorough comprehension of the components and processes that constitutes the PE business model, and thus, directly and indirectly impact the value creation process.

3.2.1. Management Company

The management company of a PE fund is governed by GPs. The main role of the GPs is to take an advisory role and manage the portfolio companies acquired using the raised capital of the investment funds. As previously mentioned, a PE fund can consist of one or multiple investment funds depending on its size. Usually, the GPs take an active role in the portfolio companies that they manage in terms of overseeing the planning and implementation of strategic and operational improvements. Simultaneously, the GPs also work on raising capital, identifying and selecting potential portfolio companies, and closing new investment deals. GPs receive income from the management fees that LPs pay on committed capital, as well as receive carried interests if they exceed an agreed threshold regarding returns.

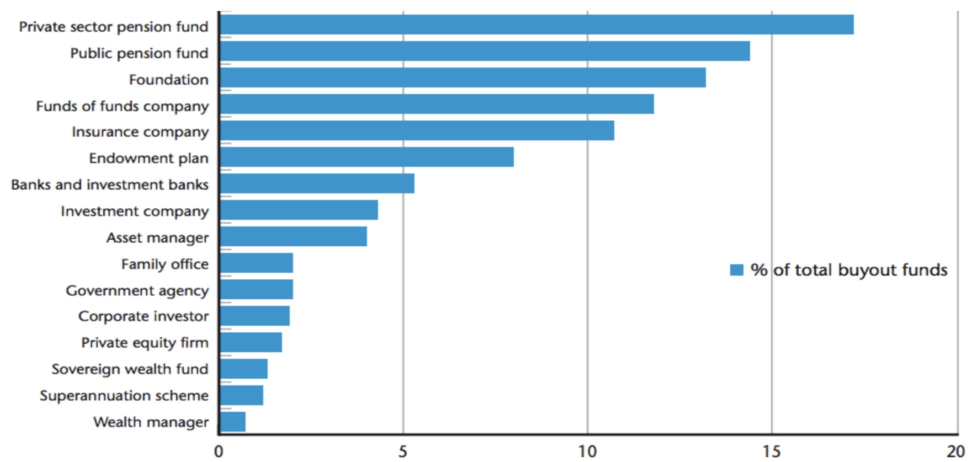
3.2.2. Investment Funds

The one or multiple investment funds that a PE fund consists of can vary greatly in size and in scope regarding investment objectives, type of portfolio companies, as well as industry and geographical focus (N. Retbøl, personal communication, 2018). Considering the number of portfolio companies in the investment funds, PE funds usually invest 8-10% of the total fund value in each portfolio company, thus equaling a number of approximately 10-12 portfolio companies in each fund (J. Breitenstein, personal communication, 2018). In this regard, the year in which an investment fund makes its first investment is referred to as the vintage year. The investment funds are usually set up as a separate limited partnership or limited liability companies with a finite economic life of 10 years (Kaplan & Strömberg, 2009). Nonetheless, if necessary, PE funds have the option of extending the life of their investment funds with an additional 1-3 years before the funds are liquidated and returns are distributed (Demaria, 2010). In this sense, the investment funds are established as closed-end funds, causing shares to not easily be sold or transferred before the funds reach the end of their economic life that has been set as a predetermined date. Therefore, PE investments are usually associated with high liquidity risk.

3.2.3. Investors

A main characteristic of the limited partnership model is the limited liability of the investors, therefore referred to as LPs. This means that the financial liabilities of LPs are limited to the amount of capital that each LP has committed to a given investment fund. In this regard, LPs make commitments to allocate a certain amount of capital to the investment funds that will be drawn over several years, usually over a 6-8 year period (J. Breitenstein, personal communication, 2018; Danske Bank, 2019). The limited partnership model provides tax benefits for the LPs as the structure ensures that the capital gains are not part of corporate income tax. Thus, double taxation is avoided as taxation only takes place at the investor level. Moreover, according to N. Retbøl (personal communication, 2018), it has become increasingly common in recent years for LPs to also participate in co-investment opportunities. This means that alongside their commitments to the investment funds, they can also participate as co-investors directly in the portfolio companies. While this exposes the co-investors to a higher risk exposure to one specific company, it may also provide them with a discount as they will not have to pay fees or carried interests on the co-investment (J. Breitenstein, personal communication, 2018).

The most common LPs of PE funds are institutional investors, where pension funds represent the main LP followed by other major institutions, such as insurance companies, foundations, banks, funds-of-funds, and government agencies (Caselli & Negri, 2018). Thus, pension funds are the single most important LP (see Figure 5) and the relationship is argued to be a consequence of the long-term investment horizon, which is highly correlated between pension funds and PE funds (Fraser-Sampson, 2010).



(*Figure 5.* Investors in Private Equity. Adapted from Preqin, 2017)

3.2.4. Portfolio Companies

Portfolio companies represent the companies that PE funds have acquired or invested in and that the GPs are managing with the objective of enhancing the companies' value to generate returns to LPs. In a later section, we will investigate the business cycle of PE funds where the process of identification, selection, and acquisition of portfolio companies, as well as the subsequent steps, will be explained in detail.

3.2.5. Holding Companies

PE funds do not need to invest in the portfolio companies directly, instead they can separate ownership by establishing a holding company structure with one or more legal structures between the investment funds and the portfolio companies. This is the type of structure that provides PE funds with the opportunity to invite co-investors in the case that a portfolio company would be too large for a PE fund to invest in by itself (N. Retbøl, personal interview, 2018). Additionally, the holding company structure enables the management to invest in unequal terms with the ownership divided into different share classes and shareholder loans (Deloitte, 2017).

When considering the various actors involved in the PE business model and their relationships with one another, agency theory provides a theoretical lens to analyze the principal-agent relationships that are apparent between PE funds and portfolio companies, as well as between PE funds and their LPs.

3.3. Agency Theory

Firstly, when looking at the apparent principal-agent relationship between PE funds and the portfolio companies, incentive systems and structures are usually implemented to align the interests of the different parties to share the common objective of creating value in the portfolio companies (Caselli & Negri, 2018). However, various aspects remain as to how value is added where the views between the parties may differ, potentially creating conflicts of interests. According to Caselli and Negri (2018), critical topics that may provoke debates and problems between PE funds and portfolio companies include: duration of PE fund involvement, strategies used to increase portfolio company value, financial and industrial alliances, and new opportunities that modify the pre-investment situation.

From the perspective of the incumbent management of a portfolio company, it is likely to have its own industrial, financial, and personal goals that may differ from the ones of the PE fund (Caselli & Negri, 2018). Therefore, it is important for the multiple parties to have built a solid foundation and try to solve all potential disagreements prior to the closing of the deal to ensure alignment of interests before the collaboration (Caselli & Negri, 2018). This is supported by J. Breitenstein and N. Retbøl (personal communication, 2018) who both state that PE funds attempt to resolve possible disputes and provide a common goal for all parties involved as early in the process as possible. As the collaboration is likely to last for several years, the unity of the PE fund and the management of the portfolio company is highly crucial for the value creation process.

The second apparent principal-agent relationship is between the PE funds and their LPs. In order to align the interests and minimize the potential principal-agent discrepancy in this context, the GPs of the PE funds normally invest in the investment funds with a contribution of 1-5% of the total capital (Demaria, 2010). As Kaplan and Strömberg (2009) note, the amount should be substantial enough to ensure that the objectives between the GPs and LPs are aligned, which is called having *skin in the game.* This means that not only do all participants benefit from the potential capital gains from the value added, but also GPs are exposed to the risks of the investment alongside the LPs (Demaria, 2010). J. Breitenstein (personal communication, 2018) confirms this and states that in some cases, the LPs can ask for the PE fund to invest as much as 20% of the investment fund to incentivize its GPs to act in the interests of the LPs. Thereby, this practice helps to ensure the LPs that the GPs will not engage in sub-optimal transactions that could be beneficial for GPs but not for LPs (Schleifer & Vishny, 1997; Kaplan & Strömberg, 2009).

Finally, according to the Boston Consulting Group (BCG, 2008), increasing attention has been given to corporate governance aspects of the PE business model such as the principal-agent problems described above. BCG (2008) states that PE funds increasingly focus on attracting more sophisticated LPs, which refers to investors with essential experience and market knowledge. Simultaneously, PE funds also focus on implementing engaged and effective boards in the portfolio companies, as well as improving the alignment between the incentives of the incumbent management teams and the value creation plans for the portfolio companies as set out by the PE funds.

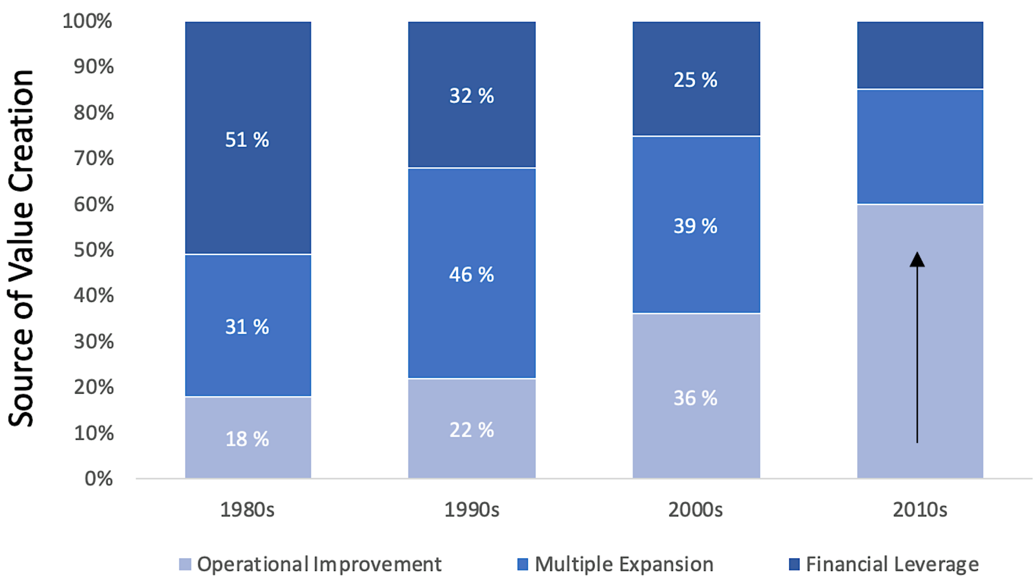
Having presented the structure of PE funds as well as the key actors involved and their potential principal-agent relationships, the paper now shifts the focus to the historical development of the PE industry and how PE funds have created value over the years.

4. Historical Development of the Private Equity Industry

4.1. The 1970s and 1980s

PE originated in the U.S. where LBOs were initiated and developed in the 1970s with the first buyout fund launched in 1976 (Robertson, 2009; Caselli & Negri, 2018). Hereafter, the number of buyout funds increased rapidly, and by the mid-1980s, LBOs were used by banks to realize acquisitions through debt financing, as they began to consider the potential economic value and profitability of companies. In this regard, banks started to develop business plans that were shared between the management of the acquired companies and the PE funds involved in the deals (Caselli & Negri, 2018).

During the 1980s, the first buyout boom took place. At this point, PE funds were managed by generalist investors who were skilled in financial engineering and transactions. Therefore, returns from PE investments were mainly driven by financial leverage and, according to a report conducted by BCG (2008), financial leverage contributed with 51% of total returns generated by PE funds in the 1980s (see Figure 6). The underlying philosophy of PE funds was to take a passive role and continuously let the incumbent management teams direct the portfolio companies. Nonetheless, the PE funds would closely monitor the investments using different performance measures (Gillian & Wright, 2014).



(*Figure 6*. Value Drivers over Time. Adapted from BCG, 2008)

As returns realized by buyout funds in the 1980s were perceived to be superior over market returns, the demand for PE investments increased and LPs began allocating more capital to PE funds. As a result, new funds emerged and existing funds grew significantly bigger in size, thus able to make even larger deals. In the late 1980s, the market peaked with the buyout of RjR Nabisco for approximately $23 billion in the U.S. and the buyout of Gateway Supermarkets for £2,2 billion in Europe (Gillian & Wright, 2014; Robertson, 2009).

4.2. The 1990s

During the first part of the 1990s, after the peak in the previous decade, the market conditions changed, with the market becoming unfavorable for the PE industry. This was caused by the recession in the early 1990s, as well as high interest rates, which led to the struggle or failure of highly-leveraged PE investments. Consequently, the 1990s had low buyout activity consisting of fewer and smaller buyouts with less financial leverage compared to the 1980s (Johnston, 2011). However, from the mid-1990s, economic growth sparked in with low inflation that re-boosted the PE industry.

During the 1990s, the buyouts that took place were characterized by the ability of PE funds to spot and acquire undervalued companies at the downturn of the economy in order to divest them at the upturn at a higher multiple than at entry. In this sense, multiple expansion acted as the main driver of the returns generated by PE funds and was argued to contribute with 46% of total returns (see Figure 6). Also, from the 1980s to the 1990s, financial leverage as a source of value creation decreased from 51% to represent 32% of total returns generated by PE funds (BCG, 2008). Ernst & Young (EY, 2016, p. 1) supports this, stating that "the era of high leverage gave way to a period of increased focus on entry and exit timing in order to achieve increased valuation multiples in the 1990s."

4.3. The 2000s

The years from the mid-1990s to the financial crisis in 2008 represented a prolonged period of economic growth, especially booming from 2005 to 2007. During this period, PE funds attracted huge amounts of capital that resulted in some of the largest mega deals ever seen. Consequently, the PE industry experienced a growing complexity in the structure of PE funds, greater leverage in PE deals, and an explosion in the size of the global PE industry with assets under management doubling to $2 trillion in the 2000s (Gillian & Wright, 2014; Robertson, 2009).

Moreover, as competition for capital and potential portfolio companies intensified, the need for PE funds to improve their success rate and generate returns from each of the individual investments increased. To do this, PE funds started to emphasize active management and began to specialize within specific industries and sectors to gain an advantage over the generalist investors (Gillian & Wright, 2014). In line with this, since the 2000s, the value created by PE funds has been stemming increasingly from operational improvements in the portfolio companies enhancing earnings growth, rather than resulting from financial leverage or multiple expansion (BCG, 2008; EY, 2016). According to BCG (2008), out of an average internal rate of return (IRR) of 48%, 22% and 5% were attributable to revenue growth and margin improvements in portfolio companies, respectively. Simultaneously, multiple expansion and financial leverage only represented 10% and 11%, respectively. Studies have shown that the success of top performing PE funds in the 2000s stemmed from three organizational capabilities, namely network access, domain expertise, and operational improvements (BCG, 2008). Accordingly, excellence in these organizational capabilities assisted the PE funds in identifying the most attractive investments, bidding competitively, and transforming the performance of the portfolio companies.

Network access came from the emerging focus on specific industries and sectors where the most successful PE funds had become real insiders within the sectors, they had specialized in. As a result, these PE funds were extremely well connected with industry experts who would serve as senior advisors and often sit on the boards of the portfolio companies. These extensive industry networks provided the PE funds with an advantage in identifying the most attractive investments (BCG, 2008). Another consequence of the focus on specific industries and sectors was domain expertise, that is, in-depth knowledge within the areas that the PE funds have specialized in. In this regard, the more focused on a particular type of portfolio company or companies within a specific sector, the more rapidly can PE funds acquire experience and thus build a competitive advantage over their less specialized competitors. At last, the capability of operational improvements came from the growing focus on value creation through improved fundamental values of the portfolio companies. Hereof, PE funds increasingly began to recruit talents with expertise within consulting and operational management, rather than solely hiring traditional dealmakers. Such PE funds "are working closely with the management of their portfolio companies to set the improvement agenda, develop a turnaround program, and install operating-metric 'dashboards' to measure performance against goals" (BCG, 2008, p. 19).

4.4. Since the Financial Crisis

The PE industry reached its peak in 2006-2008 right before the financial crisis ensued. In the years following the financial crisis, interests were kept low to boost the economy, which should have acted as fuel for PE investments (Caselli & Negri, 2018). However, the LBO activity stagnated because banks held on to capital rather than providing lending opportunities that led to deal volumes collapsing. Therefore, several PE funds who had used high levels of debt in the fund structures rapidly faced insolvency due to a mismatch between the dates of expected realized returns and repayments of debt (Gillian & Wright, 2014). Hereof, since the financial crisis, the PE industry went through a process of slow recovery. Nonetheless, from 2014 onwards, the overall PE activity began to grow significantly (PricewaterhouseCoopers [PwC], 2018; Caselli & Negri, 2018). Considering the European PE market, buyout investments increased by 16% to €36 billion, representing 77% of total PE investments during 2015. Furthermore, almost 2500 European companies were exited in 2015, representing equity divestments for €40,5 billion. Here, buyouts were by far the largest cluster of equity divestment representing €34,3 billion, coherently with the data of investments stated above, exiting 797 companies (Caselli & Negri, 2018).

4.5. Today

In 2017, the PE industry continued to grow with both buyout value and exits showing remarkable increases. Due to a continuous widely-held belief in the outperformance of PE in relation to other asset classes, LPs have been persistently allocating increasingly high amounts of capital to PE investments. This has resulted in PE funds closing out the strongest five-year period for fundraising in the history in the years 2013-2017 (Bain & Company [Bain], 2018). PwC (2018) supports this in its latest trend analysis of the European PE market that shows the market to be continuously booming with deal volumes reaching new heights. However, due to intensified competition for attractive PE investments and currently record-high valuation multiples, PE funds are currently experiencing an increasing difficulty to identify potential portfolio companies and close new investments at attractive prices. This trend has put downward pressure on the number of PE investments for the past several years (McKinsey & Company [McKinsey], 2018). Both J. Breitenstein (personal communication, 2018) and PwC (2018) support this, stating that deals have never been more expensive with current multiples and valuations on average even higher than before the financial crisis. This will continue to be one of the greatest challenges facing the PE industry.

Additionally, in recent years, practitioners and academics have increasingly researched the relative performance of PE in comparison to public equity, investigating the risk-adjusted returns. As a result, the widely-held belief that PE returns outperform public equity has been questioned as research has found the regarded gap between PE and public equity performance to be narrowing (Ilmanen et al., 2019; McKinsey, 2018). In this regard, Ilmanen et al. (2019) estimate that today the PE industry does not offer as attractive returns relative to public equity as it did 15-20 years ago. Therefore, despite PE funds are still argued to generate superior returns than the public equity market, this poses another challenge for the PE industry.

Consequently, these challenges put increasingly pressure on PE funds to consistently generate high returns on investments to stay relevant for the LPs, as stable and competitive returns are crucial for attracting new LPs and retaining existing ones (Næss-Schmidt, Heebøll & Karlsson, 2017). Hereof, the PE business model is changing with PE funds taking on a more active and collaborative approach with the several actors involved to enhance value creation on the portfolio company level to enhance returns. According to PwC (2018), LPs are also adopting a more cooperative approach than five or ten years ago. Thus, as previously stated, contemporary PE funds are putting a stronger emphasis on implementing operational improvements in the portfolio companies, and less on financial leverage and multiple expansion. In this regard, the amount of debt that is taken on to finance investments is significantly lower than before the financial crisis (PwC, 2018).

5. The Business Cycle of Private Equity Funds

Having portrayed the historical development of the PE industry since its emergence, the thesis will now focus on the business cycle that PE funds follow. The PE business cycle has five stages at which different PE processes unfold. These stages include fundraising, deal flow, investing, managing and controlling, and exit. This business cycle is employed by PE funds regardless of their size, as it is fully scalable. However, large PE funds that manage multiple investment funds can have two or more business cycles in progress at different stages simultaneously. For example, one investment fund may be at the stage of investing, whereas the other may just have begun the stage of fundraising. The five stages of the PE business cycle are highly important for the PE business model and, therefore, each one will now be examined in depth.

5.1. Fundraising

The first stage of the business cycle is the fundraising stage which represents the crucial starting point for the rest of the cycle. This is due to the fact that without successful fundraising, PE funds will not have the necessary capital to invest. Without the necessary capital to invest, it becomes impossible to progress to the following stages of deal flow and investing. During fundraising, PE funds raise capital from LPs for which they can make use of placement agents, usually investment banks, assisting them in the process. Simultaneously, LPs search for top-performing PE funds to invest in and may utilize investment advisors to determine which PE funds potentially offer the most attractive returns (Cendrowski et al., 2008).

The length of this stage depends on several factors, such as the size of the PE fund and its track record, the investment objectives of the specific fund, as well as the state of the overall economic environment among other external factors. These factors not only determine the fundraising timelines but also govern the fundraising targets that the PE funds should reach before moving on to the next step of the cycle. Thus, it is possible for the fundraising stage to last from a period of a few months to several years. However, as previously explained, PE funds are currently undergoing a more toilsome fundraising environment (PwC, 2018). This is apparent in the latest fundraising figures from Preqin (2017), which indicates that even though the demand for PE investments continues to grow, an increasing amount of capital is being concentrated into a smaller number of PE funds.

5.2. Deal Flow

The second stage of the PE business cycle is deal flow, which entails the search for target companies and subsequently narrowing them down to the ones that best match the investment criteria of the PE fund and represent attractive investment opportunities as portfolio companies. J. Breitenstein (personal communication, 2018) explains that PE funds can have various criteria, such as specific geographies, sectors, and preferred enterprise value for portfolio companies, that guide and limit potential investments. In accordance with what has been outlined in the historical development section, Retbøl (personal communication, 2018) states that within the PE industry there is a clear trend of specialization in specific types of companies or sectors that has been persistent for several years.

The process of deal flow is extremely labor intensive and complex, as PE funds must filter through hundreds of companies to identify the potential portfolio companies that not only match the investment objectives but also hold the highest potential for value creation in terms of further development. This is done through screening and due diligence where the financial standings, the competitive positions, and the incumbent management teams of the potential portfolio companies are analyzed (Caselli & Negri, 2018). For example, N. Retbøl (personal communication, 2018) states that initially, PE funds critically assess the companies and narrow the list down to approximately 15-20 potential portfolio companies, depending on the size of the fund. These selected companies will then undergo a more in-depth screening process.

The selection of the companies is based on several factors, such as their respective industries and their positions within these, the validity and reliability of the presented business plans, the entry prices, the quality and skills of the incumbent management teams, and the potential exit strategies (Caselli & Negri, 2018). Besides this, other additional strategic factors exist that PE funds can assess to further analyze the potential portfolio companies. These factors include, for example, whether the companies hold a leadership or niche position in the respective markets, or whether the companies have an asset-light business model or produce a critical component for another company. Such factors would consequently make the companies more attractive investments (J. Breitenstein, personal communication, 2018).

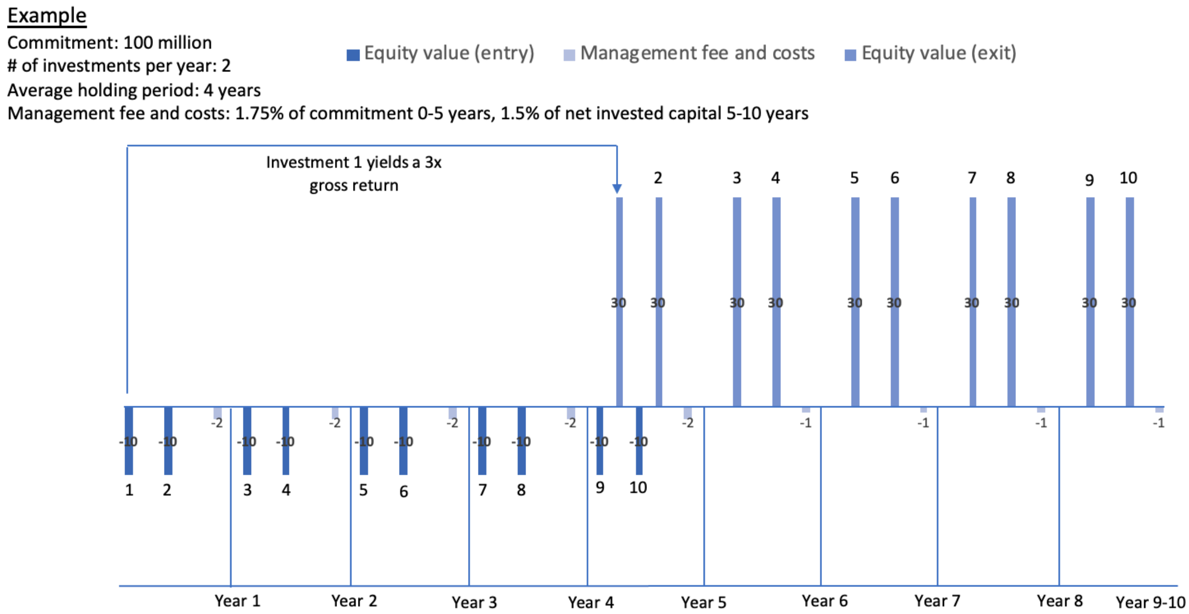
According to Caselli and Negri (2018), the scouting, screening, and eventual choice of potential portfolio companies are realized using different tools, namely: SWOT analysis, industry analysis, future financials analysis, various valuation methods, industrial and human resource (HR) skills valuation, assessment of management skills and track records, as well as due diligence in relation to market, environmental, accounting, financial, legal, and tax aspects. In this sense, N. Retbøl (personal communication, 2018) stresses the importance of conducting a strategic analysis of a potential portfolio company to assess whether it possesses a sustainable business model that serves the customers and makes sense in the environment in which it operates in. Furthermore, he acknowledges that it is crucial to investigate the historical track records of the company in question to assess its performance both during market upturns and during market downturns (N. Retbøl, personal communication, 2018). Furthermore, to get a holistic understanding of the potential portfolio companies, the analyses can be complemented with additional information from industry experts and the network of the PE fund (N. Retbøl, personal communication, 2018).

At last, when the PE funds have identified the subset of potential portfolio companies that they want to invest in, they can offer a letter of intent to each of the companies to indicate their interest in adding them to their portfolios (Slee, 2011). For the subset of companies that PE funds are interested in, PE funds usually make use of third-party consultants to perform an extra extensive due diligence (Cendrowski et al., 2008). This is done to ensure that no critical aspects of the potential portfolio companies have been overlooked in the screening process conducted by the PE funds themselves. Finally, the third party may also assist the PE funds in the preparation of all the documents required for the investments.

5.3. Investing

Following the identification of potential portfolio companies, PE funds need to allocate prices for the investment deals that satisfy both parties. This can be a difficult and prolonged process with various negotiations as the parties may have differing interests and various objectives. Regarding the negotiation process, it appears that PE funds prefer to first have a one-on-one dialogue with the potential portfolio companies. This one-on-one communication enables the creation of a personal relationship which may subsequently aid in the following negotiations (J. Breitenstein, personal communication, 2018; N. Retbøl, personal communication, 2018). Still, due to the competitive nature of the PE industry with various PE funds potentially interested in the same companies, the negotiation process is often challenging and time consuming. Considering the potential challenges faced during the negotiation process, PE funds need to possess exceptional negotiation skills. Additionally, they need to be able to offer the optimal financial structure for the given company and manage the financial risks associated with the higher levels of debt in LBOs (Gillian & Wright, 2014).

Once a PE fund has made a successful bid, the next step is to finance the investment. In this regard, because LBOs are carried out with a mix of debt and equity, it is essential for PE funds to have access to relevant debt markets (MacArthur & Rainey 2012). The investing stage usually takes place during the first five years of the economic life of investment funds and continues until a predetermined cut-off date (Caselli & Negri, 2018). Hereafter, PE funds will stop making new investments and will move on to the next stage of the cycle. The typical cash flow development of an investment fund from the stage of investing to exit is presented below (see Figure 7).



(*Figure 7*. Typical Cash Flow Development. Adapted from J. Breitenstein, 2018)

As J. Breitenstein (personal communication, 2018) notes, an investment fund usually invests 8-10% of the total fund value in each portfolio company, which means that a total of approximately 10-12 portfolio companies exists in each fund. Despite the mentioned specialization of PE funds, the portfolio companies are likely to differ in size, location, and industry, with the purpose of minimizing potential concentration risks through a certain degree of diversification (J. Breitenstein, personal communication, 2018). Additionally, already during the investment stage, PE funds attempt to outline the entry and exit strategies, as well as establish rules between the PE funds and the portfolio companies regarding transparency, involvement in the board of directors, and the general overview of the portfolio companies' management (Caselli & Negri, 2018; N. Retbøl, personal communication, 2018).

5.4. Managing and Monitoring

PE funds typically hold the portfolio companies for 3-7 years and it is during this period that the stage of managing and monitoring takes place. In the years surrounding the financial crisis, the median holding period was less than four years. However, according to Bain (2018), the average holding period has been increasing since the financial recovery, settling into an average holding period of five years. During the managing and monitoring stage, PE funds work towards enhancing the value of the acquired portfolio companies by improving their strategies and operations, reducing costs, and strengthening their performances and prospects within the respective industries. To do so, PE funds tend to take an active role in setting and monitoring the implementation of the strategies, however, they are usually not involved in the day-to-day operations of the portfolio companies (Caselli & Negri, 2018).

Regarding managing, J. Breitenstein (personal communication, 2018) explains that a PE fund will begin the process by creating an overall strategy jointly with the management of the portfolio company. Hereafter, the implementation of the agreed upon strategy will begin by identifying the necessary changes or must-win battles within the different operations and areas of the company. The implementation itself will then be run by the portfolio company but monitored by the PE fund regularly (J. Breitenstein, personal communication, 2018). In this regard, N. Retbøl (personal communication, 2018) states that assisting the portfolio company in selecting the optimal focus for its strategy and prioritizing the various strategic initiatives represents one of the most significant tasks of the PE fund. Traditionally, PE funds took a more passive role in the value-adding activities within operations and instead relied on financial leverage and multiple expansion to deliver returns on investments. However, as previously touched upon, the role of PE funds has shifted towards representing more active partners with increased involvement in the strategies and operations of the portfolio companies which requires a much greater understanding of the portfolio companies and the industries in which they operate.

Moreover, N. Retbøl (personal communication, 2018) states that PE funds monitor the portfolio companies by allocating internal teams to keep track of the progress on a weekly basis, but also through participation in board meetings. Besides this, PE funds may organize monthly meetings internally where the performance of all the portfolio companies within the investment funds are reviewed. At these meetings, the teams responsible for the different portfolio companies report on the progress, the expectations going forward, and the potential actions that can be taken from that stage onwards (N. Retbøl, personal communication, 2018). One of the tools that PE funds use for monitoring is last-twelve-months (LTM) earnings that provides an overview of portfolio company performance, taking holidays and other periods into account that may have impacted quarterly earnings. Additionally, PE funds make return projections for each portfolio company using expected returns, performance expectations, exit multiple assumptions, and incorporating potential exit channels (N. Retbøl, personal communication, 2018). This is also done for the investment fund using a bottom-up approach that counts in the prospects of each investment to forecast the overall return.

The managing and monitoring of the performance of portfolio companies will continue throughout the holding periods. Depending on the assessments and forecasts, PE funds may initiate additional changes in the portfolio companies to enhance value creation with the purpose of improving the projected expected return (N. Retbøl, personal communication, 2018).

5.5. Exit

At the end of the holding period, the final stage of the PE business cycle is to exit the investments where the potential returns are realized and thereafter distributed to the LPs. Here, the decision must be made regarding how to exit the investment in a given portfolio company so that the PE fund can realize the potential return from the value added during the holding period. To do this, PE funds are concentrating their efforts on exiting portfolio companies at the optimal time and through the most favorable exit channel so as to ensure the highest possible return.

Currently, the general exit horizon in the PE industry is four to six years and at time of exit, three main exit channels appear prevalent (Gillian & Wright, 2014). The first exit channel is to sell the portfolio company to a strategic buyer, who represents another company in the same industry that wants the acquisition for strategic purposes. The second exit channel is to float the portfolio company, which means going public, by carrying out an initial public offering (IPO). This option would allow LPs to have continued involvement in the investment, however, it limits liquidity due to a mandated lock-in period of the existing shareholders which also makes the investment exposed to the risks of share price fluctuations and market volatility. The third channel is called a secondary purchase, this refers to a sale of the portfolio company to another financial sponsor, such as another PE fund, and is also known as sponsor-to-sponsor. For PE funds, it is positive that a portfolio company has already been subject to some management rigor and provides the new owner with the opportunity to take the company through its next stage of value creation (Bain, 2018). This exit channel often takes place when the portfolio company is not yet ready for an IPO or a sale to a strategic buyer, but still has significant potential to grow or improve its operations (Kitzmann & Schiereck, 2009).

However, regardless of the value created in the portfolio company, there needs to be a buyer in place who is willing to pay the equivalent of or higher than the entry price that the selling PE fund paid for the investment in order to gain from the value added (N. Retbøl, personal communication, 2018). If such buyer cannot be obtained, the PE fund will not be able to realize a return on the investment and will thus experience a loss that is likely to diminish its ability to raise a successor investment fund.

Therefore, the exit decision must be conducted with careful consideration as it will not only impact the return on the specific investment but will directly impact the return of the entire investment fund, and thus the overall performance of the PE fund (Caselli & Negri, 2018).

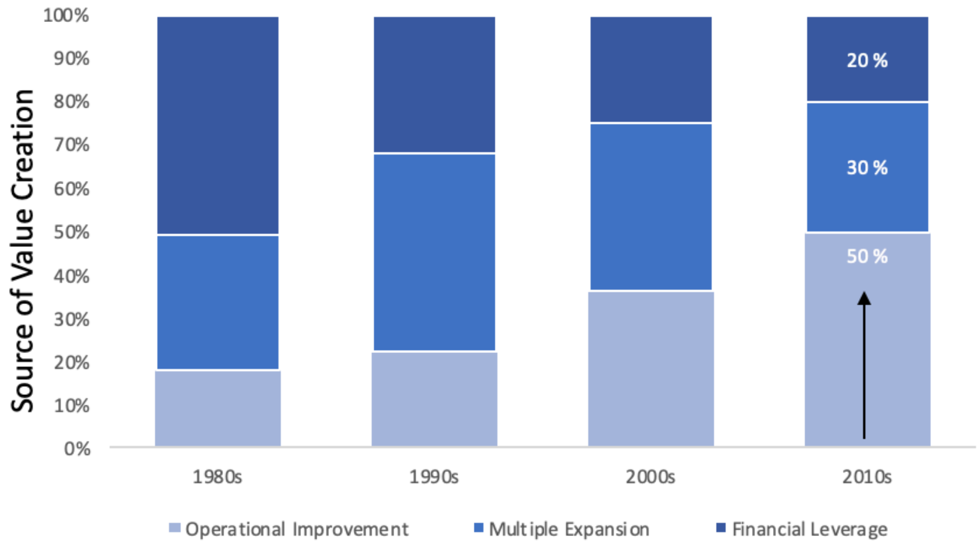
As outlined, the PE business cycle guides the different stages and the respective processes that are undertaken by PE funds, and thus represents the core of the PE business model. However, to fully understand the crucial elements and processes that enable the PE business model to create value for the LPs, the drivers of value creation need to be further investigated. Hence, the following section will identify the main value drivers employed by PE funds and analyze each of them in depth.

6. Drivers of Value Creation in Private Equity

6.1. Value Drivers

Put in a simplified way, the PE business model can be explained as satisfying two different needs. Firstly, PE funds provide companies with external capital because the companies themselves do not have sufficient financial resources to push for further development. Secondly, PE funds provide investors, who hold additional financial resources, with the opportunity to invest in high-risk high-reward portfolios (Caselli & Negri, 2018). These needs have been combined in the PE business model where the fulfillment of the first one should ideally increase the overall value of the companies. This, on the other hand, enhances the fulfillment of the second one, as increased company value should yield a return realized at exit to be distributed back to the investors. To fulfill these needs, it has been identified that PE funds employ three key value drivers (Aleszczyk et al. 2016; EY, 2016). These are financial leverage, multiple expansion, and operational improvements. Financial leverage entails leveraging the investment, and hereof the portfolio company, usually repaying the debt before exiting the investment. Operational improvements entail assisting the portfolio company to achieve further development and focuses on increasing revenues and margins, or both. Multiple expansion entails selling the portfolio company at a higher valuation multiple relative to the multiple at the time of entry.

As outlined in the historical development section, financial leverage was once the main driver employed by PE funds to increase the returns on their investments. However, the historical long-term trend has shown source of value creation moving away from financial leverage and instead towards operational improvements as the most frequently used value driver (Brigl et al., 2016). Currently, the consensus in the PE industry is that financial leverage, which in the 1980s accounted for roughly 50% of returns generated by PE funds, now only accounts for around 20%. On the contrary, operational improvements have gone up from accounting for approximately 20% to 50% (EY, 2016). This data supports the notion that the PE investment trends today are reversed from what they were in the 1980s (see Figure 8).



(*Figure 8*. Value Drivers of PE Value Creation since 1980s. Adapted from EY, 2016)

Regarding the different value drivers, J. Breitenstein (personal communication, 2018) states that:

> "If we look at what we have achieved in the past, so all our realized investments, then around 60% of the value we have created will come from operational improvements, so higher revenue and higher margins, 10% will come from lower debt through cash flows and the reason is that in many cases we reinvest some of the cash flows back into the business, and then 30% will come from a higher exit multiple, so if we buy a company at 8x EBITDA [earnings before interest, depreciation, and amortization] and sell it at 10x EBITDA then we will get an uplift in the value from that. However, it is very difficult to break the value creation further down, it will all be mixed together."

This supports the tendency of contemporary PE funds to be more operationally-minded and less focused on financial leverage. According to PwC (2018), in the year of 2016 and 2017, the potential for operational improvements in portfolio companies was cited as the single most important factor for PE funds regarding investment decisions. In this line, operational improvements represent a key value driver where PE funds can create value through active management and strategic improvements, ultimately increasing the revenues and profits of the portfolio companies. Hereof, LPs pay attention to how PE funds generate returns, increasingly seeking out the PE funds that consistently transform the operations of the portfolio companies rather than play with their capital structures (PwC, 2018). However, despite the increasing focus on operational improvements, PE funds must be able to employ each value driver as necessary in order to generate the returns that the LPs expect from the high-risk portfolios.

Hereof, the three key value drivers will be investigated to obtain a thorough understanding of what they entail and how PE funds employ each one of them to enable value creation on the portfolio company level which eventually translates into returns for the LPs. As mentioned, the key value drivers are financial leverage, operational improvements, and multiple expansion, and will be analyzed individually before their interplay is discussed.

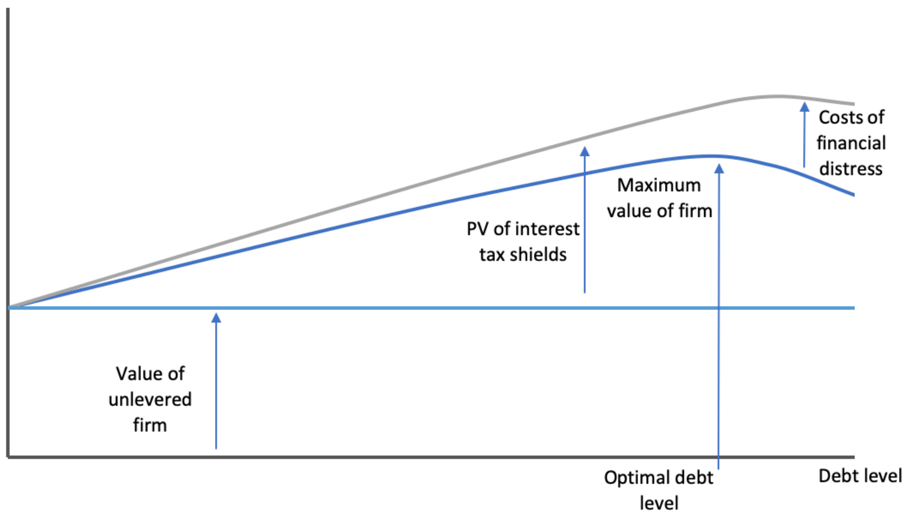
6.2. Financial Leverage

6.2.1. The Leverage Effect

The use of financial leverage has shown a positive relationship with equity returns and therefore indicates a return-enhancing effect related to high debt levels (Achleitner et al., 2012). In other words, the use of leverage can improve the profitability of PE investments and thus create value for the LPs. However, because the financial structure of an LBO is a mix of debt and equity, it is necessary to consider the optimal capital structure. This is due to the possibility of over-leveraging the portfolio company, which results in increased risk of company default that can outweigh the positive effects of leverage (Achleitner et al., 2012).

Defining the optimal capital structure is a topic that has always interested academics and practitioners. The most relevant and well-known theory about the use of financial leverage is formalized by Modigliani and Miller through three propositions that have been named MM I, MM II, and MM III (Caselli & Negri, 2018).

Modigliani and Miller (1958) suggest a positive relationship between leverage and equity returns due to the increased financial risk that follows high debt levels and thus needs to be compensated for through higher returns. MM I states that the mix of debt and equity does not impact the company value in a world without tax, without costs of financial distress, without information asymmetry, and without transaction costs. However, in the real world, these conditions are violated and thus MM I does not hold. MM II states that if debt increases, FCF raises proportionally with the tax rate applied to the interest paid, and consequently, the debt creates a tax shield that raises the company value. At last, MM III states that even if the second proposition maximizes the level of debt, costs of financial distress lead to decreases in company value due to legal expenditures and the daily pressure on management to service the debt (Caselli & Negri, 2018). Hence, the optimal capital structure is the ratio of debt-to-equity that ensures tax shield benefits and avoids any risk connected with a distressed financial structure (see Figure 9).



(*Figure 9*. Optimal Capital Structure. Adapted from Caselli & Negri, 2018)

In this respect, as debt is privileged over equity in most economies due to tax deductibility of interest payments, additional tax shields through higher leverage ratios should increase the company value (Achleitner et al., 2012). Moreover, as a higher leverage ratio also brings along increased financial risk, the LPs should be compensated for the additional risk by obtaining a higher expected return. Thus, the use of financial leverage can create value in two ways. Firstly, it can enhance the value of the portfolio companies through tax shields, and secondly, it can create value for LPs as they should be compensated for the additional financial risk resulting in an increased return to equity. In this regard, according to Achleitner et al. (2012), approximately 33% of returns generated by European buyouts can be attributed to the leverage effect.

6.2.2. The Disciplining Effect

Additionally, Jensen (1989) holds that the use of financial leverage in PE investments has a disciplining effect on the management teams of the portfolio companies. Consequently, this should diminish potential principal-agent conflicts between a portfolio company's management team and its shareholders that represent the PE fund and its LPs. This stems from the underlying assumption that management may be incentivized to use FCF for personal interests, for example, to expand the company size and/or improve their corporate reputation. Rather, the management should invest the FCFs in profitable growth and improvement of existing business or distribute the cash to the shareholders (Achleitner et al., 2012). In this line, as increased debt represents a fixed contractual liability that must be paid periodically, the possibility for management to either conduct unprofitable investments or to consume private benefits is reduced. Hereof, financial leverage can serve as a corporate governance mechanism to reduce such principal-agent conflict. Additionally, it can also increase company value as the inability to repay debt obligations will result in company default and thus the incentives of management to operate efficiently are increased (Jensen, 1989; Achleitner et al., 2012). Hereof, the disciplining effect of financial leverage should not only improve company performance but also equity returns. Hence, in the context of PE, the use of financial leverage can act to diminish the principal-agent conflicts between PE funds and their portfolio companies by disciplining the management teams to act in the interests of the PE funds regarding revenue growth and margin improvements.

6.2.3. Current Use of Financial Leverage

Currently, both equity and debt capital are highly available for PE funds, with equity having experienced a historically strong fundraising period over the past five years (PwC, 2018). Additionally, the current conditions of the debt markets are very attractive for PE investments providing PE funds with easy access to low-interest leverage (Bain, 2018). However, even though this enables PE funds to fund their investments with maximum debt levels, there is a point at which the level of debt will result in diminishing returns. According to Bain (2018), the common maximum debt multiple is 6x EBITDA for PE investments. In this sense, if deal multiples rise, PE funds must make up the difference with more equity that will result in a lower ratio of debt-to-equity. Consequently, this decreases the potential IRR obtainable from the investments which makes the deals less attractive (Bain, 2018).

Regarding the use of financial leverage, J. Breitenstein (personal communication, 2018) states that:

> "In the past, we have been leveraging up to around 4x EBITDA [...]. A rule of thumb is 50/50 debt and equity. I think at the moment you will be able to find banks that will provide you with debt of 7x-8x EBITDA on average, [...]. The idea is if you only put in a little bit of equity then the upside of the enterprise value will go to the equity and you will get a higher return on equity. So, we are leveraging the business to make sure that we can increase the return to investors, and putting more debt of course increases the risk of the investment so we have to find a balance between debt and equity."

This statement is supported in a report by PwC (2018) which found that none of the PE funds from the sample reported using more than 60% of debt in their investments. According to PwC (2018), PE funds are cautious in taking on too high debt levels in order to ensure that the portfolio companies have sufficient capital to grow and are not overwhelmed by debt repayments. Hence, it appears that the average debt levels used for PE investments have decreased over the recent years and that PE funds only take on levels of debt that are manageable for the portfolio companies (PwC, 2018).

6.3. Operational Improvements

Alongside financial leverage, PE funds also create value by implementing operational improvements in the portfolio companies. Operational improvements usually focus on revenue growth through new product development or geographic expansion, and margin improvement by enhancing EBITDA that is achieved by reducing operating costs and selling, general, and administrative expenses (SG&A). In this regard, it is crucial that PE funds possess industry and operating expertise as this increases their capability to implement the needed operational improvements that can assist the portfolio companies in adding value to their businesses (Achleitner et al., 2012).

A report conducted by Aleszczyk et al. (2016) found that portfolio companies experience growth in assets and revenues, as well as significant improvements in operating profitability over the first three years of PE ownership. These findings stress that PE funds have a dual focus on both revenue growth and margin expansion that are achieved through operational improvements. The report also found that experienced PE funds reach significantly higher EBITDA and growth for their portfolio companies than less experienced PE funds. This indicates that experienced PE funds have developed specific expertise in terms of operational practices, this, in turn, supports the notion that operational improvements stem from industry and operating expertise (Aleszczyk et al., 2016).

It is important to stress that no single formula exists as to how PE funds can create a competitive advantage within operational expertise against other PE funds, as this depends on various factors such as the specific investment strategy, the preferred deal size, and the chosen sector. However, a crucial aspect when looking to improve the operations of the portfolio companies is that PE funds must begin to consider areas for operational improvements as early as possible in the deal flow process (EY, 2016). Nonetheless, today operational improvements represent around 50% of returns generated by PE funds, having increased from around 20% in the 1980s (Brigl et al., 2016).

6.3.1. Revenue Growth and Margin Improvements

Regarding the dual focus that PE funds hold on both revenue growth and margin expansion, Aleszczyk et al. (2016) and EY (2016) argue that approximately half of the operational value created is generally attributable to increases in revenue growth, with the remainder stemming from improved operating efficiency and FCFs. EY (2016) states that when assessing how best to extract value from operations, some typical considerations include:

1. Revenue growth that entails how to establish an appropriate management reporting framework to easily identify the underperforming components of the portfolio company, as well as to conduct market research that supports the optimal go-to-market strategy;

2. Direct cost optimization, that is, how to improve the efficiency of manufacturing facilities and enhance asset utilization;

3. Leveraged sourcing that consists of how to utilize analytics to identify opportunities for sourcing solutions to drive cost savings across portfolio companies;

4. Indirect cost optimization, that is, how to transform general and administrative functions to drive margin improvements;

5. Value creation through information technology to enhance sharing of knowledge and best practices with the purpose of improving performance across all business units;

6. Process and performance optimization that entails how to plan and implement process improvements and operational excellence to sustain competitiveness;
7. Free cash flows, considering how to improve cash flow forecasting and working capital management with the purpose of reducing cash requirements and thus increasing future free cash flows.

However, in order to ensure revenue growth and margin improvements, PE funds must also manage and monitor other key activities to support operational improvements. Specifically, in relation to the above-stated considerations, it is crucial that PE funds ensure performance evaluation and review by implementing a set of required processes that should be used to monitor and measure the portfolio company value. In addition, PE funds must provide the portfolio companies with decision-making support and professional expertise, as well as assist the development of managerial discipline. To do so, PE funds should take part in board services that entails participating in all activities concerning the board of directors and other committees. Additionally, PE funds should assist with the external relationships of the portfolio companies, as PE funds usually have a large network of industrial experts, consultants, customers, and suppliers, that can support both current and future strategic activities of the portfolio companies (EY, 2016). All things considered, PE funds should be fully available for mentoring the portfolio companies. Furthermore, PE funds play a crucial role in arranging additional finance when the portfolio companies need more financing to pursue further development. Here, PE funds are often responsible for finding the financer, arranging the deal, and negotiating the terms and conditions. In this line, the reputation of PE funds can enhance the ability to secure financing (EY, 2016).

At last, one important job of the PE funds is to recruit management as the incumbent management teams of the portfolio companies can be inadequate in terms of skills for the companies' further development (EY, 2016). Hence, as acknowledged by N. Retbøl (personal communication, 2018), it is critical that PE funds assist with the recruitment of management teams, hiring professionals who hold the necessary skills and knowledge required for the specific situation of the individual portfolio companies. Hereof, human capital improvements represent another essential aspect of value creation through operational improvements.

6.3.2. Human Capital Improvements

Concerning human capital, PE funds are increasingly emphasizing the importance of having the right professionals working in the PE funds as well as on the management teams of the portfolio companies. Considering the former, PE funds have had to evolve the skillsets of their teams and establish in-house operational specialists in addition to dealmakers and fund managers. This is mainly due to the increasing focus on operational improvements, which requires specialist expertise within specific sectors and industries (Haas & Pagani, 2014; EY, 2016). Such teams take on various names from operations team, portfolio support team, and value enhancement team to operating partners. Thus, PE funds employ professionals who typically have work experience within a specific industry or from a strategy and operations-focused consulting firm. Based on their expertise, these professionals have the necessary capabilities to identify and implement the needed operational improvements in the portfolio companies. In this line, PE operations teams differ from deal teams that focus on deal searching and execution. However, for PE funds operating in the mid-market space, the two roles of operations teams and deal teams can be combined into a single team due to limited personnel (Haas & Pagani, 2014).

Regarding human capital in the portfolio companies, Bain (2018) emphasizes the importance of PE funds supporting the recruitment of management for the portfolio companies in order to ensure strong leadership at the top. The previous management teams may have performed well in one context, but may not hold the adequate capabilities, experiences, or styles, that are required for the further development of the portfolio companies as intended by the PE funds. In buyout deals, it is common practice to replace the CEO, however, it is not necessarily a prerequisite for a successful value creation process. What matters is that the management team is fit for the further development of the portfolio company and that potential human capital improvements are made early in the process (Bain, 2018). This point is also supported by J. Breitenstein (personal communication, 2018) who states that:

> "We start with the board, we will conduct some management assessment to make sure that the quality of the management is right to deliver on our plans. Then we will sit down with the management in the first period after we have acquired the company and create a new strategy plan."

In this regard, N. Retbøl (personal communication, 2018) argues that:

> "9 out of 10 cases we will start with changing the CFO, […]. It could also be that the management team is performing very well to a certain size. […] suddenly it becomes too complex and the normal way is not sufficient anymore […]. Sometimes we have to find new profiles who have tried it before or have tried a larger company and know what to do."

The further development of portfolio companies often relies on mission-critical roles throughout the entire organization, even on the lower levels. Thus, it is necessary to define and fill the mission-critical roles that can assist the portfolio companies in the value creation process laid out by the PE funds. To do so, the PE funds must determine the capabilities required for the portfolio companies to deliver on the value creation plans and identify potential holes in the organizational structures that need attention. Additionally, it is necessary to create efficient feedback systems to gain an understanding of what is working and what operational improvements are still needed (Bain, 2018).

6.3.3. Strategic Improvements

EY (2016) emphasizes that operational improvements require more than reducing costs and implementing quick wins to achieve revenue growth. Instead, a sustainable operating model should be established that aligns the value creation plan with the corporate strategy of a given portfolio company, without limiting its operating efficiency and flexibility. In this sense, the value creation plan proposed by a PE fund should be carefully examined to ensure that the intended operational improvements will not undermine the corporate strategy of the specific portfolio company (EY, 2016). In this line, J. Breitenstein (personal communication, 2018) states that:

> "Most funds will do it in different ways, but we have developed our concept or book called 'accelerating value creation' which is basically a long list of questions that we will ask the company to make sure that we get to the right strategy. It is based on the concept where we ask where to play and how to win basically following the overall strategy concept, […]."

Yet, the extent of strategic involvement by PE funds in the portfolio companies can vary from being a passive partner to taking on a more active role through hands-on management. Currently, most contemporary PE funds choose the latter option where they, for example, manage large operational improvement plans and implement new leadership structures into the portfolio companies (EY, 2016).

Typical issues in the implementation of an operational value creation plan often arise as a result of a few key oversights. These may include failing to involve the operations team early in the deal flow process, which can result in a disconnect between the deal team and implementation team. This often occurs if a PE fund does not establish a dedicated operations team to support the specific portfolio company in achieving the targets of the value creation plan.

Additionally, operational improvements require continuous refinement due to changes in strategic priorities as the portfolio companies further develop. Thus, active and frequent communication between PE funds and portfolio companies is crucial (Bain, 2018). In this regard, J. Breitenstein (personal communication, 2018) explains that:

> "We [Axcel] have three [workstreams] so it is the strategy, it is the operational, and it is the backbone, and each will be broken down in different workstreams where we will sit with the management and the next layer [of the portfolio company] and discuss the strategy in detail. […]. So, the strategy work will cover the strategy and what we need to do in terms of improving the business and secure that they have the backbone to deliver on the two other workstreams [operational and strategy]. Then we will take the conclusions or must-win battles from these different workstreams and put into a one page must-win battles paper and that will go into our operational review committee."

Hereof, as the balance shifts between quick-wins and long-term strategic objectives, the priorities of the intended value creation plan will change as well. Therefore, regular check-ins at the portfolio companies are critical to ensure that the right teams are still in place and performing well. Thus, here it is also equally critical to create efficient feedback systems, as previously mentioned.

6.4. Multiple Expansion

6.4.1. Mechanisms of Multiple Expansion

Besides financial leverage and operational improvements, the third key driver of value creation is multiple expansion. Multiple expansion can be achieved by increasing the potential market value of a given portfolio company through, for example, furthering a credible growth narrative, clarifying the strategy of the company, or lowering its risk profile (Brigl et al., 2016). Additionally, the market values of portfolio companies are also subject to external factors, such as general market conditions and the macroeconomic environment which the PE funds cannot control. Over the years, the contribution of multiple expansion has remained relatively stable around 30-40% of total returns generated by PE funds (Brigl et al., 2016). Regarding multiple expansion as a value driver, J. Breitenstein (personal communication, 2018) states that:

> "I think it is fair to say that at the moment we are at the high-end of a price cycle, so it is difficult when we buy a company now to put in a higher exit multiple than what we are paying for the investment. In most cases we will actually put in a lower exit multiple. However, the exit multiple will depend on who is buying. […] then we will do a very detailed search on the exit route that can give us the highest return."

Specifically, the multiple expansion is the value increase attributable to the change in the EBITDA multiple from investment entry to exit. Multiple expansion is achieved when the change in price between the entry and exit of a portfolio company is larger than the change in EBITDA measured in the same period, given that both have increased (Braun, 2015; Goulet, 2012). Multiple expansion is usually explained by changes in market-wide conditions. However, it could also be explained as a result of improved prospects and expectations of future earnings growth, or the ability of PE funds to find value-adding strategic or financial buyers (Braun, 2015). Whereas increases in earnings may be the immediate result of operational improvements, increases in the price of portfolio companies tend to represent the perceived sustainability of these improvements and the improved strategic position of the portfolio company in the long run. For this reason, multiple expansion does not rely solely on company performance, but is rather subject to several factors, such as market expectations, negotiation skills, and the exit channel (Goulet, 2012; N. Retbøl, personal communication, 2018).

6.4.2. Impact on Multiple Expansion

Despite the importance of understanding how prices are achieved in the market for PE investments, literature has provided limited evidence on the extent to which PE funds actually manage to achieve multiple expansion. Nonetheless, citing a report conducted by Aleszczyk et al. (2016), it was found that on average, PE funds pay EBITDA multiples that are lower by about 8,3% than the multiples paid by strategic buyers.

In accordance with the statements by J. Breitenstein and N. Retbøl (personal communication, 2018), Aleszczyk et al. (2016) hold that these findings indicate that:

> "Firstly, [PE funds] are either skilled negotiators and are able to close deals at significant discounts relative to corporate acquirers, secondly, [PE funds] are better able to identify cheaper targets that are potentially undervalued, or thirdly, corporate prices may include synergy premiums that are absent in the average PE deal."

Bargeron et al. (2008) also found that PE funds in general have been paying lower premiums than public companies when acquiring companies. As a possible explanation for this finding, they also suggest that PE funds may be superior negotiators, or that they may be more skilled in identifying undervalued companies and taking advantage of market timing. Furthermore, they too stress that PE funds have differing acquisition objectives than strategic buyers. Firstly, strategic buyers must factor in the potential gains from acquiring a competitor, such as synergies, market expansion, and improved competitive landscape. Secondly, strategic buyers also need to consider the potential costs of not acquiring a competitor, such as lower market share, eroded margins, and greater advertising expenses. As PE funds do not necessarily need to consider these strategic implications, they can thus valuate the companies based on a different set of financial criteria (Bargeron et al., 2008).

As mentioned, multiple expansion has traditionally been explained as a result of changes in market-wide conditions. Thereby, when considering multiple expansion in the PE context, market expectations and timing of investments become important factors. In this line, it is argued that skilled PE funds can time the entry and exit of portfolio companies to take advantage of momentarily suppressed prices as well as to benefit from the upturn of a favorable industry and economic environment. Nonetheless, to successfully benefit from market timing, N. Retbøl (personal communication, 2018) stresses that it is necessary to have insight into the industry life cycle, a deep understanding of the economic landscape, and a little bit of sheer luck. Investments made during recessionary periods have been found to have a greater impact from multiple expansion than investments made in growth periods (Achleitner et al., 2011). This can be explained by the low valuation multiples of the portfolio companies acquired during an economic downturn that, on average, tend to grow over the holding period. However, it is unwise for PE funds to rely solely on multiple expansion to enhance returns, as valuations and multiples of portfolio companies can fluctuate with the market. Thus, if the market is at the high-end of the price cycle, it is possible that current valuations and multiples will drop in the future (N. Retbol, personal communication, 2018).

Consequently, if a PE fund has invested in a company at 10x EBITDA and exits at 8x EBITDA, the PE fund must make up for the loss of multiple through a significant EBITDA growth.

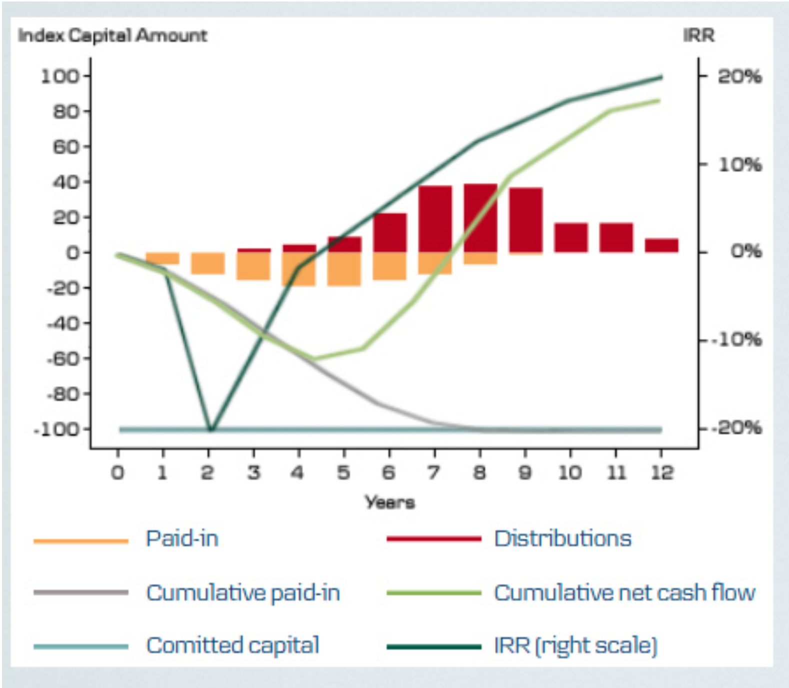
Hereof, the vintage year of an investment fund can impact its performance either positively or negatively depending on the market wide conditions and the economic environment at the time when the investments are made. Thus, in relation to comparing the performance of different PE funds, it becomes relevant to consider the respective vintage years of their investment funds as these determines the conditions surrounding the PE funds and their investments made. In this regard, concerning the performance of PE funds and investments, the thesis will now progress to examine the models and tools used for performance measurement in the PE industry.

7. Performance Measurement

7.1. The Internal Rate of Return

In order to understand the performance of PE funds, it is critical to define which models and tools they employ to evaluate the success of their investment activities. For this purpose, industry associations and government regulations provide PE funds with specific performance determinations consisting of a set of guidelines to follow. For example, as Invest Europe (2018) suggests, the IRR can be used to assess the investment performance as it compares cash outflows with cash inflows of one or more operations. This method is one of the most commonly used and it is also considered the most reliable because it provides a relative performance measure that considers the time variable and number of operations simultaneously (Caselli & Negri, 2018).

The IRR can be represented in the form of a J-curve (see Figure 10). As illustrated for an entire investment fund, the IRR is negative over the first couple of years due to the cash outflows, such as investments and management fees, with no cash inflows yet. Typically, the LPs will get the first cash inflow in year 3, whereby the J-curve will have bottomed in year 2 and then moves towards breakeven, which usually happens in year 4-5. Hereafter, the IRR becomes positive, and the LPs will then experience a continuously rising IRR until the end of the economic life of the fund (Danske Bank, 2019). The cash inflows are a direct consequences of PE fund exiting the investments and realizing the potential returns. These returns are distributed to LPs on a pro-rata basis and will thus occur until the last investment is realized, thereby liquidating the investment fund (Danske Bank, 2019).



(*Figure 10.* The J-Curve of the IRR. Adapted from Danske Bank, 2019)

Despite the common use of IRR as the performance measure for one or more investments, it has various pitfalls. Firstly, PE funds often experience issues with using the discounted cash flow (DCF) model to calculate the IRR as it tends to overvalue the investment, thus, the calculated IRR is usually allocated too high a value (N. Retbøl, personal communication, 2018). According to academics and practitioners, the tendency of the DCF model to overvalue companies and investments can be explained by the relatively high weight given to the terminal value which can account for as much as 50% of the total valuation. However, it is extremely time-consuming and difficult to measure a more reliable IRR that is based on demonstrable data rather than pure assumptions (Caselli & Negri, 2018). Secondly, as the IRR is dependent on the data provided by the portfolio companies, it may have errors and defaults that the PE funds cannot account for (Caselli & Negri, 2018). Thirdly, as the IRR is both sensitive to the timing of cash flows and can also vary significantly depending on what is included in the cash flows and what is not, it is possible to manipulate the calculations of the IRR, even if manipulation is not intended. In this line, three different types of IRR can be calculated to measure performance (Caselli & Negri, 2018):

1. Gross return on the realized investments, that is, the net present value of the entries and exits of the investments made;

2. Gross return on all investments that includes the value of portfolio companies still to be exited; and
3. Net return to investors, which is the most interesting measure for the LPs as it clearly shows their final return net of costs and commissions applied by PE funds.

Fourthly, another issue with calculating the IRR is that the net return considers a series of information that does not allow for the comparison among several PE funds. For example, as the liquidity reserve is considered for the IRR calculation, different weights of liquidity can result in unequal estimates among PE funds. Consequently, the IRR comparison of PE funds loses its usefulness. With the mentioned pitfalls in consideration, the most frequently used indicator of IRR is gross return on realized investments (Caselli & Negri, 2018).

In this regard, the consensus within the PE industry is that PE investments should yield a gross IRR of approximately 25%, as confirmed by both J. Breitenstein and N. Retbøl (personal communication, 2018). While this can vary among LPs, the general return expectations of PE investments are that they should yield higher returns relative to public equity. This is due to the higher risk of PE that stems from the increased financial risk of the investments that follows the high amount of financial leverage compared to publicly-traded companies. Also, as previously stated, another risk is the liquidity risk that both stems from the illiquid nature of PE and from the likelihood that PE funds may not be able to realize the potential returns if not successfully exiting the investments after the holding period (J. Breitenstein, personal communication, 2018).

7.2. Other Performance Measurement Tools

Besides the IRR, PE funds may use a combination of different measures to assess the performance of their investments. As J. Breitenstein (personal communication, 2018) notes:

> "We will use all these cash flows to calculate the net IRR and also a KPI [key performance indicator] that we call TVPI, what is the total value to paid-in capital, i.e. how much [LPs] have gotten out after costs and fees etc. compared to how much they have put in."

The TVPI multiple, generally referred to as the investment multiple, is a money multiple that also evaluates the performance of PE funds.

Hederstierna and Sabrie (2017, p. 8) define TVPI as the "value created by a fund by dividing the estimated value of the fund's remaining assets and all the distributions made to date, by the total amount of committed capital from the fund's investors [LPs]." Thereby, the TVPI represents the number of times a PE fund has been able to multiply the initial paid-in capital net of management fees. Thus, any TVPI multiple above 1 indicates that a PE funds has returned more than the initial paid-in capital (BVCA, 2015).

Another performance measurement tool is the use of the public market equivalent (PME) metric developed by Long and Nickels (1996). In general, PE performance is not directly comparable with public market performance due to the irregular timing of cash flows and the illiquid nature of PE investments (Preqin, 2015). However, as PME replicates timing and size of PE cash flows as if they had been invested in public equities, it hereby becomes possible to approach equal comparisons between PE and public equity performances (Bain, 2018). Yet, whereas public markets experience wide upturns and downturns over a period of months, PE fund portfolios are subject to fair value accounting and experience more modest quarter-to-quarter movements. Therefore, as PE investments represent long-term illiquid assets, short-term comparisons between PE and public equity are not particularly useful in evaluating PE performance and should not be relevant to LPs (Bain, 2018). Furthermore, as Hederstierna and Sabrie (2017) note, the PME assumes the same risk for PE and public market, whereas research suggests that PE investments are associated with higher risk.

7.3. Implications of Performance

It is important for PE funds to demonstrate that prior investments have been successful in terms of a series of good capital allocation and not based solely on one fortunate investment. As argued before, the PE industry is very competitive with several PE funds bidding for the same capital and potentially for the same companies, and thus are competing against one another (J. Breitenstein, personal communication, 2018). In this line, without consistent above-average performance, it becomes increasingly difficult for PE funds to raise capital for successor funds and win the bid for companies (Kailash Capital, 2018; McKinsey, 2018). Thus, the returns that a PE fund generates for its LPs impact the process of raising capital for another fund.

Considering an investment period of five years for PE funds, they generally wait four years before requesting LPs to commit further capital for a successor fund. However, the latest research by Cambridge Associates (2018) on PE investments benchmarking shows that it takes a minimum of six years to get a reliable measure of performance. Also, in 86% of cases, PE funds move through various different performance quartiles before settling at the final level of performance relative to others. Yet, assessing the performance track records of PE funds represents an important part of the due diligence performed by LPs and plays a crucial role in their decisions as to where to allocate capital. In this regard, due to the long wait time for final performance evaluations of PE funds, it becomes problematic for LPs to perform the due diligence. Consequently, LPs experience difficulty in examining the relative performance of PE funds before making the decisions whether to commit further capital to successor funds (Bain, 2018). In this regard, according to Kailash Capital (2018), the likelihood of a successor investment fund to replicate the previous top-performance of its predecessor has dropped from 40% in the 1990s to approximately 25% in the recent years. This further supports that it is becoming increasingly difficult for LPs to assess PE fund performance based on track records. Additionally, as bridge financing is increasingly used as a tool to smooth out capital calls, this further complicates the due diligence by LPs due to its effects on the traditional measurement of IRR. This is because not all PE funds utilize bridge financing, and thus it becomes necessary to calculate the IRR with unequal timing of cash flows (Bain, 2018).

Alongside the financial performance, PE funds usually analyze and disclose their strategic results to the LPs with the purpose of providing them with a holistic overview of the overall performance and competencies of the funds. This could include, for example, what improvements the PE funds implemented in the portfolio companies and through what means they achieved the potential value created. Although it may take several years for the LPs to get a reliable measure of performance, PE funds continuously estimate the performance of their investment funds and the individual portfolio companies during the economic life of the funds. This continuous performance measurement of investments assists the PE funds to assess successful and less successful strategies in terms of achieving the desired value creation on a portfolio company level as well as fund level.

8. Discussion of Theoretical Framework

Over the decades, three specific value drivers have been key in the value creation process of the PE business model. These key value drivers are financial leverage, multiple expansion, and operational improvements (Aleszczyk et al., 2016; EY, 2016). By varying means, each of them assists PE funds in creating value on the portfolio company level and therefore generating returns for the LPs. However, the relative contribution of each driver to the total value creation has been changing over the years and there are different opinions regarding which value driver creates the most value for PE investments. In a survey by PwC (2018), operational improvements and financial leverage were found as the two value drivers with the biggest influence on return on investments.

Hereof, PE funds are taking on a more active role in managing the portfolio companies as compared to the 1980s and 1990s when PE funds took a mainly passive involvement and relied mostly on financial leverage and multiple expansion to generate returns (EY, 2016; Brigl et al., 2016). Today, PE funds increasingly implement operational improvements with a strong emphasis on revenue growth and margin improvements. This is achieved through the further development of the portfolio companies where the PE funds support them in achieving growth and assist them in identifying the optimal focus for their strategies. In this regard, revenue growth has shown to be the most effective driver for achieving multiple expansion as it increases profits along with revenues (Bain, 2018). Hereby, the ability of PE funds to identify growth potential as early as possible can assist them during several stages of the business cycle, as it enables them to bid competitively for potential portfolio companies, create more value during the holding period, and thus exit with a higher multiple.

Regarding operational improvements, several factors can enhance the value creation plan, such as the strategic position of a portfolio company as well as the frontline customer interactions. However, it appears that PE funds have yet to fully understand how to incorporate these factors in order to assist the portfolio companies in reaching their potential for further development. That being said, it is crucial for PE funds to be able to identify strategic opportunities for the portfolio companies that can enable them to enter more markets, increase sales, and to do so more efficiently (Bain, 2018). The ability to spot such strategic opportunities and develop the portfolio companies in a specific direction is stated as the most crucial value driver by N. Retbøl (personal communication, 2018).

He emphasizes that strategic improvements represent the single most important aspect when focusing on operational improvements. However, the ways in which PE funds can initiate value-adding activities in the portfolio companies need to be assessed on a case-by-case basis, as after all, the value created is often a mix of the several value drivers that should match the situation of the portfolio company in question.

In relation to operational improvements, human capital represents an essential aspect for the success of the value creation plan. This is supported by both J. Breitenstein and N. Retbøl (personal communication, 2018) who note that it is highly necessary to hire the professionals capable of assisting a given portfolio company in achieving the intended value creation process. Therefore, PE funds must support the recruitment of management, as the performance of a portfolio company is strongly correlated with having the right team in place (Bain, 2018). Additionally, Bain (2018) maintains that if PE funds fail to make the decisions about human capital early in the process, this can result in value loss as it often entails unplanned replacements to correct for suboptimal performance.

Regarding human capital improvements internally in PE funds, PE funds can enhance their capabilities of improving the operations of portfolio companies by specializing within specific industries, deal sizes, and types of companies, among others. This is supported by research that finds that top-performing PE funds have specialized their operations within specific segments (Bain, 2018). Accordingly, top-performing PE funds have obtained capabilities in identifying the value-adding initiatives required for the portfolio companies to further develop and thus accelerating the value creation process (Bain 2018). Nonetheless, it appears that PE funds today are working harder and longer to create value, as the holding period of portfolio companies is settling into a new normal of around five years compared to less than four years in the period around the financial crisis. According to Bain (2018, p. 10), this is so as “in an era of high prices and limited future market beta, generating strong returns usually takes more time.” PwC (2018) supports that multiples and valuations are currently very high and on average even higher than before the financial crisis.

Considering the points raised above, several drivers assist PE funds in creating value on the portfolio company level and thus to generate returns for the LPs. However, the relative contributions of financial leverage, operational improvements, and multiple expansion, as the three key value drivers are often blended together.

Nonetheless, with the increasing focus on operational improvements, it has become crucial for PE funds to identify investment opportunities with potential for further development and to implement value-adding initiatives fit for each portfolio company and its competitive environment. In regard to financial leverage and multiple expansion, the relative contributions of these value drivers have decreased. Accordingly, contemporary PE funds take on lower debt levels to finance the investments than previously, and therefore, the current use of financial leverage is argued to be more balanced and healthier in the sense that portfolio companies are not overburdened with debt repayments but are given an efficient capital structure that enables them to grow (PwC, 2018).

9. Conclusion of Theoretical Framework

The value creation process of the PE business model has evolved significantly since the emergence of the PE industry in the late 1970s. Today, PE funds place increasing emphasis on improving the operations of the portfolio companies, hereby taking on a more active role to enhance the value creation. This can be partly explained by a change in market conditions, such as a more competitive environment, that consequently puts stronger pressure on PE funds to consistently generate high returns on investments to stay relevant for the LPs. PE funds that are not performing according to the LPs' expectations will lose attractiveness and thus may not be able to raise adequate capital for successor investment funds (PwC, 2018).

In this sense, the mere reliance on financial leverage and multiple expansion to drive value creation is no longer sufficient for PE funds to deliver the returns that LPs expect. Therefore, in order to build competitive advantages within the area of operational improvements, PE funds have begun to specialize within specific industries, types of companies, and deal sizes. This has shown to provide PE funds with extensive industry networks and domain expertise that assist them in identifying the most attractive investments and thereafter accelerating the value creation process during the holding period (BCG, 2008). In this regard, the more specialized PE funds are, the more rapidly they acquire valuable experiences that help them implement the value-adding initiatives that suit each specific portfolio company and its competitive environment (Bain, 2018).

PE funds utilize a variety of tools and frameworks to identify the attractive investment opportunities that not only have high potential for further development, but also match the investment objectives and criteria of the PE funds. These may differ among PE funds and can be defined in terms of geographies, sectors, and preferred enterprise value of portfolio companies. The most promising subset of potential portfolio companies go through a thorough screening and due diligence process performed by the PE funds where the financial standings, competitive positions, and the current managements of the potential portfolio companies are analyzed. Additionally, third-party consultants are often invited to complete a final due diligence on the potential portfolio companies to ensure that no critical aspects have been overlooked by the internal screening.

During the holding period of portfolio companies, PE funds employ three key value drivers to create value and improve the profitability of the investments. These are financial leverage, multiple expansion, and operational improvements. To different extents, each of them assists PE funds in enhancing value creation on the portfolio company level that eventually translates into returns for the LPs. In regard to the use of financial leverage in LBOs, PE funds tend to leverage the portfolio companies by taking on high levels of debt and using smaller amounts of equity to increase the return to equity. Additionally, PE funds intend to provide the portfolio companies with the optimal capital structure where the companies receive the benefits of leverage, such as interest tax shields, but avoid the costs of financial distress. In relation to multiple expansion, this value driver tends to be explained by external factors, such as market-wide conditions, and internal factors, such as improved prospects for the portfolio companies. Nonetheless, all together, the multiple achieved at exit is argued to be a consequence of the market expectations, the market timing, the negotiation skills of PE funds, and the exit channel (Aleszczyk et al., 2016). However, despite the continuous use of financial leverage and multiple expansion, contemporary PE funds focus on operational improvements in terms of revenue growth and margin improvements. This is evident as, today, this value driver accounts for as much as 50% of the returns generated by PE funds (Aleszczyk et al., 2016). Additionally, improvements within the areas of human capital and strategy represent crucial aspects of supporting the operational improvements.

Furthermore, as the performance of investment funds impact the ability to raise successor funds, PE funds are highly focused on the return on each investment because these directly impact the overall performance of the investment funds. For these reasons, PE funds monitor the performance of each portfolio company on a regular basis and continuously project expected returns for both the individual investments and the investment fund as a whole. Within the PE industry, the consensus is that PE investments should yield a gross IRR of approximately 25% (J. Breitenstein, N. Retbøl, personal communication, 2018). In this regard, despite return expectations may vary among LPs, PE investments are expected to at least yield higher returns relative to public equity as PE is associated with higher financial and liquidity risk.

To conclude, the PE business model employs several value drivers to enhance the value creation on the portfolio company level and thus generate returns for the LP. In this regard, the identified key value drivers, namely, financial leverage, multiple expansion, and operational improvements, are often used jointly. Thus, despite the historical trend of PE funds becoming more operationally-minded, financial leverage and multiple expansion still represent key value drivers employed by PE funds to improve the returns on investments (PwC, 2018). Yet, the most important aspect of value creation appears to be the ability of PE funds to identify attractive investment opportunities with high potential for operational improvements, as well as to initiate the value-adding activities necessary for enhancing the value of each specific portfolio company in relation to its competitive environment.

The theoretical framework has revolved around the PE business model and its drivers of value creation without considering how, for example, different regions, industries, or deal sizes, might affect the practices of PE funds. Hereof, to obtain an understanding of how the use of value drivers might deviate from the findings of the theoretical framework, further research should account for the above-mentioned factors by investigating a specific market or investment case in the PE industry. For example, the specific industry of a portfolio company can affect how value drivers are employed to generate value as the value creation process is influenced by the business model of the portfolio company and the nature of its assets. Additionally, the value creation process is also likely to be subject to the size of a portfolio company and thus it is appropriate to differentiate between small-, mid-, and large-cap investments (Braun et al., 2015). Hereof, to further explore the findings of the theoretical framework and how the PE business model drives value creation in practice, the thesis now progresses to the empirical case study of Valedo and its investment in Joe & the Juice.

Empirical Case Study

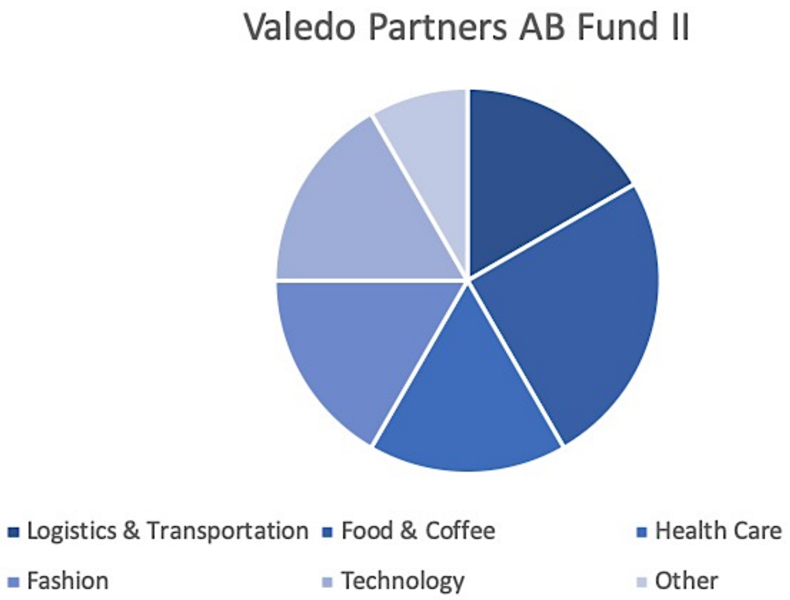
10. Introduction to Case Study

Having discussed and concluded the theoretical framework, this will now be used as the context in which the empirical case study will be placed. As stated, the empirical case study revolves around Swedish PE fund Valedo that in 2013 made an investment in Danish juice bar chain Joe & the Juice using its Valedo Partners AB Fund II (Valedo II). According to Valedo (2013, p. 1), the investment is referred to as a strategic partnership, as "the investment is made in partnership with the founder of Joe & the Juice and a large group of key employees. With Valedo as new majority owner, the company will have additional resources in terms of expertise and capital to achieve and accelerate the company's long-term growth- and development plan."

Thereby, the empirical case study will start out by presenting Valedo and its investment focus and objectives. Hereafter, the paper dives into the investment case of Joe & the Juice where the portfolio company will be analyzed from a strategic and financial perspective. The theoretical framework will be employed to assess Valedo's use of value drivers in the case of Joe & the Juice in order to examine the potential value creation. At last, a discussion will take place debating the extent to which Valedo has created value in Joe & the Juice and what could be the potential exit strategies for achieving the highest possible return on the investment.

10.1. Overview of Valedo Partners

Valedo is a PE fund that was founded in 2008 and is based in Stockholm, Sweden. Valedo specializes in investments in small and medium-sized enterprises (SMEs) in the mid-cap market that are based in Sweden and selectively in the rest of the Nordic region (Bloomberg, 2019). Valedo's past investments span across various sectors and thus Valedo cannot claim to be specialized within a specific sector. This also holds for Valedo II, as shown in Figure 11 below.



(*Figure 11.* Investments by Sectors. Adapted from Valedo, 2018)

Valedo describes itself as a growth-oriented active owner that assists management teams in driving long-term value creation initiatives and strengthening the market positions of the respective portfolio companies. Valedo believes that long-term value creation is primarily driven by growth. In this regard, Valedo is founded on the values and principles of long-term partnerships, striving for continuous development and improvements, commitment, transparency, and ethics (Valedo, 2018a). According to Valedo (2018a), it is stated that:

> "Together with ambitious entrepreneurs, management teams and co-owners Valedo grow companies and transform industries."

Until today, Valedo has managed three investment funds: Valedo I established in 2006, Valedo II established in 2011, and Valedo III established in 2016. Valedo III and Valedo II were established with a committed capital of 2 billion SEK, whereas their predecessor Valedo I had half of this amount, with committed capital of 1 billion SEK (Valedo, 2017). The shareholders of these funds are the employees of Valedo, entrepreneurs, charities, endowment funds, pension funds, and financial institutions (Valedo, 2018a). The investment funds are set up as Swedish private limited liability companies and are based in and managed from Stockholm, Sweden. In this regard, Valedo follows the limited liability model that was presented in the theoretical framework.

10.1.1. Investment Objectives and Criteria

Valedo invests in companies that are primarily located in Sweden and the rest of the Nordic region. According to Bloomberg (2019), Valedo invests in companies with revenues between $3,68 million (30 million SEK) and $67,72 million (500 million SEK), whereas, according to Valedo (2018a), the PE fund targets companies with revenues of 100 million SEK to 500 million SEK. Thus, as Bloomberg tracks investments made, it can be assumed that Valedo has previously invested in companies with revenues in the range of 30 million SEK to 500 million SEK. However, as the committed capital in Valedo I was 1 billion SEK and Valedo II is 2 billion SEK, it can be expected that the revenues of the portfolio companies would have increased closer to the high end of the range. Besides the revenue criteria, the potential portfolio companies need to be well-established and profitable with unique and strong market positions within their respective markets (Valedo, 2018a). In this line, Valedo focuses on companies with particular growth and development potential where Valedo's involvement will provide further opportunities to build the companies through add-on acquisitions, geographic expansion, and development of new products and services, among others (Valedo, 2018a). To do so, Valedo ordinarily takes a majority stake in its portfolio companies, as well as board positions.

10.1.2. Competencies and Experiences

Despite Valedo has only had one predecessor investment fund prior to Valedo II, the PE fund still has significant experience in driving development and growth strategies for their portfolio companies. In this regard, to act as an active owner supporting the growth of its portfolio companies, Valedo draws on a network of professionals with diverse operational expertise from a broad range of industries (Valedo, 2018a). This is in accordance with the findings of the theoretical framework that PE funds often rely on such experts to provide in-depth industrial competence, experience, and commitment. While this represents a crucial part of the identification of potential portfolio companies, these experts also assist Valedo in creating value during the holding periods of portfolio companies where they usually act as board members. In this regard, Valedo (2018a) states that each portfolio company is developed based on the specific opportunities and prospects for the given company.

As Valedo believes in long-term value creation, its investments are based on a multi-year development plan aimed at developing, securing, and strengthening the strategic positions of the companies through growth. In this regard, Valedo (2018a) states that close collaboration between management, the board of directors, and owners, is vital to ensure the long-term value creation. Hereof, Valedo (2018a) refers to itself as partnership-oriented and states to prioritize transparency of goals and strategies between itself and its portfolio companies. Additionally, Valedo is open for co-investments with former owners of the companies and always invests alongside the management and key employees to align the interests of the actors involved (Valedo, 2018a). Hence, Valedo appears to hold the three organizational capabilities of network access, domain expertise, and organizational improvements, as have been identified to be crucial for top-performing PE funds (BCG, 2008).

10.1.3 The Swedish PE Market

Historically, as Valedo's home market, Sweden has been a particularly successful PE market. In this regard, from 2007-2015, the Swedish buyout investments as a share of GDP was the second largest in Europe, only surpassed by the UK market (Næss-Schmidt et al., 2017). Despite the the global trend of concentration of capital to fewer PE funds, the total number of PE funds in the Nordics appears to be growing. In this regard, in 2011, Preqin (2011) reported that 164 PE funds were operating in the Nordics, whereas in 2015, this number increased to 264 (Preqin, 2015a). In Sweden in 2015, 67 PE funds were operating with around €46 billion assets under management in total, which made the country the third largest PE market in terms of absolute numbers (Næss-Schmidt et al., 2017). Thus, Valedo competes against various other PE funds both in terms of fundraising for capital as well as bidding for potential portfolio companies.

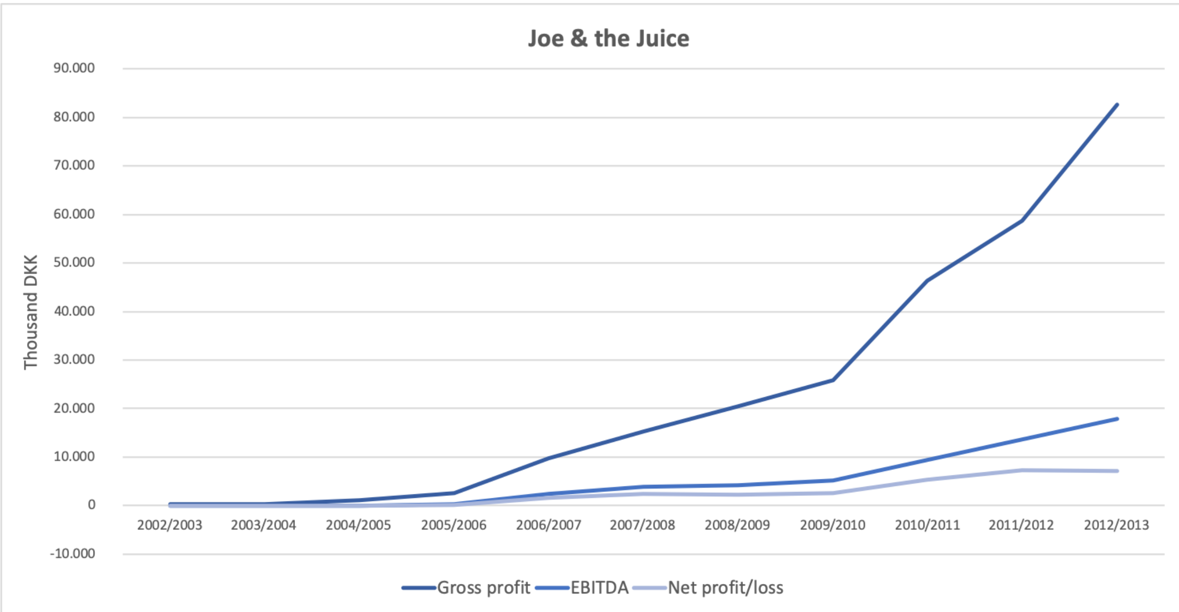
Over the years, the average fund size has increased across the European countries, with the exception of Italy. However, the increase in Sweden has been more rapid which is associated with the success of Swedish PE funds particularly (Næss-Schmidt et al., 2017). In this regard, Swedish PE funds have been found to focus on investments in SMEs, which correlates with the relatively high number of entrepreneurs and growth companies in the country. Per 1000 capita, Sweden has approximately 70 SMEs whereas the average number for European countries is 47. Additionally, since 2007, SME investments as a share of GDP has been approximately twice as big in Sweden when compared to other countries in Europe (Næss-Schmidt et al., 2017).

As Valedo invests in SMEs specifically, the PE fund faces even tougher competition within its home market. In this line, it is crucial for Valedo to ensure competent management and efficient operations to enable value creation in its portfolio companies, if they want to remain competitive and attract new LPs as well as retain existing ones. To assess this, the thesis will now analyze the investment case of Joe & the Juice.

11. Joe & the Juice

11.1. Introduction

Joe & the Juice was founded in 2002 by Kaspar Basse, opening up the first store on Ny Østergade 11 in Copenhagen where Basse worked as juicer and as the sole employee for the first two years (Rouen & Srinivasan, 2018). Then, in 2004, the first additional employee, Philip Finsteen, was hired. Finsteen came to represent one of the key employees in Joe & the Juice and is currently the Partner and Creative Director of the company (Finans, 2017). Since 2004, the company has continued to open up new stores, both in Denmark and abroad, leading to significant growth. By 2013, Joe & the Juice counted 52 stores in Denmark, London, Oslo, and Stockholm, with gross profit of 82,6 million DKK (see Figure 12) and total revenue of 145 million DKK.



(*Figure 12*. Own creation adapted from Joe & the Juice annual reports)

By 2013, it appears that Joe & the Juice was fit for the investment objectives and criteria of Valedo as a result of a Nordic background and potential for further growth, as well as a revenue of approximately 207 million SEK. With the strategic partnership entered in late 2013, Valedo bought a majority stake in Joe & the Juice with plans to double the number of Joe & the Juice stores and enter the U.S. market within two years (Rouen & Srinivasan, 2018; Børsen, 2013). In relation to the investment, Basse stated that "this partnership will provide [Joe & the Juice] with new opportunities to continue its growth. [Joe & the Juice] will both obtain an optimal capital structure as well as new expertise."[1] (Børsen, 2013, p. 1)

As set out, by 2014, Joe & the Juice had expanded further across Europe, opening up its 75th store and, subsequently, in 2015, the company reached 100 stores and opened up its first store in the U.S. in New York. In the same year, the company reached a total revenue of 404,55 million DKK with an EBITDA of 69 million DKK (see Appendix 2). In 2016, shortly after having opened the store in New York, Joe & the Juice received a second round of funding from the American PE fund General Atlantic (Berlingske, 2016; Rouen & Srinivasan, 2018). General Atlantic bought a minority stake in the company and came onboard to support Joe & the Juice in its further expansion in the U.S. and the U.K. In relation to this investment, Basse stated that "General Atlantic supports growth companies that want to expand globally. We look forward to benefit from their expertise within the retail- and restaurant industry."[2] (Berlingske, 2016, p. 1) By 2016, Joe & the Juice counted approximately 160 stores all over the world with the majority located in Scandinavia and the U.K., and around 700 employees worldwide. By 2017, the company had opened 40 stores in the U.S. and was present in 15 countries worldwide operating 210 stores and employing more than 800 people in total (Joe & the Juice, 2017; Rouen & Srinivasan, 2018; Berlingske, 2016b). See Appendix 3 for timeline of Joe & the Juice.

11.2. Strategic Analysis

With the journey of Joe & the Juice outlined, this section aims to analyze the company's current position by conducting a strategic analysis to better understand the qualitative factors that play a significant role in its performance. Firstly, an internal analysis is carried out for Joe & the Juice and its business model using the MSA framework that has been developed by Morris, Schindehutte, and

[1] Translated from Danish into English.
[2] Translated from Danish into English.

Allen (2005). The framework suggests six dimensions to analyze the business model of a company. Secondly, an external analysis will be conducted to assess the competitive position of Joe & the Juice by applying the model of Porter's Five Forces. As the name suggests, the model takes into account five factors that define the structure and attractiveness of a given industry. While PESTLE analysis could have provided a general understanding of the macro-level elements influencing the industry of Joe & the Juice, we have chosen to primarily focus our analysis to the micro-environment of the investment case. Additionally, as Valedo entered the investment in 2013, Valedo is due to exit the investment in the near future given the average holding period of portfolio companies is five years. Therefore, the long-term developments of the industry are not of particular importance in this case.

11.2.1. Internal Analysis

To get an understanding of the internal capabilities and competitive positioning of Joe & the Juice, its business model needs to be analyzed thoroughly. For this, the MSA framework is used that proposes an integrative, six-component framework to characterize the business model of a venture (Nicholson et al., 2009). The framework covers the basic decision areas that are perceived as essential to the operations and strategy of a company. The six dimensions and respective key questions are presented below in Figure 13.

(*Figure 13.* Own creation adapted from: Morris et al., 2005)

As illustrated by the figure above, the first four dimensions involve the core of the business model where value offering, customer value, core competencies, and competitive positioning of the company are examined. These are complemented with a fifth and sixth dimension which concern the economic and investment model. The fifth dimension discusses how the company makes money and how it has been able to translate the first four dimensions into a competitive position. At last, the sixth dimension analyses the ambitions for the company in terms of growth, time, resources, and potential exit (Morris et al., 2005). Each one of these dimensions will now be applied in the case of Joe & the Juice to deepen the understanding of its business model.

11.2.1.1 Value Offering

As the first dimension of the MSA framework relates to the value offering of the company, it covers decisions about the product mix and how the offering is made available to customers (Morris et al., 2005). As Morris et al. (2005) acknowledge there would be no businesses without a defined value proposition as this justifies the existence of the company.

Joe & the Juice was founded based on Basse's own inner logic and his dream of establishing a cool and energizing chain with healthy product offerings (Hansen & Basse, 2016). While the company offers variants of juice, sandwiches, and coffee, its value offering does not revolve around these three main products. Rather, according to Hansen and Basse (2016), the value offering revolves around the entire customer experience built on a unique ambience of the stores and human interactions with the juicers. In this regard, the stores have been decorated to resemble a living room and the juicers have been granted the autonomy to wear their own outfits, select the music of the stores, and engage in informal and personal interactions with the customers (Rouen & Srinivasan, 2016). In concert, Joe & the Juice claims to offer its customers inclusion in a welcoming environment where they can enjoy the above-mentioned ambience of the stores, interact with the juicers, and consume healthy products (Hansen & Basse, 2016). This aspect of inclusion will throughout the analysis be referred to as *inclusion*.

The value offering of Joe & the Juice will be explored further in a later section investigating how it was developed through strategy work conducted after Valedo became the majority owner. Yet, it is certain that the value offering is a result of a lot of decisions made in regard to a combination of various aspects. For example, as outlined above, the juicers are provided with a certain degree of autonomy in order to deliver on the customer experience of Joe & the Juice.

Nonetheless, besides the freedom concerning the frontline customer interactions, operations are tightly controlled, centralized, and with strict supervision of the back-office functions that ensures efficiency of a rather inefficient production where products are prepared in the stores on order (Rouen & Srinivasan, 2016). This way of production undoubtedly takes more time and thus comes with a cost, however, this preparation of the products on order is an important part of the value offering of Joe & the Juice as it enables customers to see exactly what goes into their orders and provides the juicers with the opportunity to interact with the customers (Rouen & Srinivasan, 2016). This personal interaction with customers is a crucial aspect of the value proposition of Joe & the Juice as it attributes significantly to the creation of an inclusive environment and tailored customer experiences.

11.2.1.2 Customer Value

Customer value is closely related to the value proposition but focuses increasingly on the customers that the company aims to create value for. Hereof, it is concerned with the nature of the market that the company operates in, the place of the company within the value chain, and the specific customer segments that are relevant for the value offering (Morris et al., 2005). As these factors have a significant impact on the resource requirements of the company, it is critical to define what the company sells and how the company is organized (Morris et al., 2005).

As the company sells freshly made juices, sandwiches, and coffee, directly to end consumers, Joe & the Juice represents a business to consumer company. Thus, the company offers value to everyone who want healthy beverages or food, yet its main target segment is the youth population (Hansen & Basse, 2016). Nonetheless, the value offering of Joe & the Juice appears to be relevant for several segments as both more mature individuals and families are also frequent visitors in the stores (Hansen & Basse, 2016).

Despite the international expansion of Joe & the Juice, the customer value offered has remained relatively stable focusing on providing an inclusive environment with unique ambience and human interactions between the juicers and the customers. For example, several competitors have introduced apps enabling customers to pre-order products that has significantly reduced wait time in stores and increased customer convenience. However, Joe & the Juice has refused to go along with such trend, as according to Basse, these types of shortcuts could make the interactions between juicers and customers more transactional and thus damage the customers' relationship with the brand in the long run (Rouen & Srinivasan, 2016).

Additionally, the more transactional interaction could reduce the meaningfulness of the juicers' work that represents an important aspect of the customer value offered by Joe & the Juice as this is directly linked to how the value is delivered to the customers. In this sense, the company emphasizes providing meaningful work for its employees that is done by empowering the juicers with the time and creative freedom to engage in human interactions and create the ambience of the stores while preparing the products (Hansen & Basse, 2016).

11.2.1.3 Core Competencies

The third dimension of the MSA framework relates to a company's internal sources of advantage in the form of resources and capabilities that provide the company with a competitive advantage in the market (Hamel, 2001; Applegate, 2001). While resources and capabilities do not provide a sustainable competitive advantage by default, companies can use one or more core competencies to build a competitive advantage that enables them to "provide particular benefits to customers in particular ways" (Morris et al., 2006, p. 34).

To analyze the core competencies of Joe & the Juice, the VRIO model developed by Barney (1995) can be applied. The VRIO model outlines the four properties of valuable, rare, inimitable, and organizational support, that the resources and capabilities of a company should possess in order to hold a sustainable competitive advantage. In the context of Joe & the Juice, four particular resources and capabilities have been identified as sources of competitive advantage, namely the founder, the organizational culture and HR management, the brand value, and the supply chain management. Taking these into consideration, each one will now be investigated in the light of the VRIO model to better understand their individual contributions to the core competencies of the company.

The Founder

Firstly, Kaspar Basse, the founder and previous CEO of Joe & the Juice, can be considered a valuable resource for the company. As Hambrick and Mason (1984) cite, the leaders within a company can greatly affect the organizational outcomes, strategic choices, and performance levels. In this regard, the expertise, personality, and leadership style of Basse has had a strong, beneficial impact on the development of Joe & the Juice that has been closely linked to Basse's own personal venture. Basse's young age, combined with his limited professional experience, tattoos, and informal style make him unlike the typical CEO (Rouen & Srinivasan, 2016).

Yet, he has managed to establish a multinational company with a global presence whose every aspect is deeply rooted in his vision, which is especially evident in the organizational culture. Additionally, even after Valedo bought a majority stake in 2013, Basse kept his position as CEO and maintained a high level of engagement in Joe & the Juice. Hereof, Basse can be considered an extremely valuable resource who has driven the exploitation of growth opportunities given the drastic expansion of Joe & the Juice over the years, which has been supported by external capital.

Representing the vision of the company, Basse is a source of sustainable competitive advantage, and thus fulfills the criteria of the VRIO model. His unique personal story and his role as the face of the company make him a resource that is both rare and difficult for others to replicate. Even more so, Rivkin (2000) notes that the more numerous interconnected decisions that have been made, the more these contribute to the inimitability of a resource. In this line, due to the magnitude of decisions that Basse has taken since the founding of Joe & the Juice, the imitation attempts from other companies to reproduce the strategy of Joe & the Juice can be expected to be less successful (Rivkin, 2000). Moreover, given the essential role of Basse in building and shaping the culture, strategy, and brand of Joe & the Juice, it would be improbable for another organization to arise in the same fashion.

Organizational Culture & Human Resource Management

Alongside a strong founder, another key source of competitive advantage for Joe & the Juice is its organizational culture and HR management. As Schein (2010) acknowledges, leaders are the ones who initiate the process of culture creation. Taking this analysis into account, it can be claimed that the culture of the organization is inevitably connected to Basse’s own personal values. Furthermore, the strength and clarity of the leaders represent one crucial aspect that can support the creation of a stronger shared organizational culture. The other crucial aspects are the intensity of the learning experience, the stability as well as the length of a group’s existence, and the mechanisms through which the learning occurs (Schein, 2010). In this sense, many of the Joe & the Juice employees have been employed for several years and have grown with the brand as the majority started out as juicers or bar managers. Hence, the employees of Joe & the Juice can be inferred to hold a strong shared organizational culture and loyalty towards the brand (Hansen & Basse, 2016). This can be considered as a valuable resource for the company as a strong organizational culture has proven to result in higher job satisfaction, stronger motivation, increased job proficiency, and longer tenure (Ashkanasy & Jackson, 2001).

Additionally, the strong organizational culture of Joe & the Juice is emphasized through various initiatives catered to building relations across the organization. Firstly, Rouen and Srinivasan (2016) outline that each country manager has a budget allocated to set up a social calendar for the employees enabling them to build relations both vertically and horizontally. Secondly, an annual juicer competition is held, called *ShowOff*, bringing juicers together from all over the world providing them with an opportunity to share experiences, acquire new skills, and socialize with one another. Furthermore, the employees who are preparing for a promotion are encouraged to travel to another country to gain exposure to a new culture while working in a local Joe & the Juice store (Hansen & Basse, 2016). The aim of the transfer program is to foster the common culture of Joe & the Juice across countries amidst international expansion (Rouen & Srinivasan, 2016). While these programs require significant investment from the management, the strong organizational culture assists Joe & the Juice in setting itself apart from its competitors.

Another related aspect that bolsters the organizational culture of Joe & the Juice is its HR management and promotion structure. As can be seen in Appendix 4, the members of the leadership team of Joe & the Juice in 2016, except for the Director of Legal and Compliance, had started their careers in the company as juicers. While the average age of the leadership team is just around 30 years, the members have spent several years at Joe & the Juice obtaining learning-by-doing experience, holding roles as bar, shift, and country managers, in order to better understand the operations before reaching leadership positions (Rouen & Srinivasan, 2016). Hereof, the current leadership team serves as an inspiration for the lower level employees, portraying how it is possible to climb the ranks within Joe & the Juice. In this regard, the company developed the so called *Moneyball* program which outlines the 10-step process it takes to reach an executive position from an entry-level juicer role (Rouen & Srinivasan, 2016). The objective of the program is to make the promotion process as transparent as possible, and, therefore, both job descriptions, required skills, and compensation, are clearly defined for each level and easily accessible for all employees in Joe & the Juice (Rouen & Srinivasan, 2016).

As noted by Nicholson et al. (2009), the organizational culture and HR management of a company represent two intertwined aspects that contribute to the internal identity of the brand. In this regard, it appears that Joe & the Juice is utilizing the four levers identified by Schein (2010) within HR management to strengthen its culture. These four levers are selection, socialization, reward system, and setting an example. Firstly, in regard to socialization, Joe & the Juice scouts candidates whose values are a potential match to those of the company (Rouen & Srinivasan, 2016).

Also, the above described training programs and social gatherings support socialization and help new employees to internalize and integrate the values and the norms of the company. Furthermore, the Moneyball program assures rewards and promotions to the best performing employees. At last, the leadership team, including Basse, is still involved in the operations setting an example for others to follow.

It is evident that the organizational culture and HR management provide Joe & the Juice with valuable resources. This is especially clear in the company's ability to establish a culture where employees represent a deeply integrated part of the value proposition. This can also be perceived as one of the facilitators of the sharp growth the company has experienced (Rouen & Srinivasan, 2016). Considering the points raised above, the organizational culture and HR management of Joe & the Juice can be argued to be difficult to replicate. Lastly, given the organizational set-up of the company, and the Moneyball program, which were both developed to support employee development and strengthen the culture, it is evident that the organizational support for this source of competitive advantage is present as well.

Brand value

The strong organizational culture forms part of the brand value associated with Joe & the Juice, where the juicers are known for being "largely good looking, tattooed millennials, dressed as they would for a day at the skatepark" (Rouen & Srinivasan, 2016, p. 2). As acknowledged by Chugh (2017), a clear brand can assist a company to stand out from competitors and make customers connect to and identify with it. The stated purpose of Joe & the Juice is to change the world through a positive influence on the global youth culture (Hansen & Basse, 2016). In this sense, a significant amount of the brand value of Joe & the Juice is directly link to the juicers because they represent the company's frontline interactions with the customers and hereof project the brand to the youth. Hence, considering the stated purpose of Joe & the Juice, high engagement between juicers and customers lies at the very core of the brand (Hansen & Basse, 2016). In this regard, juicers are encouraged to treat the customers with a high degree of familiarity and low degree of formality to make the interactions more natural. Hereof, to support and reinforce this aspect, Joe & the Juice has developed 15 principles to guide its employees to behave in accordance with the brand (see Appendix 5).

It is rare to find a chain where the individual personality and creativity of entry level employees play such a crucial role in the brand. Hereof, the brand value of Joe & the Juice can be considered as another valuable resource that assists the company in building stronger connections with its customers. Although other companies may attempt to reproduce the concept of Joe & the Juice, the company holds a well-established and recognizable brand. As a result, consumers ascribe specific attributes to the brand value, and therefore, a potential imitation attempt of Joe & the Juice could easily be perceived as fake or unoriginal. In terms of organizational support, it appears that Joe & the Juice has implemented initiatives and guidelines to support its brand value. Additionally, the company has allowed for the autonomy of the juicers to create the ambience of the stores and the cool image of the brand while top management focuses on other responsibilities (Rouen & Srinivasan, 2016).

Supply chain management

Finally, Joe & the Juice has developed an efficient supply chain system. The system that the company uses was developed internally by one of the key employees and it seeks to facilitate and automate all administrative tasks to be run from mobile devices (Rouen & Srinivasan, 2016). The system facilitates reporting on all levels of the organization and enables the use of historical data for future planning, both in terms of inventory and HR management alongside other data points (see Appendix 6). Consequently, the development of the system has eliminated the need for Joe & the Juice stores to hold regular back offices and has significantly reduced the time needed for traditional management tasks, such as payroll (Rouen & Srinivasan, 2016). The system not only provides managers with access to financial data, employee performance, and store-related information in real time, but also enables the management of Joe & the Juice to use the collected historical data for sound decision-making moving forward.

As a result of the time and cost savings, the system provides Joe & the Juice with a valuable source of competitive advantage. Furthermore, it enables more informed decision-making and helps planning for future activities, such as inventory ordering and automation of shift planning based on customer traffic data (Rouen & Srinivasan, 2016). While many companies are utilizing effective reporting systems, this highly technological system has been developed for and tailored to the specific operations of Joe & the Juice and can thus be considered rare. Additionally, such highly developed systems are not commonly used in the café restaurant industry. While other companies can attempt to imitate similar systems, it would require extensive time and resources to reach the technology and collected data required to assist sound decision-making to the same extent as Joe & the Juice.

Thus, the degree of imitability is limited. Furthermore, as the system is used across the various organizational levels by various departments and job tasks, this shows that the organizational support for the resource is in place. Jointly, these four elements, the founder, the organizational culture and HR management, brand value, and supply chain management, can be considered as VRIO resources and capabilities, and can thus be argued to represent the core competencies that provide Joe & the Juice with a competitive advantage.

11.2.1.4 Competitive Positioning

The fourth dimension of the MSA framework is the competitive positioning. This dimension considers how the identified core competencies of Joe & the Juice provide the basis for its competitive positioning in the café restaurant industry (Morris et al., 2005). Furthermore, as Morris et al. (2006) acknowledge, this dimension aims to identify points of differentiation that enable a company to obtain a unique, defensible position and thus to sustain a competitive positioning in the long run.

As identified in the previous section, it appears that Joe & the Juice maintains several core competencies to differentiate itself from its competitors and defend its competitive position. Especially, the organizational culture and brand value can be considered as key differentiators that set Joe & the Juice apart from other companies competing in the same market. Yet, as Morris et al. (2005) note, the difficulty is to maintain the competitive position. This is especially true in the highly competitive café restaurant industry where various companies are in constant rivalry for market share. Due to the close proximity and easy access to various cafés in the major cities, companies need to be able to differentiate themselves from other competitors who provide relatively similar product offerings. With this in mind, Joe & the Juice has aimed for a differentiation strategy focused on setting itself apart through a unique value offering rather than cost leadership strategy where companies try to compete on prices. Nonetheless, this will be further investigated in the external analysis section where the model of Porter’s Five Forces is utilized to examine the market dynamics in the café restaurant industry and the competitive positioning of Joe & the Juice.

11.2.1.5 Economic Model

The economic model is the fifth dimension which complements the first four strategic dimensions of the MSA framework. As Linder and Cantrell (2000) acknowledge, the economic model represents a core element of a company’s the business model.

This dimension is assessed through four aspects revolving around the company, including the revenue, the cost structure, the profitability margins, and market opportunities for further growth (Morris et al., 2005). To understand the economic model of Joe & the Juice, a financial analysis is completed in a following section of the paper, taking these four aspects into consideration. Hence, we shed light on the financial situation of Joe & the Juice by analyzing the historical track record of revenue and cost, margins, and key financial ratios.

11.2.1.6 Investment Model

The sixth and final dimension of the MSA framework is the investment model of the company which analyses the ambitions for the company in terms of growth, time, resources, and potential exit. Hereof, this dimension considers the future outlook for the company and Morris et al. (2005) identify four models within this dimension, namely subsistence, income, growth, and speculative, depending on the state at which the company is at.

In the case of Joe & the Juice, its current investment model is evidently the growth model which is characterized by substantial investments but also significant reinvestments in an attempt to grow the value of the company to the point where it can result in a major capital gain for investors (Morris et al., 2005). In this regard, the growth is heavily focused on further international expansion (Vækstfonden, 2018). This is to enhance the performance and future prospects of the company to heighten the likelihood of Valedo, as the main investor, to realize a return when exiting the investment. Furthermore, according to the previous CFO and current CEO of Joe & the Juice, Sebastian Vestergaard, the aspirations for the company in 2018 were to open 60 stores globally and to reach 1 billion DKK in revenue (Vækstfonden, 2018).

Considering the exit ambitions, it has been stated that Valedo may be preparing Joe & the Juice for an IPO in the near future (Bloomberg, 2018). However, this has not been confirmed by the owners of Joe & the Juice. Nonetheless, Bloomberg (2018) reports that an estimated valuation of the potential IPO could possibly be as high as $1,5 billion when benchmarked against the American fast food chain Shake Shack. As these future plans are only speculative at this point in time, the potential exit strategies for Valedo and its investment in Joe & the Juice will be analyzed in a later section.

11.2.2. External Analysis

Moving from the internal to the external strategic analysis, the model of Porter's Five Forces (Porter, 1979) is utilized to examine the competitive dynamics of the café restaurant industry and how the identified core competencies of Joe & the Juice provide the basis for its competitive positioning in this industry. This is done by investigating the threat of new entry, the threat of substitution, the bargaining power of suppliers as well as customers, and how these affect the rivalry among competitors. By applying Porter's Five Forces, it becomes possible to map the potential threats that influence Joe & the Juice and the other companies in the industry. This analysis can also assist the company in identifying points of differentiation and reaching the main objective of corporate strategy, namely, to build a sustainable competitive advantage that mitigates potential competitive challenges (Porter, 1987).

11.2.2.1 Threat of New Entry

The threat of new entrants refers to the barriers and costs associated with entering the market. In this sense, the lower the barriers to entry, the higher the potential entry of new competitors in the industry (Morrison, 2011). One of the key barriers is the cost of entering the market. In the industry context of Joe & the Juice, the initial capital investment depends on the intended scale of operations. In general, concerning the potential fixed costs of running a café restaurant, the initial required capital investment can be considered relatively high due to the need of obtaining venue and equipment with the former depending on location and size (Tice, 2013). Nonetheless, it is possible to employ a franchise strategy that would significantly reduce the required capital investment. Additionally, the magnitude of the required capital investment depends on whether a potential entrant is a new business opening a single café restaurant or is an established company expanding its operations into new markets. In the case of entry of a smaller, independent company, the potential threat to Joe & the Juice is limited because the company has the advantages of scale of operations and learning-by-doing experience, as well as a high degree of brand value well-known to customers. Contrastingly, if an established company would expand into the markets of Joe & the Juice, this could entail a higher potential threat, as the established company would be likely to also benefit from the above-mentioned advantages. For example, if Pret a Manger would broaden its product offering to include freshly made juices and sandwiches, this could pose a severe threat to the operations of Joe & the Juice.

Another factor that impacts the threat of new entrants is the degree of differentiation among the existing products and services. If a clear gap exists in the market where the needs of consumers are not met, this can represent an attractive opportunity for new entrants to enter with more differentiated and unique products tailored to cater those unsatisfied needs (Hooley et al., 2012). In this line, highly diversified product offerings by incumbents increase the entry barriers for potential new companies as they would likely struggle to find an attractive market for their products and services. In the context of Joe & the Juice, the company offers a quite narrow product range that has only changed slightly over the years. However, according to Joe & the Juice (Hansen & Basse, 2016), this is intentional, as the company has adopted an inside-out approach where the brand is created and developed independent of customer demands and expectations.

Finally, as Hooley et al. (2012) acknowledge, the possibility of retaliation from incumbent companies reduces the threat of new entrants. Within the café restaurant industry, several big companies such as Starbucks, Pret a Manger, Espresso House, and Joe & the Juice, have established presences in several markets and would likely retaliate heavily if new entrants would target these markets. Jointly, barriers to entry can limit the number of companies in a market that, in turn, protect the earnings of incumbent companies due to lower competition. Hereof, in the case of Joe & the Juice, the threat of new entrants can be considered as intermediate. This is because, firstly, establishing a café restaurant can require substantial capital investments, secondly, the existing product offerings in the market can be considered extensive, if not by a sole incumbent then collectively, and thirdly, there would likely be high retaliation from incumbent companies, including Joe & the Juice itself.

11.2.2.2 Threat of Substitutes

Given the simple product offering of Joe & the Juice (see Appendix 7), the presence of substitute products is high. When considering the company's beverage selection of juices and coffee, potential substitutes, such as sodas, energy drinks, and pre-packaged juices, can be bought in several different stores in many locations. Additionally, regarding the food selection of Joe & the Juice, any meal offering can potentially be considered as a substitute product. Hereof, the potential substitutes are not limited to the companies that are direct competitors of Joe & the Juice, and thus, this increases the number of potential substitutes for the products of Joe & the Juice. Finally, when simply considering how to fulfill the basic physiological need of hunger, even a home-cooked meal can serve as a potential substitute product. Hereof, as consumers can easily find substitute products, the switching costs associated with the products of Joe & the Juice appear to be low (Hooley et al., 2012).

However, as Yang and Peterson (2004) cite, companies can raise the switching costs of their products by increasing customer satisfaction and the perceived value of their offerings. This can be argued to be the case for Joe & the Juice, as the company argues that its value offering revolves around the unique customer experience of Joe & the Juice rather than its products.

11.2.2.3 Bargaining Power of Suppliers

The bargaining power of suppliers refers to the extent to which suppliers have differentiated products and the intensity of the competition among them (Porter, 1979). This is impacted by the number of potential suppliers for Joe & the Juice in the market. The higher the number of potential suppliers in the market, the lower the bargaining power of suppliers, as buyers are able to select from a large pool of suppliers and choose the one that matches their requirements the best.

The fact that Joe & the Juice prepares its products in store and only buys basic food ingredients reduces the bargaining power of their suppliers due to the high number of suppliers selling such commodities. Hereof, Joe & the Juice can choose from a large pool of suppliers and does not have to rely on one specifically, which might be the case with more specialized products. Furthermore, despite the customers' expectations for high quality food have increased over recent years (Trienekes & Zuurbier, 2007), the ingredients that Joe & the Juice uses, mainly vegetables, fruit, and bread, can still be considered as commodities. Hereof, many suppliers offer comparable products of same quality which further contributes to a low bargaining power of suppliers. In this regard, if Joe & the Juice is not satisfied with a current supplier, the company can change the supplier without high switching costs (Morrison, 2011). Consequently, Joe & the Juice can bargain with suppliers in regard to delivery and prices and can choose the supplier that offers the optimal terms and conditions. Additionally, the size of the company can also provide Joe & the Juice with additional advantage as the company is likely to buy products in bulk and can use the purchase of big quantities as a bargaining tool when negotiating with suppliers. This reduces the switching costs furthermore as the possibility of Joe & the Juice to negotiate an equal or better deal from a competitor supplier can be considered high.

11.2.2.4 Bargaining Power of Customers

According to Hooley et al. (2012), customer bargaining power can be considered high if many comparable products are easily available to them. As acknowledged previously, there is a broad range of comparable and substitute in the café restaurant industry. Taking this factor into account, in addition with the narrow product offering of Joe & the Juice, this should increase the bargaining power of customers (Morrison, 2011). Nonetheless, as Joe & the Juice has adopted an inside-out approach, the company considers itself not to be customer-driven (Hansen & Basse, 2016). For this reason, it can be inferred that Joe & the Juice does not pay particular attention to its customers' bargaining power, regardless of whether it is high or low.

When considering the arguably high prices in comparison to the target consumers' monthly incomes, it can be observed that those who consume the products of Joe & the Juice have a low price sensitivity. In this sense, as Porter (2008) argues, the price sensitivity of customers is subject to the perceived value that they obtain from consuming the products and can be reduced through differentiation of the value offering. Nonetheless, due to the low switching costs of transitioning between competitors, consumers in the café restaurant industry are found to have the ability to bargain for lower prices, better quality, and improved services (Haskova, 2015). Consequently, the low switching costs for the customers of Joe & the Juice can be considered to increase their bargaining power further. However, again this appears not to be the case for Joe & the Juice, as the company is not aiming to accommodate the various demands from customers and thus can be claimed to give less importance to their bargaining power. Yet, as many café chains, Joe & the Juice also utilizes various types of loyalty and discount programs with the attempts of continuously attracting and retaining customers. Hereof, it is worth considering whether Joe and the Juice would continue its claimed non-customer-driven approach if the company would start losing customers and experience decreasing attractiveness.

11.2.2.5 Competitive Industry Rivalry

Rivalry among the incumbent companies is central to Porter's Five Forces model and is influenced by the number and relative size of the incumbents, as well as their relative differences (Porter, 1979). In this line, Hooley et al. (2012) acknowledge that rivalry intensifies with a high number of companies with relatively even market shares within the same industry. This is so, as it incentivizes the companies to increase efforts of competition in order to steal market share from one another. In the café restaurant industry, Joe & the Juice has several large competitors, Starbucks being the largest of these competitors with approximately 30.000 stores worldwide by 2018 (Starbucks, 2018). Particularly considering the U.S. market, Starbucks poses a considerable threat as it holds approximately 40% of the market share in coffee chains (Statista, 2016). Considering the European market, Costa Coffee and Caffe Nero have the largest presence with 2.755 and 755 operating stores in 2017, respectively (BBC News, 2018).

Furthermore, the low switching costs in the café restaurant industry increase the competition significantly (Randall, 1993). Consequently, this leads to fierce competition where companies try to attract customers and differentiate their offerings by improving their services, products, and brand images (Hooley et al., 2012; Randall, 1993). This appears to hold true for Joe & the Juice. However, the company has arguably established a competitive position by following a differentiation strategy rather than a cost leadership strategy. In this regard, since its founding, Basse has focused on doing business differently just to be different as he believes that is the way towards a sustainable differentiation (Hansen & Basse, 2016). Accordingly, Joe & the Juice has emphasized creative thinking and problem-solving in the various elements of its business model, for example, pertaining to the concept development, the organizational planning, and the requirements for juicers.

Yet, the extent to which Joe & the Juice is actually differentiated in the market can be questioned. This is due to the fact that there are various competitors with similar products. For example, the above-mentioned competitors all have a broad selection of beverages and food options for customers to choose from. Therefore, their product offerings can be considered to cover the offering of Joe & the Juice. Additionally, while none of the competitors provides sandwiches prepared on order or freshly squeezed juices, the risk of these companies to start doing so remains rather high. Nonetheless, the strategies of the competitors are based on different value offerings whereof the value offering of Joe & the Juice set it apart by revolving around the customer experience built on an inclusive environment with a unique ambience and human interactions (Raphael, 2018).

11.3. Financial Analysis

With the strategic positioning of Joe & the Juice now established, the thesis conducts a financial analysis of the company. The financial analysis will present the quantitative facts about the performance of Joe & the Juice to complement a holistic analysis of the company that thus far has examined the qualitative factors.

The financial analysis is based on an examination of the annual reports of Joe & the Juice since it was founded in 2002 until its latest available report for the 2017 fiscal year. Even though the annual reports from 2002 to 2017 have been assessed, the financial analysis will focus on investigating the financial performance of Joe & the during the holding period of Valedo. Hereof, as Valedo made the investment in Joe & the Juice in late 2013, the period of analysis covers 2014 to 2017. As N. Retbøl (personal communication, 2018) notes, it is crucial to investigate the historical track records of a portfolio company to assess performance during market upturns and downturns. In this regard, we believe that the analysis has been extended beyond a reasonable period to reflect both positive and negative fluctuations to ensure as accurate an analysis as possible.

11.3.1. Quality of Annual Reports

The financial analysis is performed on the basis of the annual reports. The annual reports of Joe & the Juice have been prepared in a cooperation between external auditors and the management of the company. However, it is management who maintains the responsibility for these reports and determines the content. Thus, it is necessary to first assess the reliability of the annual reports before the financial analysis is conducted. Also, as Joe & the Juice is a privately-held company, the information available for the financial analysis tends to be limited in terms of both history and depth as private firms are not governed by the standardized accounting and reporting standards of publicly-traded firms (Damodaran, 2012). Compared to public companies, private companies operate under far looser standard, and there can be wide differences between companies on how items are accounted for. Therefore, the annual reports have been scrutinized for inconsistencies and hereafter the income statements and balance sheets have been gathered in excel sheets to provide a clear overview of the financial development of Joe & the Juice (see Appendix 8).

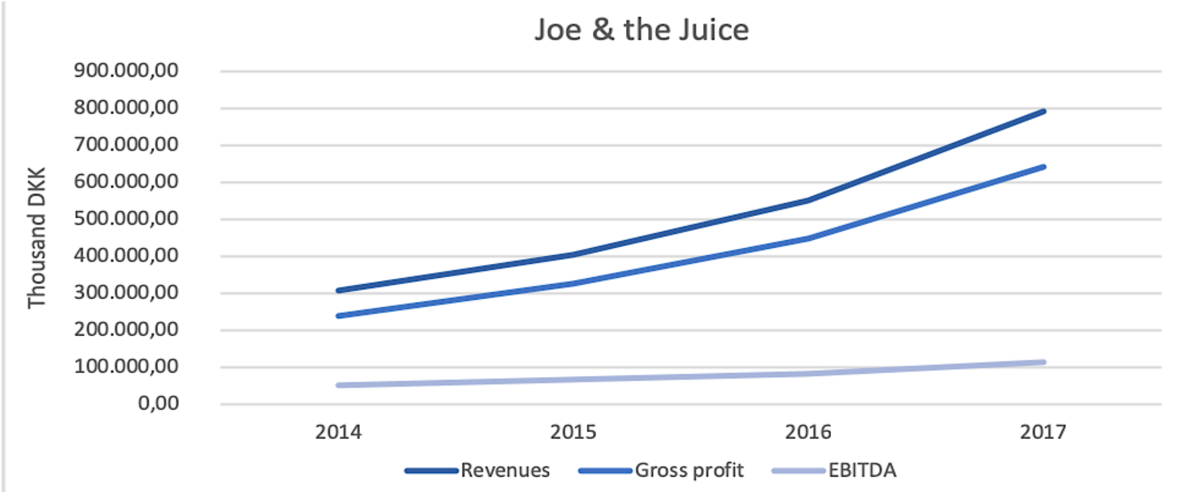
A review of the accounting principles applied in the annual reports from the years of analysis reveals that since its founding, Joe & the Juice has presented its financial statements in accordance to Danish accounting principles (Joe & the Juice, 2003). Additionally, from the beginning, Joe & the Juice has made use of a certified public audit company to conduct an external audit. Since 2012, when the investment negotiations began with Valedo, the financial statements have been prepared not only in accordance with the Danish accounting principles, but also the International Financial Reporting Standards (Joe & the Juice, 2012). In relation to the investment made in the end of 2013, PricewaterhouseCoopers became the external audit company for Joe & the Juice where subsequently the accounting period was changed. Since the founding of Joe & the Juice up until the investment, the financial year ran from July 1st of the current year to June 30th of the following year. However, after Valedo's investment, the accounting period was changed to run from January 1st until December 31st of the same year. This was corrected by accounting for the last six months of 2013 before initiating the new accounting period of year 2014. Consequently, this has led to a certain degree of discrepancies between the financial statements of the period before and after the investment.

Additionally, the annual reports changed from reporting on the local Danish Joe & the Juice company to reporting the numbers from the entire group. Consequently, this results in further discrepancies. Hereof, we have chosen to only analyze the financial performance of Joe & the Juice since 2014. However, we still find that the trend graph constructed (see Figure 12) serves to portray the financial development of Joe & the Juice since its founding. Concerning the financial reports since 2014, smaller inconsistencies have been identified in the order of components of the income statement and these have been reformulated to increase the degree of comparison. For example, since 2014, the component of other external expenses has varied to be accounted for either before or after gross profit. This has been corrected for in the reformulated income statement (see Appendix 8.1) so that other external expenses are consistently subtracted after gross profit. Similarly, other income has been moved from before gross profit to after gross profit. Thus, in the reformulated income statements, gross profit consistently equals revenues less cost of goods sold (COGS).

Hence, financial figures, such as the income statement and balance sheet, have been built and reformulated with the purpose of examining the historical development of Joe & the Juice. These are based on the publicly available financial information but have been adjusted to account for the points raised above. Regarding the balance sheet, companies often alter the combination of assets and methods of financing them, however, in a gradual fashion (Fridson & Alvarez, 2011). To spot these subtle yet frequently significant changes, a common form balance sheet has been constructed that converts each asset into a percentage of total assets and each liability or component of equity into a percentage of total liabilities and shareholders' equity. Additionally, we reclassified the balance sheets according to the liquidity criterion, separating short-term and long-term assets and liabilities (see Appendix 8.2). Concerning the income statement, the EBITDA format has been adopted as it allows us to better identify the contribution of the operating activity to the overall performance. Moreover, to compare the performance of Joe & the Juice throughout the period of analysis, the components of the income statements have been converted to percentages of revenues (see Appendix 8.1).

11.3.2. Income Statement

Examining the income statements from the period of 2014 to 2017, it is evident that Joe & the Juice has experienced sharp growth in both revenues and gross profit, and a certain growth in EBITDA as well (see Figure 14). Calculating the compound annual growth rate (CAGR) for the period of analysis shows a growth rate of 26,41% for revenues, 27,98% for gross profit and 21,82% for EBITDA. The relatively slower growth of EBITDA can be attributed to a slight increase in both SG&A and other external expenses as percentage of revenue, as shown in the income statement (see Appendix 8.1). Nonetheless, this appears to be of minor significance.



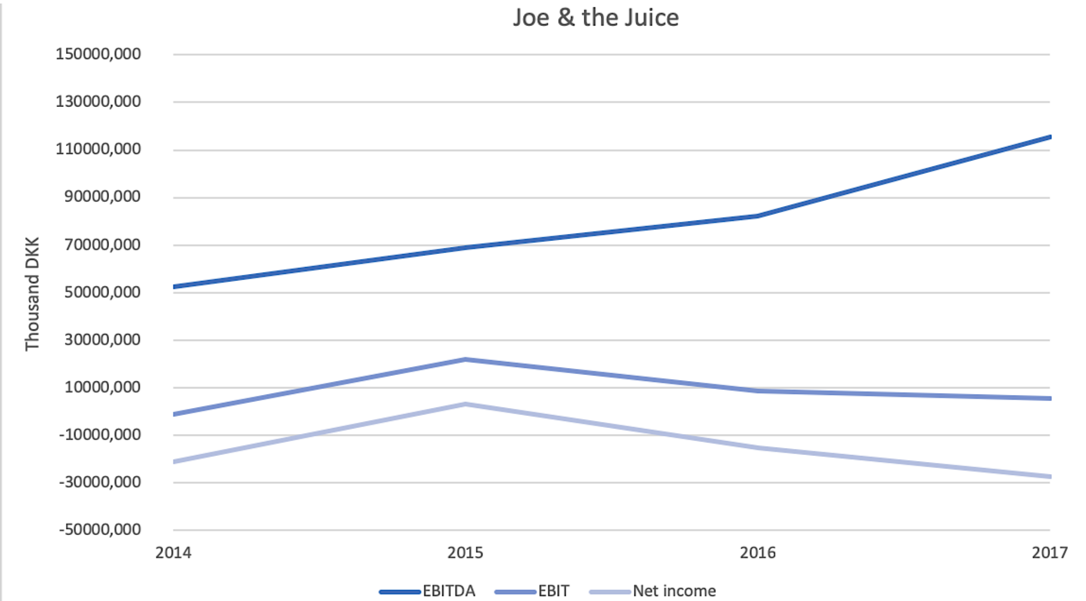
(*Figure 14.* Own creation adapted from Joe & the Juice Annual Reports, 2014-2017)

Instead of CAGR, the average annual growth rate (AAGR) could also have been used to assess the long-term trends of Joe & the Juice. AAGR applies to various financial measures such as growth rates of profits, revenue, expenses, and such, and provides investors with an idea about the direction wherein the company is headed. Using AAGR, Joe & the Juice has experienced even sharper growth (see Figure 15), however, CAGR is the growth rate commonly-used.

Year	Revenues	AGR	Gross profit	AGR	EBITDA	AGR
2014	309.610,15		239.307,93		52.463,80	
2015	404.550,76	30,66%	326.063,56	36,25%	69.043,47	31,60%
2016	551.350,00	36,29%	448.858,00	37,66%	82.333,00	19,25%
2017	790.678,00	43,41%	642.052,00	43,04%	115.552,00	40,35%
Average AGR		**36,79%**		**38,98%**		**30,40%**

(*Figure 15.* Own creation adapted from Joe & the Juice Annual Reports, 2014-2017)

When examining earnings before interest and taxes (EBIT) and net income of Joe & the Juice, the performance shows a different trend (see Figure 16). Over the period of analysis, D&A represents an average of 14,07% of revenue. In 2014, D&A was as much as 17,36% of revenue that resulted in a positive EBITDA turning into a negative EBIT of -1,299 million DKK. Nonetheless, from 2014 to 2015, the percentage of D&A decreased while revenues increased with approximately 100 million DKK, resulting in a positive EBIT of 21,97 million DKK. Yet, though still positive, EBIT has been decreasing again from 2015 to 2017. Concerning the net income, Joe & the Juice has had a negative net income of more than 10 million DKK in the years of analysis, except from year 2015 where the company had a positive net income of 3,036 million DKK. Besides taxes, it is evident that the company is subject to major financial expenses that on average represent 5,71% of revenues in the four-year period (see Appendix 8.1).



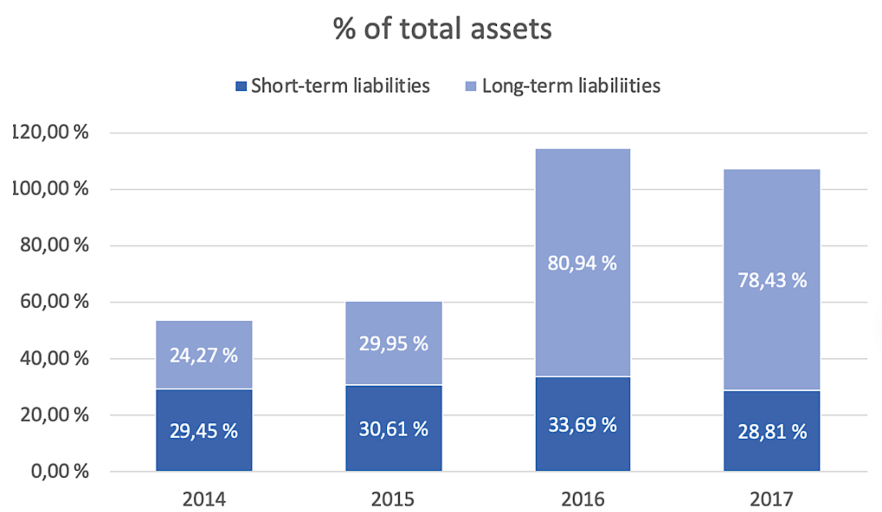
(*Figure 16.* Own creation adapted from Joe & the Juice Annual Reports, 2014-2017)

Examining the cost components in the income statement throughout the period of analysis, the main components as average percentages of revenue are COGS (19,87%), SG&A (33,51%), and other external expenses (32,68%), as well as D&A (14,07%). COGS represents the direct costs attributable to the production of the goods sold in a company. Thus, this is to a certain extent dependent on external factors that Joe & the Juice cannot influence. Additionally, D&A is a non-cash operating expense linked to capital expenditures that allows for Joe & the Juice to invest in growth by supporting acquisition, upgrading, and maintenance of existing and new business. Hereof, to optimize profits, it appears that Joe & the Juice could potentially focus on improving operating efficiency by reducing the costs from SG&A and other external expenses.

11.3.3. Balance Sheet

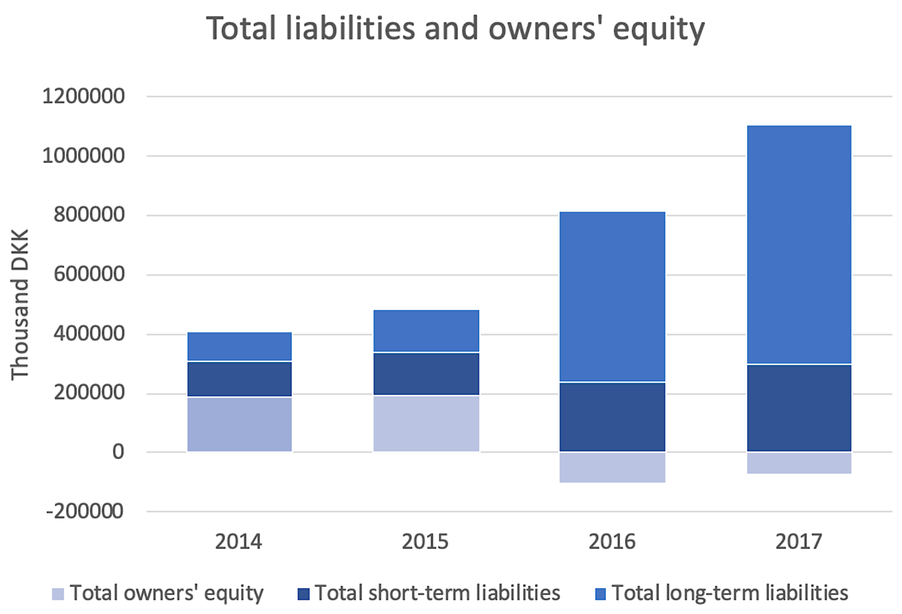
Examining the balance sheets from the period of 2014 to 2017, it is evident that Joe & the Juice has also experienced a sharp growth in terms of total assets. These increased more than double the value from 408,075 million DKK in 2014 to 1,031 billion DKK in 2017 – representing a total growth of 152,7% in the four-year period (see Appendix 8.2). Yet, the percentages of short-term and long-term assets as a share of total assets have remained fairly stable, representing around 20% and 80%, respectively. As opposite to short-term assets, long-term assets cannot be readily liquidated to facilitate day-to-day operational expenses. Hereof, considering the heavy weight of long-term assets, it is possible Joe & the Juice may struggle to meet its short-term operational expenses if the company experiences financial difficulty. Yet, it can also be a sign of investment in the company's long-term health. In this case, it is common to use capital for asset purchases that is intended to drive earnings in the long-run. Moreover, the heavy weight of long-term assets can explain why D&A represent one of the main expenses in the income statement, as shown in the previous section.

Simultaneously, total liabilities increased with a total growth of 404,37%, mainly resulting from an annual increase of 176,88% from 2015 until 2016. Investigating this growth further using the common form balance sheet shows that total liabilities increased from representing 53,72% to 107,24% of total assets, thus its share of total assets in percentage terms doubled. This increase mainly stems from a rise in long-term liabilities that rose from representing 24,27% to 78,43%, whereas short-term liabilities have remained stable, representing around 30% of total assets (see Figure 17).



(*Figure 17.* Own creation adapted from Joe & the Juice Annual Reports, 2014-2017)

From the annual reports (Joe & the Juice, 2016; Joe & the Juice, 2017), it appears that the increase in long-term liabilities mainly stems from a significant expansion in liabilities for credit institutions of around 400 million DKK from 2015 to 2016, and an additional 150 million from 2016 to 2017, together with an addition of subordinate loan capital of almost 100 million DKK. Consequently, with total liabilities representing more than 100% of total assets in the year 2016 and 2017, owners' equity represents a negative share of total assets that is caused by significant losses assigned to retained earnings of more than 100 million DKK in both years (see Figure 18).



(*Figure 18.* Own creation adapted from Joe & the Juice Annual Reports, 2014-2017)

11.3.4. Ratio Analysis

In terms of analyzing financial performance of companies, the DuPont model is commonly used as it allows for a more readily perception of the drivers of ROA. This can further be expanded to ascertain the contribution of financial leverage to ROE that is particularly interesting to assess in an LBO investment case as Joe & the Juice. However, for a company with negative equity as Joe & the Juice obtained in year 2016 and 2017, the DuPont model is relevant only for analyzing ROA. This is because a positive net income divided by negative equity produces a negative figure, implying that a profitable company has a negative return on equity (Fridson & Alvarez, 2011). However, as Joe & the Juice also has negative net income currently, the DuPont model completely loses its usefulness as it only serves as a meaningful tool of analysis for more stable companies.

We have chosen to examine return on invested capital (ROIC) net of taxes to assess the operating profitability of Joe & the Juice in terms of efficiency in allocating its capital to profitable investments (see Figure 19). ROIC is arguably preferable to ROE because ROIC is unaffected by financial leverage, whereas ROE varies based on a company's capital structure, thus ROIC is optimal for assessing economic returns (CreditSuisse, 2014).

ROIC = Net operating profit after tax (NOPAT) / Invested capital (IC)

The numerator, NOPAT, measures the earnings of a company before financing costs, thus it assumes no financial leverage and therefore remains the same whether a company is highly levered or free of debt. This is essential for comparability. The denominator, IC, can be defined in two ways that are equal: either as the amount of net assets a company needs to run its business, or, alternatively, as the amount of financing a company's creditors and shareholders need to supply to fund the net assets.

Year (TDKK)	**2014**	**2015**	**2016**	**2017**
NOPAT = EBIT(1-T)	- 981,01	16.806,66	6.867,12	4.208,88
Invested Capital	287.877,00	336.928,00	471.018,00	733.977,00
ROIC	**-0,34%**	**4,99%**	**1,46%**	**0,57%**

(*Figure 19.* Own creation adapted from Joe & the Juice Annual Reports, 2014-2017)

In the case of Joe & the Juice, ROIC shows to be less well-performing compared to the industry average for food brands that, in 2014, was 1,2% and since 2015, has been higher than 5% (FinBox, 2019). Furthermore, according to McKinsey (2019), the long-term median ROIC for the food and beverage industry has even been above 10%. To complement this performance measure, a range of financial ratios have been calculated for Joe & the Juice to obtain a more holistic assessment of its liquidity, solvency, growth, and profitability (see Figure 20).

	2014	2015	2016	2017
Liquidity				
Current ratio	0.59	0.45	0.51	0.72
Quick ratio	0.41	0.35	0.39	0.62
Solvency				
Debt ratio	0.54	0.61	1.15	1.07
Debt-to-equity ratio	1.16	1.54	-7.83	-14.81
Interest coverage ratio	-0.10	1.50	0.27	0.15
Long-term assets coverage	0.85	0.81	0.80	0.90
Growth				
Growth rate in revenues		30.66 %	36.29 %	43.41 %
Growth rate in assets		18.99 %	46.28 %	45.15 %
Profitability				
ROE	-10.93 %	1.59 %	14.56 %	36.61 %
ROA = EBIT/TA	-0.32 %	4.52 %	1.24 %	0.52 %
ROS = EBIT margin	-0.42 %	5.43 %	1.60 %	0.68 %
Asset turnover	0.76	0.83	0.78	0.77

(*Figure 20.* Own creation adapted from Joe & the Juice Annual Reports, 2014-2017)

When examining the liquidity ratios that provide insight as to whether or not Joe & the Juice has the ability to meet its short-term liabilities, it appears that the company is highly illiquid. The general benchmark suggests that the current ratio should not be lower than 1, and usually a current ratio higher than 2 is preferred. Additionally, a quick ratio of 1 is considered acceptable. Joe & the Juice performs below these standards in both ratios, however, it appears that its ratios have been improving since 2015.

To estimate the ability of Joe & the Juice to repay its long-term debt, four solvency ratios have been calculated that all indicate a potential solvency issue for the company. Concerning the debt ratio, it appears that it has increased to above 1 in the past years resulting from Joe & the Juice having more liabilities than total assets that results in negative equity in those years. Hence, all the assets of Joe & the Juice are financed with debt which increases the debt ratio of the company far above the generally accepted maximum of 0,67. Regarding the debt-to-equity ratio, it is preferred for a company to have this ratio below 2. This was the case for Joe & the Juice for the first two years of the analysis, in 2014 and 2015. However, in the past two years, as a consequence of negative equity, the ratio goes negative and is therefore not applicable. Preferably a company should have a balance between debt and equity, and thus, the negative ratio of Joe & the Juice presents an undesirable situation.

Moreover, the interest coverage below 1 signals that Joe & the Juice does not have sufficient EBIT to cover its significant interest expenses and, as has been examined, the interest expenses of Joe & the Juice result in a negative net income for the company. The last solvency ratio, which is the long-term assets coverage, is preferred to be above 1, however Joe & the Juice has a ratio below. Hence, the company has an imbalance between long-term assets and long-term liabilities plus equity, meaning that the company's fixed operating assets do not cover its liabilities to creditors in a satisfactory manner.

Concerning the growth of Joe & the Juice, the company is experiencing sharp growth in both revenues and assets, as also found in the previous sections. However, the profitability of the company appears not as attractive as its growth. ROE is not providing appropriate measures as both net income and equity are negative in year 2016 and 2017 that gives a false positive figure of the company's profitability. ROA, as also the case for ROIC, indicated an acceptable positive figure in 2015 but has decreased ever since. As asset turnover has stayed fairly stable over the years, the decrease in ROA appears to stem from a falling EBIT margin due to slight increases in expenses and D&A.

Hence, it appears that Joe & the Juice is highly leveraged and illiquid, arguably caused by its sharp growth which is mainly being financed by debt. Hence, at the present time, the business appears not to be profitable. Nonetheless, as previously stated, as a result of the leveraged capital structure of LBOs, a formerly profitable portfolio company may report reduced net income in the following years after an LBO due to interest expenses. In this regard, given the crucial importance of generating FCF to debt repayment and unimportance of dividends, showing an accounting profit is not a priority for the PE fund and its portfolio company.

12. Value Drivers Employed in Joe & Juice

Having analyzed Joe & the Juice from a strategic and financial perspective, the paper now dives into examining how Valedo has employed the identified key value drivers to generate value creation in this specific portfolio company. This is done to assess the extent to which Valedo has assisted Joe & the Juice in strengthening its business and its further development, growing from a Danish juice brand with 52 stores, mainly in Denmark (Børsen, 2013), to a multinational company with global presence in 15 countries operating 210 stores, by the end of 2017 (Joe & the Juice, 2017).

Prior to the investment in Joe & the Juice, senior consultant Lars Bo Hansen was brought in to work closely together with Basse to clarify the strategic elements of and ambitions for the company. Here, a crucial element was to ascertain the strategic path that Basse had in mind for the company to ensure the value creation plan intended by Valedo fit the corporate strategy of Joe & the Juice (Hansen & Basse, 2016). As noted by J. Breitenstein (personal communication, 2018), this is usually done by PE funds to ensure they understand the strategies of the portfolio companies from the beginning. Hereby, the strategic work conducted by Basse and Hansen can be inferred as preparing Joe & the Juice for the strategic partnership with Valedo, as well as to achieve alignment of interests between the two parties prior to the investment.

Additionally, as stated in the theoretical framework, it is critical to address the topics regarding the duration of the strategic partnership, the intended value creation strategies, and the potential new opportunities for the portfolio company. While there is no data to confirm precisely which topics were discussed between Valedo and Joe & the Juice, it appears that Basse had clear ambitions regarding the international expansion of Joe & the Juice even prior to the strategic partnership with Valedo. Valedo also saw the potential for Joe & the Juice in achieving this and, hereby, one of the main objectives of the strategic partnership has been to enable fast international expansion with special focus on entering the U.S. market (Børsen, 2013).

Besides providing Joe & the Juice with the initial capital and strategic expertise for the expansion, it appears that Valedo has also played a crucial role in arranging additional capital (EY, 2016). In this regard, Joe & the Juice entered into an additional strategic partnership with the American PE fund General Atlantic in 2016 (Berlingske, 2016), as well as received a double-digit million DKK loan from Vækstfonden in 2018 (Vækstfonden, 2018). Nonetheless, the most crucial role of PE funds is to drive value creation in the portfolio companies during the holding period. Hereof, the following section will analyze how Valedo has employed the value drivers of financial leverage, operational improvements, and multiple expansion, in the case of Joe & the Juice.

12.1. Financial Leverage

As identified in the theoretical framework, the use of financial leverage has shown a return-enhancing effect related to high debt levels, thus making it possible to enhance the profitability of PE investments. However, it is important to consider the optimal debt-to-equity ratio as too much debt can result in overleveraging the portfolio company (Achleitner et al., 2012).

As found in the case of Joe & the Juice, the debt-to-equity ratio was between 1-2x for the years of 2014 and 2015, which is an acceptable ratio, before equity turned negative in 2016 and 2017. Nonetheless, it seems that Joe & the Juice is having substantial high interest expenses with recent interest coverage ratios below 1. This suggests that the company may be overwhelmed by debt repayments and may have low ability to attend to interest expenses. Hereof, regarding the disciplining effect of financial leverage, it is reasonable to infer that all FCFs are used to repay debt rather than used for unprofitable investments or private benefits for management. Consequently, the incentives of management to operate efficiently should be high as the inability to repay debt obligations may result in company default (Jensen, 1989), thus diminishing potential conflicts of interest between the management team of Joe & the Juice and Valedo.

Nonetheless, in an LBO, the main purpose of financial leverage is to increase return on equity by investing the smallest possible amount of equity and finance the rest with debt. Consequently, the upside of the investment when exited will go to the equity, generating a higher return on a smaller amount of equity. Besides this, other benefits of financial leverage include enhanced value of portfolio company through tax shields. To investigate this further, an LBO model has been built in the case of Valedo and Joe & the Juice where the investment took place in 2013 and has been assumed to be exited in 2020 (see Appendix 9). As stated, the holding period in a classic LBO is usually five years. However, as of today, Valedo is still the majority owner in Joe & the Juice and therefore 2020 has been assumed as the potential exit year implying a holding period of seven years. Theoretically, all else being equal, using more leverage should consequently result in Valedo earning a higher return on its investment. This is evident in the simplified LBO example of Joe & the Juice (see Figure 21). Here it is shown that with 0%, 30%, and 50% debt the IRR goes from 36% to 43% to 54%, respectively, assuming that no debt is paid off during the holding. Nonetheless, in real LBOs, some of the debt is repaid during the holding period, boosting the return to the PE fund even further. Concerning the increased financial risks associated with higher leverage ratios, the example below also illustrates that Valedo and its LPs should be compensated for the additional risks by obtaining a higher expected return.

Scenario 1: 0% debt (TDKK)		
Time	t(0)	t(+7)
EBITDA	36.514	321.548
Multiple	8x	8x
EV	292.114	2.572.385
Debt	0	0
Equity	292.114	2.572.385
Money Multiple	8,8x	
IRR	36%	

Scenario 2: 30% debt (TDKK)		
Time	t(0)	t(+7)
EBITDA	36.514	321.548
Multiple	8x	8x
EV	292.114	2.572.385
Debt	87.634	87.634
Equity	204.480	2.484.751
Money Multiple	12,2x	
IRR	43%	

Scenario 3: 50% debt (TDKK)		
Time	t(0)	t(+7)
EBITDA	36.514	321.548
Multiple	8x	8x
EV	292.114	2.572.385
Debt	146.057	146.057
Equity	116.846	2.426.328
Money Multiple	20,8x	
IRR	54%	

(*Figure 21.* Own creation based on LBO model)

Despite the return-enhancing effect of leverage, PE funds tend to be careful with financing investments with too high debt levels in order to ensure that the portfolio companies have sufficient capital to grow and are not overwhelmed by debt repayments (PwC, 2018). Additionally, as discussed in the theoretical framework, it is crucial to consider the optimal capital structure where tax shield benefits are obtained, and costs of financial distress are avoided. However, in practice, it can be difficult to achieve the optimal capital structure for a company as it depends on a variety of factors such as the industry of the company, the type of business, and the stage of development, and external factors such as interest rates. In the case of Joe & the Juice, the more detailed LBO model has been assumed to be financed with 40% debt and 60% equity contribution (see Appendix 9.1). In this regard, according to PwC (2018a), during 2013, European LBOs were financed with approximately 50% debt on average. Yet, as stated by J. Breitenstein (personal communication), PE funds will put in less debt in cases of more risky businesses compared to cases with more stable businesses. Furthermore, if the portfolio company is capital intensive with half of EBITDA is invested in CapEx, the level of debt to be used as financing will be limited (J. Breitenstein, personal communication, 2019). Hereof, as Joe & the Juice is currently in a phase of rapid growth with CapEx representing more than 20% of revenue since 2014, it appears that the company has little FCF available for debt repayments. Thus, we have assumed the employed debt level to finance the investment to be lower than average and that it will not be repaid before exit.

Besides the mix of debt and equity to finance the investment, several other assumptions have been made to build the LBO model. These will now be outlined and justified. In regard to the entry price for Valedo in 2013, this has been assumed to be just below 300 million DKK with an entry multiple of 8x. The price has been based on several reasons. Firstly, several articles (e.g. CPH Post Online, 2016; Ross, 2017) hinted to this approximate price for the investment in Joe & the Juice.

Secondly, estimating the company's EBITDA for 2013 to be 36,515 million DKK, this would have entailed an entry multiple of 8,22x which shows consistency with the reported average LBO entry multiple in 2013, according to PwC (2018a). Thirdly, following the investment, there was reported additional paid-in capital of 205,56 million DKK in the annual report of 2014 for the group (Joe & the Juice, 2014) where the book value of the company was 83,41 million DKK per December 31, 2013 (Joe & the Juice, 2013). Hereof, the final entry price for Valedo's investment in Joe & the Juice has been estimated to be 292,114 million DKK.

In regard to the revenue growth assumption, this has been forecasted in accordance with the growth rates found in the financial analysis. The revenue growth has been estimated to be 36,79% which was calculated using the historical average in the period from 2015 to 2017. Thus, this has been assumed to be the expected annual growth for the forecasted years. Estimating EBITDA for the forecasted years, this has also been kept in accordance with the findings of the financial analysis where EBITDA on average represented 15,89% of revenue. Thus, going from revenue to EBITDA, COGS, SG&A, and other external expenses, were also calculated as percentage of revenue using the historical average (see Appendix 9.2).

Concerning the exit multiple, which will be elaborated further in the later section about multiple expansion, it has been assumed to be equal to the entry multiple as the base case. As found in the theoretical framework, PE funds should not solely rely on multiple expansion as a means of value creation. Consequently, they tend to use the same multiple as at entry or even slightly below to be conservative and use it as the baseline for projecting the return on investment. Nonetheless, our findings indicate that it may be possible for Valedo to achieve a higher exit multiple thus enhancing the potential returns further.

Having introduced the LBO model built in the case of Joe & the Juice to showcase the potential value created from financial leverage, this LBO model will be used in the discussion as the baseline to examine the possible exit strategies and their implications in terms of return on investment. However, at first, the following sections investigate the potential value created stemming from the other identified key value drivers, namely, operational improvements and multiple expansion, in the case of Joe & the Juice.

12.2. Operational Improvements

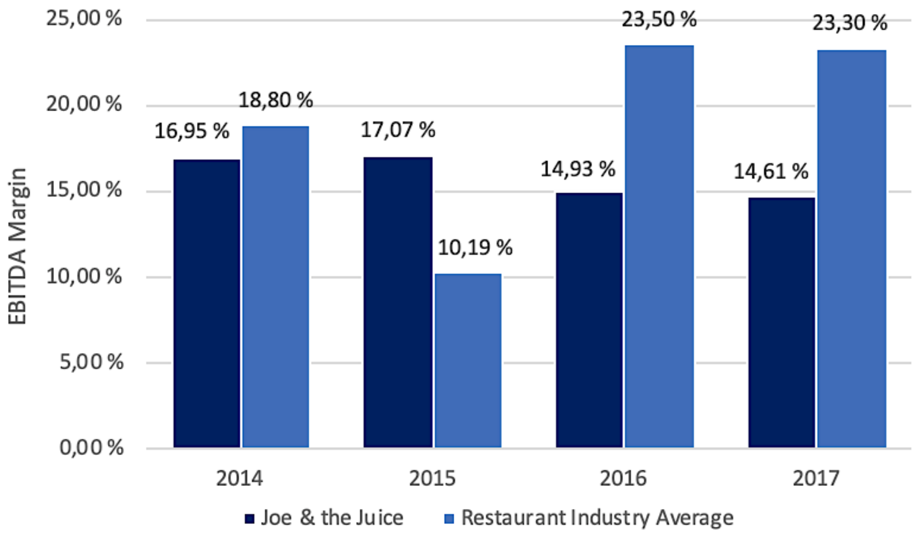
As stated in the theoretical framework, PE funds aim to create value in the portfolio companies by improving their strategies and operations, reducing costs, and strengthening the performances and prospects within the respective industries. Based on the financial analysis of Joe & the Juice, it can be debated to what extent costs have been reduced and, hereof, whether operational improvements in terms of cost efficiency have been implemented. However, given that costs have not increased significantly as percentages of revenues following the rapid global expansion, operations are likely to have improved in terms of capacity and coordination. Also, based on both the strategic and financial analysis, it appears highly reasonable that the strategy of and prospects for Joe & the Juice have been improved to a great extent given its growth in terms of revenues and rapid international expansion.

12.2.1. Revenue Growth and Margin Improvements

According to J. Breitenstein (personal communication, 2018), approximately 60% of the value created in PE investments usually stems from operational improvements, thus higher revenues and higher margins. In this regard, when analyzing the development of the financial performance of Joe & the Juice (see Appendix 8.1), it is evident that the company has experienced an extremely sharp revenue growth after the investment by Valedo, increasing from 309,61 million DKK in 2014 to 790,678 million DKK in 2017. However, EBITDA appears to have decreased slightly throughout the holding period, representing 14,61% of total revenues in 2017 which is a negative change of 13,8% since 2014. Hereof, in the case of Joe & the Juice, it appears that the value creation would stem from the significant revenue growth rather than EBITDA improvements.

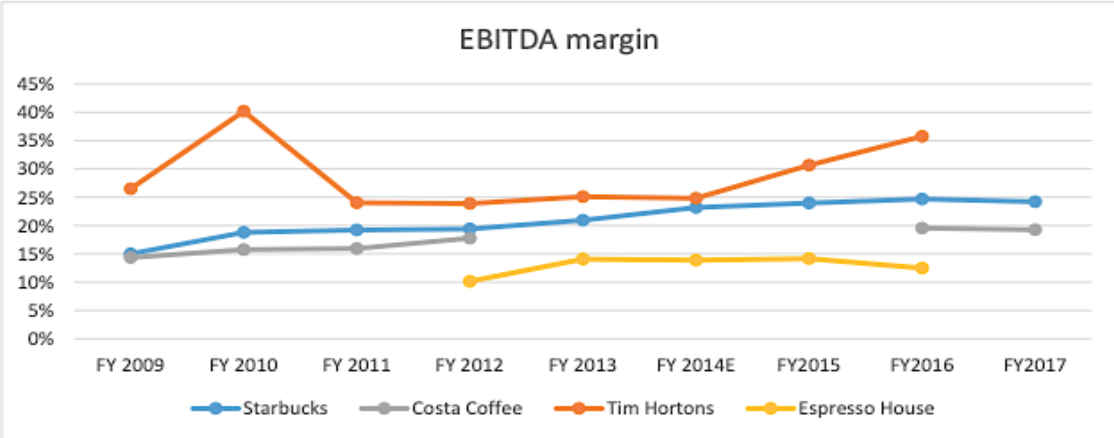
As stated in the theoretical framework, EY (2016) finds that around 50% of value created from operational improvements stems from revenue growth. However, according to Aleszczyk et al. (2016), EBITDA improvements represent another crucial aspect within operational improvements. Nonetheless, given the findings presented above, it appears that Valedo has not emphasized enhancing the EBITDA margin of Joe & the Juice. Part of the explanation for this may be, as identified in the internal strategic analysis, that the supply chain management of Joe & the Juice is already exceedingly efficient and highly optimized, leaving little room for further improvements. In the period of analysis, comparing the EBITDA of Joe & the Juice to other companies in the café restaurant industry shows that the company finds its EBITDA below the average (see Figure 22).

It can be argued that Joe & the Juice does not quite qualify for the restaurant industry as its product offering is limited to coffee, juice, and sandwiches. However, for data gathering we have identified the restaurant industry as the most suitable industry given that even the coffee chain Starbucks is located within this industry (Aaron Allen & Associates, 2017).



(Figure 22. Own creation adapted from CSI Market, 2019; Appendix 8.1)

Additionally, we have chosen to consider the American chain Panera Bread and British Pret a Manger as fitting peers for comparing EBITDA margins due to their product offerings which similarly to Joe & the Juice revolve around sandwiches and a variety of other options. Comparing the average EBITDA margin of 15,89% for Joe & the Juice to the average EBITDA margins of these identified competitors, it is found that Panera Bread and Pret a Manger have average EBITDA margins around 15,7% and 11%, respectively (Franchise Times, 2016; Donnellan, 2018). Thus, in this regard, the EBITDA margin of Joe & the Juice appears to be more competitive. Also, when compared to the companies that Joe & the Juice itself refers to as its main competitors (Hansen & Basse, 2016), it also indicates a more competitive EBITDA margin placing itself just above Espresso House though below Starbucks and Costa Coffee (see Figure 23).

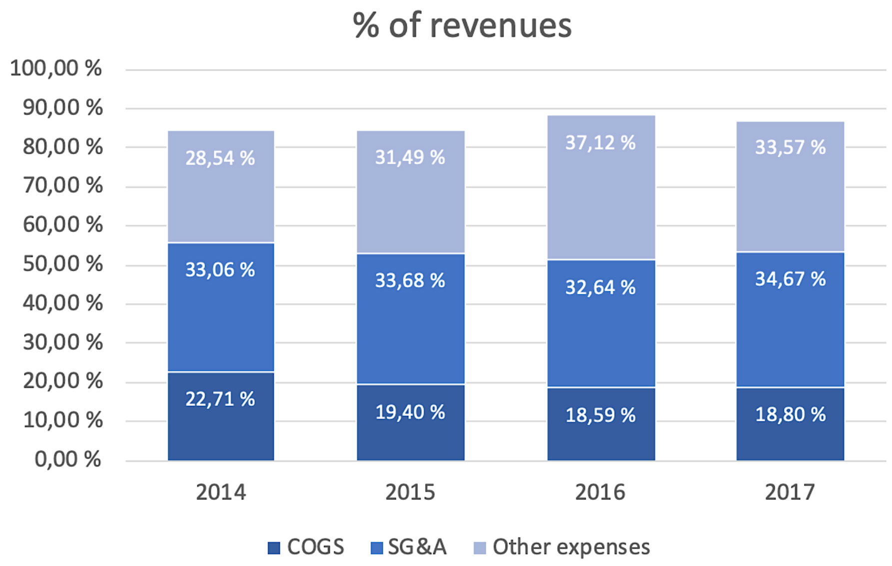


(Figure 23. Adapted from Sifter, 2018)

Nonetheless, without an above-average EBITDA in either comparison, it could be inferred that Joe & the Juice still has potential for operational improvements in terms of the EBITDA margin. Regarding how to create value from operations, EY (2016) has suggested seven considerations as outlined in the theoretical framework. Out of these seven considerations, four appear to be applicable in the case of Joe & the Juice.

Firstly, it seems highly reasonable that Valedo has considered how to foster revenue growth. In terms of appropriate management reporting framework to improve the internal operations of the company, a main strategic objective for Joe & the Juice has been to continuously develop a transparent hierarchical structure with a clear chain of command and well-established job responsibilities (Rouen & Srinivasan, 2016). Moreover, regarding optimal go-to-market strategies, Valedo, and lately General Atlantic, have served Joe & the Juice with expertise and experience in terms of expansion, providing the company with the necessary market research to identify the optimal strategies for expanding into the various new international markets.

Secondly, concerning direct cost optimization, it appears that COGS have decreased slightly from representing 22,71% of revenues in 2014 to representing 19,87% in 2017. Yet, in regard to indirect cost optimization, SG&A has remained fairly stable while other external expenses have increased from 28,54% to 33,57% of revenues, thus more than offsetting the decrease in COGS (see Figure 24). Consequently, Joe & the Juice has experienced a modest rise in total costs. Nonetheless, as shown in the asset turnover calculations in the financial analysis, asset utilization has proven stable throughout the four-year period.



(Figure 24. Own creation adapted from Appendix 8.1)

Thirdly, regarding value creation through information technology to enhance sharing of knowledge and best practices to improve performance across stores, Joe & the Juice has made use of an e-learning platform that enables faster and consistent training of employees across their numerous stores (Rouen & Srinivasan, 2016).

Fourthly, in terms of process and performance optimization, the developed supply chain system for Joe & the Juice has allowed the company to continuously improve operations. As acknowledged in the strategic analysis, the supply chain system has enabled many back-office functions to be automated and standardized. For example, inventory count has been automated which has reduced the frequency of inventory count by personnel to once a year (Rouen & Srinivasan, 2016). Additionally, the system has allowed for shift planning and improved HR management in terms of monitoring performance and planning promotions.

12.2.2. Human Capital Improvements

As identified in the theoretical framework, PE funds often make human capital improvements in the portfolio companies to facilitate the implementation of the value creation plans. In buyout deals, PE funds usually replace the CEO, though this should not be regarded as a prerequisite for the intended value creation. Contrarily, in VC investments, the founder who often acts as the CEO is kept on board with a majority stake in the company. This is to ensure the continued commitment of the founder as it is considered highly crucial for the further development of the company (Arundale, 2010).

In the case of Joe & the Juice, when Valedo took majority ownership in 2013, the founder Basse kept a minority stake in the company and continued as the CEO until the year of 2019. Hence, as this is not common practice for buyout investments, Valedo must have considered Basse as fit for the position and for taking his company through the next stages of development. In this sense, as identified in the strategic analysis, it is likely that Valedo also perceived Basse as a valuable resource for Joe & the Juice, representing an internal source of competitive advantage for the future expansion. Also, considering the strong brand and growth that Basse has managed to build based on his own vision and ambitions, it appears plausible that Valedo saw the value and the drive that he could continue to bring to the company. Similarly, considering Basse has been the face of the company since its founding, replacing him could have been a risky and potentially damaging decision for Valedo to make. Yet, as presented by agency theory, the decision to keep the CEO can potentially increase the conflicts of interest between the management of the portfolio company and the PE fund. Hereof, the continuous involvement of Basse could potentially also have complicated the relationship with Valedo rather than added value. Nonetheless, it can be inferred that Valedo ensured alignment with Basse as he continued as CEO for several years and even today he sits on the Board of Directors.

Besides the CEO, another mission-critical role for the further development of portfolio companies is the CFO. In this regard, N. Retbøl (personal communication, 2018) states that, in the majority of investment cases, PE funds will start by changing the CFO. This was also the case for Joe & the Juice where Vestergaard became the CFO following the investment by Valedo. According to J. Breitenstein (personal communication, 2018), the opportunity of selecting the CFO is highly important for PE funds. Accordingly, Vestergaard has played an essential role for the growth of Joe & the Juice and can be recognized as a mission-critical employee who has contributed significantly to the value creation process. Since Vestergaard started working at Joe & the Juice in 2004, he has taken areas of responsibility in economics, finances, and IT-related matters. Moreover, despite Joe & the Juice was only operating approximately 10 stores at the time, Vestergaard drove the development of the supply chain system that already from its development was designed with high capacity to support rapid growth and run a chain with 200 stores (Hansen & Basse, 2016). After Basse stepped down as CEO for Joe & the Juice, Vestergaard took the position. This validates his essential role for the company and possibly as another valuable resource for Joe & the Juice alongside Basse. Additionally, it supports Valedo's assessment of Vestergaard as fit for a management position. This is particularly important as the capability of the management to drive growth significantly impacts the value creation in the company.

Besides human capital improvements at the top level of Joe & the Juice, such as the appointment of new members to the management team, Valedo has also used the restructuring of ownership to acknowledge and motivate other mission-critical employees. Hereby, when Valedo took a majority stake in Joe & the Juice, 15 additional leading employees in the company were added to the ownership structure (Børsen, 2013). This can be inferred as a means to increase the motivation of the employees essential for the success of Joe & the Juice. By including them in the ownership structure, these employees are more attached to the company and have more at stake in relation to the potential gains of its growth and international expansion.

Furthermore, given that the value offering of Joe & the Juice is highly dependent on frontline customer interactions, juicers also represent an essential group of employees. This is supported by the argument that the mission-critical roles extend throughout the entire organization, even on the lower levels (Bain, 2018). In this line, various initiatives have been directed to this specific group of employees in Joe & the Juice. One example is the Moneyball program, as previously mentioned, which serves as an impactful HR management tool as it enables managers to motivate, control, and develop employees, as well as identify the top performers with the highest potential for creating additional value for the company. Another example of such initiatives is the establishment of *Joe House*, initiated by Basse in 2015 in Copenhagen. Joe House serves as an internal academy for operational and managerial development training, as well as hosts employees when abroad with the Joe & the Juice transfer program (Hansen & Basse, 2016). The initial Joe House was followed by international copies and is now found in multiple countries worldwide (Rouen & Srinivasan, 2016). According to Basse, the Joe House initiative was necessary for Joe & the Juice because its brand is dependent on the juicers and their capabilities of delivering on the value offering of the company (Hansen & Basse, 2016). While a significant amount of investment was needed to develop the concept, the Board of Directors approved it and made it the main strategic objective for the year 2015 (Hansen & Basse, 2016).

Additionally, following the investment by Valedo, the structure of the Board of Directors of Joe & the Juice was changed where Per Forsberg from Valedo, Sven Mattson, and Danny Feltmann Espersen were added (Joe & the Juice, 2013). Furthermore, at the time General Atlantic took minority stake in Joe & the Juice, two new additional board members joined the Board of Directors. As Valedo has participated in board activities to assist Joe & the Juice in its further growth and international expansion, General Atlantic has served to provide expertise and support for the expansion of Joe &

the Juice beyond European borders (General Atlantic, 2016). In this regard, according to Basse, "General Atlantic has a strong track record of supporting high-growth companies as they expand globally and we look forward to leveraging the firm's expertise in the retail and restaurant sectors as we continue to build our brand globally" (General Atlantic, 2016). Hereof, in accordance with the findings of the theoretical framework, it appears that both Valedo and General Atlantic appointed new board members to sit on the Board of Directors to serve as senior advisors and provide Joe & the Juice with decision-making support.

12.2.3. Strategic Improvements

As the final aspect within operational improvements, strategic improvements have taken place in Joe & the Juice since the entry of Valedo as a majority owner. As mentioned, PE funds that take active ownerships tend to work closely with the management of the portfolio companies to set the improvement agenda, develop a turnaround program, and install performance measures against goals (BCG, 2008). In the case of Joe & the Juice, it is evident that a turnaround program has not been necessary. Nonetheless, its strategic objectives and vision have needed clarification in order to develop its international expansion further.

According to EY (2016), it is crucial that the value creation plan intended by a PE fund does not undermine the corporate strategy of the given portfolio company. This is apparent in the case of Joe & the Juice where in 2012, Hansen was brought in to work on the strategy in joint conjunction with Basse to prepare Joe & the Juice for the potential strategic partnership with Valedo. Subsequently, in 2014, half a year after Valedo's investment, Hansen was again hired to work on the strategy of Joe & the Juice with the objective of clarifying and strengthening the strategy of Joe & the Juice to support its international expansion (Hansen & Basse, 2016). In this regard, as discovered in the theoretical framework, strategy work within the portfolio companies can take place in different ways. In the case of Joe & the Juice, the strategy work has been conducted mainly by Hansen and Basse that focused on analyzing a potential *blue ocean strategy* for Joe & the Juice as well as clarify the company's strategy in accordance with the *Golden Circle* framework (Sinek, 2009).

In regard to the blue ocean strategy, the strategy work investigated to what extent Joe & the Juice possess a differentiated position enabling the company to compete in a market that is characterized by less intense competition. A blue ocean strategy usually stems from a unique value offering of a given company that assists the company to differentiate itself from its competitors.

A blue ocean position entails a sustainable competitive advantage that allows the company in such position to earn above-average profits. It was during this strategy work that Hansen and Basse developed the aspect of inclusion which they claim to represent a differential factor for Joe & the Juice together with the unique ambience of the stores and the human interactions with the juicers (see Appendix 10). The blue ocean concept served as point of analysis of Joe & the Juice and was used in the strategy work to assess its then current competitive position and whether it needed improvements to continuously be sustainable.

The Golden Circle framework revolves around the why, how, and what of a brand whereof the why represents its reason of existence, the how represents its value offering, and the what represent its product offering. With this in mind, the strategy work was conducted to be presented for the Board of Directors, evaluating the different elements of the strategy of Joe & the Juice in terms of what needs improvements and what does not. In this regard, it appears that Valedo has taken an active role in Joe & the Juice by overseeing the planning and implementation of improvements within strategy through its participation in all board activities. The strategy work particularly investigated the why of Joe & the Juice came to be formulated as found below:

> "Joe & the Juice wants to change the world through positively influencing the global youth culture. Joe & the Juice wants to be widely well-known and always respected for building a changing and different company that is founded on a unique and admired culture and unity."[3] (Hansen & Basse, 2016, pp. 195)

Concerning the how, it needed refinement to secure that Joe & the Juice would be able to hold a sustainable competitive position as the how describes the way in which the company differentiates itself from competitors (Sinek, 2009). In this regard, the strategy work focused on the value map of Joe & the Juice and how to improve that current positioning (see Appendix 10). Here, the different parameters were discussed whether they could be increased to support the value offering of Joe & the Juice. In particular, the product offering of the company was debated as to whether or not there was a need for broadening or deepening the product range that subsequently led to a slight change in variants. Additionally, the brand was discussed whether it could further harvest on the strong youth brand by going into business within clothing, music, festivals, and such (Hansen & Basse, 2016).

[3] Translated from Danish into English.

As previously stated, the value offering of Joe & the Juice revolve around the customer experience rather than its products. Accordingly, the how came to revolve around the same differential factors of unique ambience, human interactions, and an inclusive environment:

> "In a world characterized by increasing loneliness, Joe & the Juice wants to be the one place for all to feel special. Joe & the Juice will offer this inclusion by providing attractive health in an environment with an unprecedented mix of ambience, quality, and health."[4] (Hansen & Basse, 2016, p. 204)

Concerning the final element of the Golden Circle, the what, the strategy work concluded that the what is not the appropriate terminology in the case of Joe & the Juice (Hansen & Bassem 2016). According to Joe & the Juice, the company is not product- or service-based but rather a company that is rooted in people and human interactions. Hereof, the concept was altered to fit Joe & the Juice and, instead of the what, the who became the last element representing Joe & the Juice and its strategy. The who represents the dedication of the company to training, development, commitment, and motivation, on all levels both internally and externally. The who of Joe & the Juice can be found below:

> "Joe & the Juice is motivated by the fear of being normal and average and will always seek disruption and to be different. Joe & the Juice expects and delivers passion and love and wants its culture to reach all human beings in the world one day. Joe & the Juice is all about people."[5] (Hansen & Basse, 2016, p. 214)

The final result of the strategy work was presented by Basse to the Board of Directors where the underlying analyses of customers, competitors, and internal operations, were shown. Furthermore, the suggested long-term strategy and short-term strategic objectives for 12 to 18 months were discussed as well as a transformational process focusing on must-win battles within key areas of improvements (Hansen & Basse, 2016). Following the initial meeting, the strategic plan and transformational process have been regularly checked up on by Valedo through its board involvement to secure the further development of Joe & the Juice in the right strategic direction.

[4] Translated from Danish into English.
[5] Translated from Danish into English.

This aligns with the findings of the theoretical framework that PE funds assist portfolio companies in identifying the necessary changes or must-win battles within different areas of the companies. However, the implementation of the strategies tends to be run by the portfolio companies themselves.

Hereof, the strategic improvements in Joe & the Juice support that operational improvements require more than reducing costs and implementing quick-wins to achieve revenue growth. Rather, most of the strategy work was focused on manifesting a sustainable operating model to be established aligning the intended value creation plan of Valedo with the corporate strategy of Joe & the Juice. Hereof, as explicated in this section, the strategy work in Joe & the Juice covered how to clarify and strengthen the strategy of the company as well as how to secure the needed internal capabilities to deliver on its strategy and operations. Hereof, it appears that Valedo has taken an active role in Joe & the Juice by overseeing the planning and implementation of important changes to improve the strategy and operations, mainly through engagement in all board activities. However, as other PE funds practicing active ownership, Valedo has not gotten involved in the day-to-day operations of the company. In this sense, much of the strategy work covering the areas for potential improvements, such as value offering, competitive positioning, and standardization of employee development programs, have been devised by Basse in close cooperation with Hansen (Hansen & Basse, 2016). Based on their ideas and suggestions, the potential operational improvements have been discussed with the Board of Directors from which they would not only receive approval and/or disapproval but also derive expertise and support.

Furthermore, in terms of PE funds strengthening the performance and prospects of portfolio companies within their respective industries, it appears that Valedo has highly prioritized the strategic aspect to assist the international expansion and thus to improve the company's performance and prospects. Such improvement of the prospects for the company has also been found to have a significant impact on multiple expansion. Hereof, the thesis now progresses to analyze how multiple expansion potentially has driven value creation in Joe & the Juice.

12.3. Multiple Expansion

The third value driver, namely multiple expansion, is subject to both the internal factors of the portfolio companies and the external factors, such as market wide conditions and the macroeconomic environment. Assessing the macroeconomic environment in terms of real gross domestic product (GDP) growth shows that world and advanced economies GDP growth was 3,6% and 2,1% in 2014, respectively. By 2017, this had increased to 3,8% and 2,4%. In 2023, world GDP growth is expected to be stable around 3,6%, whereas advanced economies GDP growth is expected to be 1,6%. As these levels resemble the GDP growth rates in 2013 when Valedo entered the investment in Joe & the Juice, it can be inferred that the macroeconomic environment will not have a crucial impact on multiple expansion in this case (International Monetary Fund, 2019).

Considering the market wide conditions in the case of Joe & the Juice, the company can arguably be located in both the coffee shop and juice bar industry within the wider café restaurant industry. Additionally, being highly established in various national markets, an important driver for the further growth of Joe & the Juice is represented by the U.S. market. In this sense, in 2018, the U.S. coffee shop market had a total value of $45,4 billion and was reported to have increased by 3,8% in volume, counting 35.616 stores in total. By 2023, the number of stores in the market is expected to increase to 40.800, anticipating an industry 5-year CAGR growth of 2,8% (Newhart, 2018). Regarding the European market, the coffee shop industry experienced a growth of 6% in 2018, with a total of 33.745 coffee shops spread across 24 national markets. Continuously, the industry is expected to grow with a CAGR of 4,8% and thus reach 42.000 stores by 2023 (Brown, 2018). Furthermore, the combined smoothie and juice industry is expected to grow by 1,6% in the U.S. market and hereby to reach a total value of $2,5 billion in 2019 (IbisWorld, 2019). Thus, it appears that both industries are experiencing significant growth that validates the potential for Joe & the Juice to continue its further expansion across markets. Hereof, the market wide conditions support the company's credible growth narrative and thus increase the likelihood of Valedo achieving multiple expansion with its investment case of Joe & the Juice.

Alongside market wide conditions, a potential higher exit multiple can also be explained by internal factors of the portfolio company through improved prospects for future earnings growth, as it can result in increased company value (Braun, 2015). With this in mind, the demand for healthier food and beverage offerings is reported to be increasing (Raphael, 2018). This increasing demand is likely to result in a growing customer base and an increased attractiveness for Joe & the Juice. In this sense, it can enable the company to sway more health-conscious customers from competitors, such as Starbucks and Panera Bread. Furthermore, given the aggressive expansion of Joe & the Juice, it can be expected that number of countries the company is present in and number of stores will continue to increase. Thus, concerning prospects for future earnings, the potentially growing customer base and further penetration in the existing markets is likely to further add to the credible growth narrative of the company.

Yet, as noted in the theoretical framework, whereas increases in earnings may be the immediate result of operational improvements, increases in the company value result from the perceived sustainability of these improvements and the improved strategic position of the portfolio company. In the case of Joe & the Juice, the market for the product offering of the company shows no signals of the current growth slowing down in the near future. This aligns with the continuous growth of both the coffee and juice industry, as well as the increasing demand for healthier offerings. Nonetheless, the financial analysis and the section of revenues growth and margin improvements showed no clear signs of operational improvements or increases in earnings. Rather, the analysis indicates growth mainly from revenues whereas the EBITDA margin has remained fairly stable. Additionally, the EBIT margin appears to be decreasing, and over the past years, the company has operated with a net loss that appears to be increasing. Yet, according to Bain (2018), accelerated revenue growth has shown to have the most powerful impact on exit multiples. Thus, the ability of Valedo to spot further growth opportunities for Joe & the Juice is likely to enhance the value creation stemming from multiple expansion.

Furthermore, it is argued that multiples have been growing over the recent years and are currently at a record high (J. Breitenstein, personal communication, 2018; PwC, 2018; Bain, 2018; McKinsey, 2018). Hereof, considering the vintage of Valedo II and the potential exit horizon of the investment in Joe & the Juice, this favors Valedo as it indicates a positive seller's market, favorable for exiting investments in the near future. Additionally, according to a report by Bain (2018, p. 10), "the average multiple for [LBOs] in the U.S. and Europe has hovered around 11 times EBITDA in recent years, above levels leading up to the global financial crisis." Therefore, it is likely that Valedo will have less difficulty in setting a higher exit multiple or obtaining a higher valuation of Joe & the Juice compared to the time of entry.

In terms of the value creation that is attributed to multiple expansion, J. Breitenstein (personal communication, 2018) notes “[...] 30% will come from a higher exit multiple, so if we buy a company at 8x EBITDA and sell it at 10x EBITDA then we will get an uplift in the value from that.” However, given the uncertainty and difficulty with predicting market conditions and company performance accurately, it is important to acknowledge that it is unwise for PE funds to solely rely on multiple expansion to create value. Yet, in the case of Joe & the Juice, it seems to be possible for Valedo to achieve multiple expansion given the favorable market-wide conditions and the positive prospects in terms of the growth potential of the company.

13. Discussion of Value Creation and Potential Exit Strategies

13.1. Value Created

Having thoroughly analyzed the historical performance of Joe & the Juice, it is evident that substantial growth has occurred after Valedo’s investment in the company in 2013. In this line, the financial analysis of the company shows significant growth in revenues as well as assets. Both aspects more than doubled, with revenues and assets increasing from 309,61 and 208,075 million DKK in 2014 up to 790,68 million and 1,031 billion DKK in 2017, respectively. This increase is in alignment with the findings of Aleszczyk et al. (2016) who reported that portfolio companies experience growth in revenues and assets following an LBO. It was also found that significant improvements in operating profitability should take place over the first three years of PE ownership, however, this appears not to be the case in Joe & the Juice where EBITDA has stayed more or less stable as 15,89% of revenues on average.

According to the theoretical framework, revenue growth alone can have a significant impact on the potential value creation as approximately half of the operational value created is attributable to this factor (Aleszczyk et al., 2016; EY, 2016). In addition, revenue growth has also shown to have the most effective impact on multiple expansion, and therefore, it drives value creation both in terms of operational improvements and multiple expansion. Hereof, in the case of Joe & the Juice, the achieved revenue growth is likely to contribute significantly to the return obtainable by Valedo when exiting the investment. Consequently, from this perspective, it can be argued that Valedo has successfully implemented operational improvements in Joe & the Juice. Yet, it can be questioned as to what extent improvements in operating efficiencies have been achieved.

In this regard, while Valedo has been able to slightly decrease the COGS of Joe & the Juice, this decrease has been offset by increases in SG&A and other external expenses. However, as Joe & the Juice can be characterized as a growth company with current CapEx representing more than 30% of revenues, it may be that the main strategic objective for Valedo has been focused on accelerating the company's international expansion, rather than improving an already well-performing EBITDA. In this line, given the successful international expansion, the focus may shift towards emphasizing the profitability of Joe & the Juice. Supporting this, the company is currently implementing a comprehensive waste control program to complement the current supply chain management system. The waste control program serves to improve the ability of the company to track waste on a weekly basis and helps the improvement of waste management as well as decision-making related to operations and purchasing of goods (Joe & the Juice, 2017).

Besides revenue growth and margin improvements, Valedo has also taken an active role in enhancing operational value through the implementation of human capital improvements to secure that the company holds the talents needed for the intended value creation plan. In this regard, the mission-critical employees across the different levels of Joe & the Juice were identified. These included individuals on the management level, such as Basse and Vestergaard, as well as individuals on the lower levels such as juicers working at the frontline. In this regard, with focus on the mission-critical roles, various employee training programs such as Joe House and Moneyball were established to support the identification and development of in-house talents in order to secure the right candidates for future management positions. This commitment to internal development and recruitment has been of high importance to Joe & the Juice since its founding and became of even higher importance during Valedo's ownership. By way of example, Joe House became the strategic priority for 2015 that was approved by the Board of Directors and was allocated a large amount of resources with support from Valedo.

Furthermore, it appears that Valedo has assisted Joe & the Juice in contextualizing and prioritizing its strategy and strategic objectives. In this regard, much of the strategy work was conducted by Basse and Hansen which focused on clearly establishing the value offering and competitive positioning of Joe & the Juice (Hansen & Basse, 2016). The ideas and suggestions stemming from the strategy work were presented for the Board of Directors who then provided their expertise and either approved or disapproved these ideas. Hence, through its participation in all board activities, Valedo has supervised and overseen the implementation of the value creation plan set out for Joe & the Juice.

This is consistent with the findings of the theoretical framework which outlines that although PE funds tend to plan and monitor the implementation of strategic initiatives, they do not normally involve themselves in the day-to-day operations of the portfolio companies (Caselli & Negri, 2018).

The ability of PE funds to identify strategic opportunities for the portfolio companies and develop them in a specific direction has proven to be decisive for driving value creation (N. Retbol, 2018; Bain, 2018). In this regard, it is reasonable that the four identified core competencies of Joe & the Juice resemble the strategic opportunities that Valedo spotted prior to the investment in 2013, alongside with the prevailing growth of the company and its potential for international expansion. For example, as one of the core competencies identified in the strategic analysis, Basse continued to serve as CEO for an extended period of time, which is an unusual practice in such PE investments. Additionally, as another identified core competence, the brand value of Joe & the Juice came to represent one of the main priorities for the strategy work and has been clarified and strengthened significantly during Valedo's ownership. Here, the strategy of Joe & the Juice was solidified and the factors differentiating the brand from its competitors were identified. For example, while the ambience of the stores and the juicer personas represented important differentiating elements of Joe & the Juice prior to Valedo's investment, the emphasis on these was subsequently emphasized further (Hansen & Basse, 2016).

As stated in the strategic analysis, Basse had high ambitions for Joe & the Juice from the beginning and the international expansion of the company had already begun before Valedo came on board. For example, in 2012, a new COO was hired to specifically drive the international expansion that, at this point, was dedicated to opening up 100 stores outside Denmark over the next 4-5 years (Berlingske, 2012). Contrasting this to 2014, when Valedo had been the majority owner for approximately a year, Joe & the Juice operated 79 stores and was planning to reach 130 stores by the end of 2015 (Joe & the Juice, 2014). By 2016, Joe & the Juice had achieved further expansion in existing and new markets, including the U.S. and Australia, and operated 175 stores worldwide (Joe & the Juice, 2016). In other words, with Valedo as the majority owner, the initial timeline for the planned international expansion was halved, with the company opening approximately 50 stores each year.

Hereof, it can be inferred that Valedo has significantly contributed to an accelerated pace of the international expansion of Joe & the Juice. In particular, it appears that operational improvements have acted as the main value driver in the case of Joe & the Juice where Valedo has assisted clarifying the strategy, prioritizing strategic objectives, and driving growth mainly through international expansion. This has led to a significant increase in revenues as shown. This proves consistent with the findings of the theoretical framework, where it was demonstrated that PE funds are increasingly becoming more operationally-minded and less focused on financial leverage and multiple expansion to drive value creation in portfolio companies. However, as the potential value created during the holding period will only be realized upon exit, Valedo must carefully consider and decide on the optimal exit channel and timing. This is so, as these exit decisions will eventually determine the exit multiple obtainable by Valedo, and thus, will have a crucial impact on the return on the investment in Joe & the Juice.

13.2. Potential Exit Strategies

Considering the average holding period for classic LBOs is five years, and Valedo has now held Joe & the Juice as its portfolio company for six years, their exit should be approaching. Thus, as stated above, it is relevant to examine the potential exit channels and timing that will generate the highest possible return for Valedo and its LPs. As identified in the theoretical framework, three exit channels are prevalent, namely, sale to a strategic buyer, sale to another financial sponsor, and to carry out an IPO. In the case of Joe & the Juice, a sale to a strategic buyer appears unlikely given that the current ambitions of Joe & the Juice are to become a global concept and that such exit channel entails a sale to another company in the same industry for strategic purposes. Hereof, the analysis of the potential exit channels for Valedo and its investment in Joe & the Juice will focus on the two latter exit channels.

As it can be argued that Joe & the Juice still holds potential for further growth and operational improvements, the company becomes relevant for a sale to another financial sponsor. However, according to a Bloomberg article (2018), Valedo together with General Atlantic are considering an IPO for Joe & the Juice toward the end of 2019, weighing a U.S. listing as this market represents the focal point for the further expansion of the company. Yet, this has not been confirmed and as an IPO represents the least common exit strategy for PE funds, this opportunity is likely to not have been considered by Valedo at the time of entry in Joe & the Juice.

Rather, as discussed with J. Breitenstein (personal communication, 2019), it is likely that Valedo saw potential in the chain and wanted to get onboard to accelerate its international expansion before selling it again to another PE fund. However, it may be that Joe & the Juice grew more rapidly and with more success than expected, resulting in a company potentially ready for an IPO. In this regard, J. Breitenstein (personal communication, 2019) stated that:

> "It's probably difficult to find an industrial buyer for a company like Joe & the Juice. So they have probably been looking at other [PE] funds or an IPO. In some cases, IPO is not relevant because the company will not be ready, [...] they cannot live up to all the reporting requirements [...] so then they just look at a financial buyer where they will start an auction and sell to the highest bidder. But if they have the option of doing an IPO, most will run a dual track where they search for financial sponsor and the listed market. The listed market will usually pay a higher price than what you see in peer-to-peer or [PE] to [PE] fund."

Hereof, we will now examine the potential exit channels of sponsor-to-sponsor and IPO in the case of Joe & the Juice.

13.2.1. Sponsor-to-Sponsor

From the buyer perspective, considering a sale to another financial sponsor, Joe & the Juice represents an attractive investment opportunity as the company has already been subject to some management rigor imposed by Valedo while still having potential for further development. Hence, the new financial sponsor would have the opportunity to take the company through its next stage of value creation. From Valedo's perspective, this exit channel could be appealing due to the current market conditions with valuations and multiples at the high-end of the price cycle, as identified in the multiple expansion section. In particular, private valuations and multiples are reported to be relatively high compared to public ones (Bain, 2019). Hereof, there subsists a highly favorable sellers-market in the PE industry. This proves advantageous for Valedo if exiting Joe & the Juice in the near future. However, as the market conditions may change rapidly, it can be recommended that Valedo would not wait too long if they wish to benefit from the currently favorable seller conditions.

Additionally, in 2018, the exit channel of sponsor-to-sponsor had its third-strongest year ever experienced in the PE industry in terms of total value and thus remains as a crucial exit channel for PE funds (Bain, 2019). This being the case, to analyze the potential for Valedo exiting Joe & the Juice through sponsor-to-sponsor, the LBO model has been built assuming an exit multiple of 8x which is equal to the one at entry. This will be used as the baseline for assessing the potential exit price and its implications. The LBO model and the related assumptions were elaborated in the financial leverage section and, as can be seen in Figure 25 below, the enterprise value at exit has been estimated to be 2,572 billion DKK based on a forecasted EBITDA of 321,548 million DKK and an EBITDA multiple of 8x. Accordingly, assuming debt is repaid at the time of exit, the equity value will equal 1,540 billion DKK that should yield a gross IRR of 36% and a net IRR of 34% for Valedo's investment in Joe & the Juice.

	Investor Returns (thousand DKK)							
	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018E	FY2019E	FY2020E
EBITDA	36.514,25	52.463,80	69.043,47	82.333,00	115.552,00	171.854,24	235.073,22	321.548,18
EBITDA Multiple	8x							8x
Enterprise Value	292.113,98							2.572.385,40
Investor equity	-175.502,08	0,00	0,00	0,00	0,00	0,00	0,00	1.540.349,17
Gross IRR	**36%**							
Money Multiple	**8,78**							
Management Fee	2%							
Carried Interest	20%							
Investor equity	-175.502,08	-3.510,04	-3.510,04	-3.510,04	-3.510,04	-3.510,04	-3.510,04	1.423.282,63
Net IRR	**34%**							

(*Figure 25*. LBO model. Own creation)

However, when analyzing the selected peer group of Joe & the Juice as well as industry reports, it appears that the valuation of the company could potentially obtain a higher EBITDA multiple than 8x. In 2018, the average EBITDA multiple for companies in the category of coffee, breakfast, and snacks, was 14,7x based on data from S&P Global Market Report (Duff & Phelps, 2018). Additionally, for the same year, Harris Williams (2018) reported that the average EBITDA multiple for companies operating in snacks and beverages was 14,3x. Similar valuation multiples can also be found for recent deals within the selected peer group of Joe & the Juice (see Figure 26 below[6]).

[6] Data compiled from: Yahoo Finance, 2019; Fifth Third Capital Markets, 2018; Mulier, 2018; Sullivan & Massoudi, 2017; Reuters, 2017; Herkules, 2015; SEC, 2013; Harris Williams, 2012; Reuters, 2012; and SEC, 2011.

For example, in 2016, JAB Holdings acquired Krispy Kreme for $1,35 billion and, a year later, in 2017, they also acquired the U.S. bakery and sandwich chain, Panera Bread, for $7,5 billion. Both companies were bought for an EBITDA multiple equaling approximately 18x (Sullivan & Massoudi, 2017; Fifth Third Capital Markets, 2018). Nonetheless, 9,9x was the average EBITDA multiple for the reported restaurant deals taking place in the period of 2015-2018, according Fifth Third Capital Markets (2018). Hereof, even this average EBITDA multiple suggests potential for multiple expansion in the case of Joe & the Juice.

Year	Company	Countries present	# of Stores	Buyer	Seller	Enterprise Value	Buying price	EBITDA	EBITDA multiple
2018	Pret a Manger	Global (9 countries)	530	JAB Holding Co.	Bridgepoint	$2B	$2B	$128M	15x
2018	Costa Coffee	Global (32 countries)	3800	Coca Cola Co.	Whitboard	$5,1B	$5,1B	$310M	16,4x
2017	Panera Bread	USA & Canada	2000	JAB Holding Co.	Publicly traded	$6,5B	$7,5B	$424M	18x
2016	Krispy Kreme	Global (26 countries)	1100	JAB Holding Co.	Publicly traded	$1B	$1,35B	$73M	18x
2015	Espresso House Baresso	Sweden & Norway	193	JAB Holding Co.	Herkules	$328M	$328M	$22M	15x
2012	Peets Coffee	USA	196	JAB Holding Co.	Publicly traded	$691M	$956M	$46M	21x
2012	Caribou Coffee	USA (Franchises in 10 countries)	610	JAB Holding Co.	Publicly traded	$263M	$340M	$28M	11x
N/A	Starbucks	Global (76 Countries)	28	N/A	N/A	$101.51B	N/A	$5.14B	19,7x
Average									16,8x

(*Figure 26*. EBITDA Multiples for Peer Group. Adapted from: see footnote)

Additionally, among the selected peer group of Joe & the Juice, Starbucks represents the only public company that is currently trading at 19x EBITDA (Yahoo Finance, 2019). Hereof, it seems plausible for Valedo to obtain a higher exit multiple than 8x for its investment in Joe & the Juice, whether the company is exited through a sponsor-to-sponsor sale or through an IPO. This potential for obtaining a higher exit multiple compared to entry is also supported by J. Breitenstein (personal communication, 2019) who emphasizes that if a PE fund invests in a local SME, such as Joe & the Juice, and adds additional value, such as expanding the business internationally, the next buyer would likely pay a higher multiple.

Additionally, it is reasonable to assume that Valedo extended the holding period of Joe & the Juice because they recognized the opportunity to further develop the company towards being ready for an IPO. Also, Valedo may have projected the market conditions to improve in the future, which in fact did happen, and decided to postpone the timing of exit with the expectations of realizing an enhanced return. Hereof, it is reasonable that Valedo and General Atlantic are currently running a dual track where they search for potential financial sponsors while researching the listed market to assess the exit channels in terms of which can provide the highest exit multiple.

Such dual track was followed by PE fund Bridgepoint when exiting its investment in Pret a Manger, one of the main competitors of Joe & the Juice. Here, Bridgepoint had come a long way with preparations for a potential IPO of Pret a Manger until the investment was finally exited in 2018, through a sale to PE fund JAB Holdings who bought the company for $2 billion representing an EBITDA multiple of 15x (Martin, 2018).

13.2.2. Initial Public Offering

In order to examine Joe & the Juice for a potential IPO, research has been conducted on previous IPOs as well as the valuations and multiples of peers have been investigated. In this regard, the built LBO model continuously serves as the baseline for the potential exit price for Joe & the Juice to either be adjusted upwards or downwards dependent on the IPO-specific considerations. As mentioned, exiting PE investments through an IPO is the least common exit strategy. Nonetheless, according to J. Breitenstein (personal communication, 2019), it also represents the exit channel with the greatest potential to generate the highest return for Valedo. In this regard, the IPO is considered for the U.S. market (Bloomberg, 2018), as this market provides the IPO with access to a large pool of possible investors worldwide. Additionally, while Joe & the Juice has established itself in major cities of this market, the U.S. still holds significant potential for further expansion, which, in turn, may make the company an attractive investment opportunity for public equity investors. Consequently, this could assist Valedo in obtaining a notable uplift in the potential exit multiple.

Nonetheless, according to Bain (2019), the value of IPOs has been falling by 34% globally due to market uncertainty and higher volatility, and thus, an IPO may represent a less attractive exit strategy for PE funds compared to one-time sales, such as sponsor-to-sponsor. This is because an IPO represents a lengthy exit due to the mandated holding period for existing shareholders and market timing considerations (J. Breitenstein, personal communication, 2019; Bain, 2019). As a consequence, the PE fund may be forced to hold onto a large percentage of its investment for a long period of time. Hence, if deciding on an IPO, Valedo will not be able to exit its investment instantly, because, as the current majority owner, Valedo will be subject to a lock-in period of approximately 180 days whereupon the investment can be exited. Additionally, it is likely that Valedo will not be able to sell the entirety of its investment even after the lock-in period. Consequently, the investment becomes subject to potential fluctuations of share price and general market conditions that, if fatal, can result in a loss of the investment.

Similarly, Valedo can risk exiting its investment with a lower return than expected or can be forced to hold on to the shares for an extended period of time, if the share price drops to a level where Valedo does not want to sell (J. Breitenstein, personal communication, 2019). However, if the IPO exit proves successful, perhaps Valedo will be able to exit fully after two to three placements and, in this regard, J. Breitenstein (personal communication, 2019) states that exit through "an IPO will in most cases get the highest price, but also make [the PE fund] hold on to [the] shares for a longer time."

Furthermore, as identified in the financial analysis, Joe & the Juice realized a net loss in both 2016 and 2017. This loss has been forecasted to continue due to substantial financial expenses. However, in 2017, 76% of the companies that listed in the U.S. were unprofitable the year before the IPO (Lee, 2018) and thus it is becoming increasingly common for companies with negative earnings to go public. However, it is important to note that this trend is most applicable for tech companies. For this reason, it would be considered unusual for a company within the café restaurant industry to go public with a negative net income. Thus, an exit through an IPO can be argued to be less likely compared to exiting the investment through a sale to another financial sponsor. Nonetheless, the rise of unprofitable companies going for IPOs may reflect a general trend whereby the growth of a company is valued over its current profitability. Hereof, it is still reasonable that Valedo may consider exiting the investment through an IPO, however it would require that the company's infrastructure in terms of its financial reporting systems, governance and compliance is ready (EY, 2013). J. Breitenstein (personal communication, 2019) supports this, stating that the internal capabilities of the company need to be able to live up to the increased reporting requirements following an IPO. Additionally, considering the selected peer group of Joe & the Juice, there appears to be a reverse trend where several previously publicly-held companies, such as Panera, Caribou Coffee, and Peet's Coffee, have been taken private. This further supports that sponsor-to-sponsor represents a more suitable exit channel for Valedo and its investment in Joe & the Juice.

Furthermore, as previously stated, the potential IPO of Joe & the Juice has been benchmarked against American fast food chain, Shake Shack, which suggests a valuation of $1,5 billion for Joe & the Juice (Bloomberg, 2018). Based on the built LBO model, Joe & the Juice would need to obtain an EBITDA multiple of approximately 31x to achieve such a high valuation through an IPO. Taking into consideration the EBITDA multiples found from the peer group and industry reports, as outlined above, it appears overly optimistic that Joe & the Juice would reach such valuation.

From a different perspective, if the company were to obtain an EBITDA multiple equal to the average of 16,8x for the selected peer group, Joe & the Juice would be valued at 5,402 billion DKK corresponding to approximately $812,5 million (see Figure 27). Given that such valuation still only represents just above half of the benchmark of $1,5 billion, this benchmark seems to be unreachable for Joe & the Juice.

	Investor Returns (thousand DKK)							
	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018E	FY2019E	FY2020E
EBITDA	36.514,25	52.463,80	69.043,47	82.333,00	115.552,00	171.854,24	235.073,22	321.548,18
EBITDA Multiple	8x							16,8x
Enterprise Value	292.113,98							5.402.009,35
Investor equity	-175.502,08	0,00	0,00	0,00	0,00	0,00	0,00	4.369.973,11
Gross IRR	**58%**							
Money Multiple	**24,90**							

(*Figure 27.* LBO model. Own creation)

13.2.3. Implications

Concerning the potential implications of PE funds exiting investments through IPOs, the case of Danish PE fund Axcel and its investment in Pandora serves as an example. In 2010, Pandora went public with a market capitalization of 27,33 billion DKK, representing an EBITDA multiple of 14x, after having been under the ownership of Axcel for only two years (Reuters, 2010). By exiting the investment, Axcel achieved an extraordinary IRR. However, Axcel was not able to exit the full investment until four years later, in 2014, at which time the final shares were sold at a discount (Axcel, 2014). Additionally, since Axcel sold its final shares in Pandora, the multiple at which the stock trades over forward earnings decreased from 18,3x in 2015 to 10,4x in 2018 where the industry average was 22,4x (Felsted, 2018). This serves as an example for an essential consideration to be made by potential future and continuing investors of former portfolio companies. In this line, as PE funds are experts in assisting portfolio companies to optimize their operations and maximize their potential value creation, it can be questioned how likely it is for the level of value creation to continue once the PE funds have exited. Hereof, for future ex-portfolio companies, such as Joe & the Juice, and its future investors, potential implications may entail that the companies cannot sustain the experienced growth and development trajectory as during the ownership of PE funds. Consequently, the performance of such companies, in addition to the shares of investors, may experience a downward trend. This is best illustrated by the circumstances surrounding Pandora.

Furthermore, if exiting the investment in Joe & the Juice through an IPO, such exit channel will impact the timing of when the return will be realized. As discussed previously, due to the mandated lock-in period, the investment will become exposed to the fluctuations of the shares price which can either increase or decrease the value of the investment, something Valedo will have no control over. Hereof, considering the time value of money, and the uncertainty of the final return on investment, an IPO should imply a less attractive exit channel for Valedo compared to a sale to another sponsor where the investment would be realized both instantly and completely. Also, given the finite economic life of approximately 10 years for investment funds, Valedo has limited time to exit the current investments made with Valedo II that has the vintage year of 2011. Thus, if exiting Joe & the Juice through an IPO, Valedo may be obliged to sell the shares at a discount similarly to the case of Axcel and Pandora.

Based on the points and considerations raised above, and balancing the potential return and implications against each other, a sponsor-to-sponsor sale appears to be the optimal exit channel for Valedo and its investment in Joe & the Juice. Nonetheless, considering the simplifications of the constructed LBO model and the restraints posed by the limited access to information about Joe & the Juice and Valedo, precautions have to be taken in relation to the estimated exit prices and multiples, and hereof, the potential returns obtainable. According to the analysis presented in this thesis, with an EBITDA multiple of 8x and an estimated EBITDA of 321,548 million DKK, the investment in Joe & the Juice should provide a gross IRR of approximately 36% and a money multiple of 8,78x for Valedo and its LPs. However, it needs to be considered that despite the potential value created from the investment in Joe & the Juice, this represents one single investment out of the total of 12 investments made with Valedo II. Thus, the actual return that the LPs of Valedo II get can differ significantly from the estimated IRR stated above. Hereof, the final value created for Valedo's LPs will be dependent on the performance of the rest of the individual investments. Yet, as the consensus remains that PE investments should yield an IRR of approximately 25%, the IRR of Joe & the Juice could thus compensate for the less well-performing portfolio companies in Valedo II that might provide IRRs below the expected 25%. Hereby, it can be concluded that Valedo has been successful in creating value on the portfolio company level in the case of Joe & the Juice and, therefore, for its LPs. This is so, as even if the estimated IRR would turn out be too high, it still has a substantial buffer before reaching the minimum return expected by LPs.

14. Conclusion

Throughout the thesis we have investigated how PE funds drive value creation on the portfolio company level. In this regard, a theoretical framework was established to provide a basis of knowledge regarding the business model of private equity funds and how it drives value creation for its investors. It was found that the PE business model has evolved significantly since the emergence of the PE industry in the late 1970s where PE funds mainly relied on financial leverage and multiple expansion to enhance value. Today, an increasing emphasis is placed on implementing operational improvements, which represent as much as 50% of total returns generated by contemporary PE funds (BCG, 2008; EY, 2016), and thus, it appears that PE funds are taking a more active role in managing their portfolio companies. Consequently, operational improvements have been identified as the main value driver employed by PE funds to enhance value creation on the portfolio company level. Nonetheless, despite the relative contributions of financial leverage and multiple expansion have decreased, these value drivers are still employed by PE funds to enhance return on investments.

Concerning operational improvements as a key value driver, it was found that PE funds hold a strong emphasis on assisting the portfolio companies to achieve revenue growth and margin improvements. Furthermore, two other aspects supporting operational improvements were identified. Firstly, PE funds concentrate their attention on implementing human capital improvements in portfolio companies to ensure that the mission-critical roles for the intended value creation plan are in place. Secondly, PE funds assist strategic improvements in portfolio companies, mainly through clarifying the strategic focus and prioritizing the objectives. In this regard, according to N. Retbøl (personal communication, 2018), the development of portfolio companies in a specific strategic direction represents the most crucial value driver. Nonetheless, revenue growth has shown to have the most effective impact on multiple expansion and thus the potential exit price, as it increases profits along with revenues and makes it easier to achieve a higher exit multiple (Bain, 2018). Hereof, it has been identified as an essential ability of PE funds to identify investment opportunities with high potential for further development and to implement the value-adding initiatives that suit the specific context of a given portfolio company.

However, the ways in which PE funds can initiate value-adding activities in portfolio companies needs to be assessed on a case-by-case basis, as after all, the value created is often a mix of the several value drivers that should match the specific situation of a given portfolio company. In this regard, to obtain an in-depth understanding of how PE funds can drive value creation in practice, the thesis conducted an empirical case study analysis of Valedo and its investment in Joe & the Juice. Here, the theoretical framework was used to assess how Joe & the Juice was a fit investment case for Valedo, to what extent Valedo has created value in Joe & the Juice by employing the identified key value drivers, what the potential exit strategy for the investment could be, and what might be the resulting implications for Valedo and its investors.

Valedo is specialized in investments in Nordic SMEs with revenues of 100 million to 500 million SEK. In this regard, considering a Danish background and a revenue equaling 446 million SEK in 2014, Joe & the Juice appears to have fit the investment scope of Valedo. Additionally, at the time of investment, Joe & the Juice was operating approximately 45 stores in the Nordics and the U.K., and was already experiencing significant growth. This further support the company as a fit investment case for Valedo, as Valedo searches for well-established companies with potential for international expansion. At last, Valedo describes itself as a growth-oriented active owner that assists management teams in strengthening the market positions of the respective portfolio companies. This appears evident in the case of Joe & the Juice, as the company has more than doubled its revenue and significantly increased its number of stores during Valedo's ownership (Joe & the Juice, 2017).

Hereby, the analysis found that Valedo has significantly increased the performance of Joe & the Juice. Concerning the use of value drivers to accomplish this, the findings indicate that Valedo has mainly implemented operational improvements to drive revenue growth. This has further been supported by improvements within the areas of human capital and strategy. As a result, during Valedo's ownership, Joe & the Juice has experienced a total revenue growth rate of 155% where its revenues have increased from 309,61 million DKK in 2014 to 790,678 million DKK in 2017. Nonetheless, it appears that the EBITDA margin of Joe & the Juice has not experienced any significant improvement but rather has remained fairly stable as 15,89% of revenue on average during the period of analysis. Yet, comparing the average EBITDA margin of Joe & the Juice with selected peers, it shows to be neither above nor below the average. Thus, in accordance with the stated objectives of the strategic partnership, Valedo has focused on creating value in Joe & the Juice through assisting the accelerated growth and international expansion, rather than focusing on improving the EBITDA margin.

Furthermore, regarding human capital improvements, this is usually implemented by PE funds in their portfolio companies to facilitate the implementation of the intended value creation plans. As found in the theoretical framework, it is important to make such improvements as early as possible, which is also the case in Joe & the Juice. When Valedo became the majority owner, several new board members were added to the Board of Directors and a new CFO, Sebastian Vestergaard, was appointed. Nonetheless, as an uncommon practice in such investment, the incumbent CEO, Kaspar Basse, was not replaced but instead continued to act as the CEO until 2019. Hereof, it appears that Valedo recognized the importance of Basse as a valuable resource for the competitive advantage of Joe & the Juice and its international expansion. Additionally, Valedo emphasized the mission-critical roles throughout the entire organization of Joe & the Juice, even on the lower levels where the juicers were acknowledged as crucial for the success of the company. Thus, various initiatives, including Joe House and Moneyball, were implemented to identify and further develop in-house talents with potential for creating additional value for the company. Emphasizing the importance of these initiatives for the value creation, the Board of Directors approved and allocated a substantial amount of resources for these.

Furthermore, strategic improvements have also taken place within Joe & the Juice since the entry of Valedo. In this regard, Valedo took an active role in overseeing the planning and implementation of the strategy, mainly through engagement in all board activities. However, as other PE funds practicing active ownership, Valedo did not get involved in the day-to-day operations of the company. Rather, these responsibilities were entrusted to Basse and other key employees. In regard to the strategy work, this was mainly conducted by Basse himself in close collaboration with external consultants. Nonetheless, the ideas and suggestions were presented for and discussed with the Board of Directors. The focal point of the strategy work was to clarify and strengthen the vision and strategic objectives of Joe & the Juice to support its international expansion, mainly utilizing the strategy frameworks of blue ocean strategy and the Golden Circle (Sinek, 2009). As a result, the why, the how, and the who were devised which now serves as the strategic direction for Joe & the Juice. Additionally, the unique ambience of the stores and the human interactions provided by the juicers were identified as crucial factors differentiating the company from its competitors.

Finally, given that the potential returns from PE investments are only realized at exit, the decisions regarding the exit channel and timing represent crucial factors for the value creation. In this regard, given the average holding period of portfolio companies is five years, it can be assumed that Valedo is due to exit Joe & the Juice in the near future as the company has been held for six years. In this line, it is likely that Valedo is investigating both an IPO and sponsor-to-sponsor as potential exit channels for the investment in Joe & the Juice. As noted by J. Breitenstein (personal communication, 2019), an IPO represents the exit channel that can potentially generate the highest return. Yet, the reported value of IPOs has been falling (Bain, 2019). Also, if exiting through an IPO, Valedo would encounter an uncertainty regarding the time of actually realizing the potential return due to a mandated lock-in period. Additionally, as the shares will become subject to price fluctuations, Valedo may have to sell at a discount or hold the shares for a longer period, if the share price fall below Valedo's minimum selling price. Furthermore, given the current and forecasted negative net income of Joe & the Juice, an IPO appears as a less likely exit channel even though the number of companies going public with negative earnings has been increasing.

Hereby, a sponsor-to-sponsor sale appears to be the optimal exit channel for Valedo and its investment in Joe & the Juice, taking into consideration the potential return, the timing of realizing the return, as well as the lower risk compared to an IPO. Supporting this, private valuations and multiples have been found to be higher relative to public ones. Also, the market is currently at the high-end of the price cycle which implies a positive seller's market in the PE. Hereof, through a sponsor-to-sponsor sale, Valedo could benefit from these favorable market conditions if exiting before the market conditions changes. Additionally, it appears possible for Valedo to obtain a higher exit multiple than at entry which has been estimated as 8x EBITDA. This is apparent when examining the average EBITDA multiples from industry reports and for the selected peer group for Joe & the Juice that provide a range from 9,9x to 16,8x. However, even with an EBITDA multiple of 8x, the built LBO model estimates that the investment in Joe & the Juice should yield a gross IRR of 36% if exited in 2020. Hereof, in the case of Joe & the Juice, it can be inferred that Valedo has successfully created value on the portfolio company level and thus for its investors. Yet, it needs to be taken into consideration that the investment in Joe & the Juice only represents one of 12 investments made with Valedo II. Hence, the final return generated for the investors will be dependent on the performances of the other portfolio companies held by Valedo II.

15. References

Aaron Allen & Associates. (2017, September 28). *Restaurant EBITDA.* Retrieved from: https://aaronallen.com/blog/restaurant-ebitda

Achleitner, A.K., Braun, R., and Engel, N. (2012). Leverage and the Performance of Buyouts: How Does the Use of Debt Impact Equity Returns? *Journal of Business Economics: 2012*(82), 451-490.

Aleszczyk, A.A., De George, E.T., Ertan, A., and Vasvari, F. (2016). Value Creation in Buyout Deals: European Evidence*. Adveq Applied Research Series*. Retrieved from: https://www.schroderadveq.com/sites/default/files/pdf/pei-research-report-sept-2016_0.pdf

Applegate, L. M. (2001). Emerging e-business models. *Harvard Business Review*, 79(1), 79-87.

Ashkanasy, N.M., & Jackson, C.R.A. (2001) Organizational culture and climate. In N. Anderson, D.S. Ones, H.K. Sinangil, & C.Viswesvaran (Eds.) *Handbook of Industrial, Work & Organizational Psychology.* Sage.

Axcel. (2014, December 9). *Sale of Pandora Shares.* Retrieved from: http://uk.axcel.dk/news/press-releases/sale-of-pandora-shares/

Bain. (2016). *Global Private Equity Report 2016.* Retrieved from: https://psik.org.pl/images/publikacje-i-raporty---publikacje/BAIN_REPORT_Global_Private_Equity_Report_2016.pdf

Bain. (2019). *Global Private Equity Report 2019*. Retrieved from: https://www.bain.com/contentassets/f7daf9c1ab3f4dde850672597e82277f/bain_report_private_equity_report_2019.pdf

Bain. (2018). *Global Private Equity Report 2018.* Retrieved from: https://go.bain.com/global-private-equity-report-2018.html

Bargeron, L.L., Schlingemann, F., Stulz, R., and Zutter, C.J. (2008), Why do private acquirers pay so little compared to public acquirers? *Journal of Financial Economics*, 89, (3), 375-390

Barney, J. (1995). Looking Inside for Competitive Advantage. *Academy of Management Executive*, 9(4), 49-61

BBC News. (2018, April 13). Coffee: Who grows, drinks and pays the most? *BBC News*. Retrieved from: https://www.bbc.com/news/business-43742686

Boston Consulting Group. (2008). *Global Asset Management 2018: The Digital Metamorphosis.* Retrieved from: https://www.bcg.com/publications/2018/global-asset-management-2018-digital-metamorphosis.aspx

Berlingske. (2016, October 11). Kapitalfond Køber sig ind i Joe & the Juice. *Berlingske.* Retrieved from: https://www.berlingske.dk/virksomheder/kapitalfond-koeber-sig-ind-i-joe-the-juice

Berlingske. (2016a, June 2). Joe & the Juice: Om Fem År er Danmark 10 Procent af Vores Forretning. *Berlingske.* Retrieved from: https://www.berlingske.dk/virksomheder/joe-the-juice-om-fem-aar-er-danmark-10-procent-af-vores-forretning

Berlingske. (2012, September 16). Joe & The Juice får ny direktør og partner. *Berlingske*. Retrieved from: https://www.berlingske.dk/virksomheder/joe-the-juice-faar-ny-direktoer-og-partner

Bloomberg. (2019, October 26). Company Overview of Valedo Partners. *Bloomberg.* Retrieved from: https://www.bloomberg.com/research/stocks/private/snapshot.asp?privcapId=26673566

Bloomberg. (Oct 26, 2018). Joe & the Juice's Private Equity Owners Considering IPO in 2019. *Bloomberg News*. Retrieved from: https://www.bloomberg.com/news/articles/2018-10-26/joe-the-juice-s-private-equity-owners-said-to-mull-ipo-in-2019

Braun, R., Puche, B., and Achleitner, A.K. (2015). International Evidence on Value Creation in Private Equity Transactions. *Journal of Applied Corporate Finance, 27* (4), 105-122.

Braun, R., and Schmidt, M. (2014). The Limited Partnership Model in Private Equity: Deal Returns over a Fund's Life. *Center for Entrepreneurial and Financial Studies, 2014* (1), 1-43.

Brigl, M., Jansen, A., Schwetzler, B., Hammer, B. and Hinrichs, H. (2016, February 19). How Private Equity Firms Fuel Next-Level Value Creation. *The Boston Consulting Group*. Retrieved from https://www.bcg.com/publications/2016/private-equity-power-of-buy-build.aspx

Brown, N. (2018, December 12). European Coffee Shop Market Grew 6 Percent in 2018, Allegra Says. *Daily Coffee News by Roast Magazine.* Retrieved from: https://dailycoffeenews.com/2018/12/12/european-coffee-shop-market-grew-6-percent-in-2018-allegra-says/

BVCA. (2015). Private Equity Performance Measurement. *British Private Equity & Venture Capital Association.* Retrieved from: https://www.bvca.co.uk/Portals/0/library/documents/BVCA%20Perspective%20Series/Private%20Equity%20Performance%20Measurement.pdf?ver=2015-04-09-105554-523

Børsen. (2013, December 2). Svensk Kapitalfond Køber Joe & the Juice. *Børsen*. Retrieved from: https://borsen.dk/nyheder/virksomheder/artikel/1/271717/svensk_kapitalfond_koeber_joe_the_juice.html

Cambridge Associates. (2018, March 31). US Private Equity Index® and Selected Benchmark Statistics. *Cambridge Associates*. Retrieved from: https://www.cambridgeassociates.com/wp-content/uploads/2018/07/WEB-2018-Q1-USPE-Benchmark-Book.pdf

Caselli, S., and Negri, G. (2018). *Private Equity and Venture Capital in Europe.* London, UK: Elsevier.

Cendrowski, H., Martin, J. P., Petro, L. W., and Wadecki, A. A. (2008). *Private Equity;*

History, Governance, and Operations. Hoboken, New Jersey: John Wiley & Sons, Inc.

Chugh, A. (2017, November 7). Why Is It Important to Brand Your Business? *Forbes*. https://www.forbes.com/sites/forbescoachescouncil/2017/11/07/why-is-it-important-to-brand-your-business/#493dd326c15f

CPH Post Online. (2016, August 31). Joe & The Juice close to agreement with a US investor. *CPH Post Online.* Retrieved from: http://cphpost.dk/news/business/joe-the-juice-close-to-agreement-with-a-us-investor.html

CreditSuisse. (2014, June 4). *Calculating Return on Invested Capital.* Retrieved from: https://plus.credit-suisse.com/rpc4/ravDocView?docid=P8BJ3Y

CSI Market. (2019). *Restaurants Industry Profitability.* Retrieved from: https://csimarket.com/Industry/industry_Profitability_Ratios.php?ind=914&hist=12

Damodaran, A. (2012). *Investment Valuation: Tools and Techniques for Determining the Value of Any Asset.* Hoboken, New Jersey: *John Wiley & Sons, Inc*.

Danske Bank (2019). *What is Private Equity?* Retrieved from: https://danskebank.com/en-uk/DPE/What-is-Private-Equity/Pages/What-is-Private-Equity.aspx

Deloitte. (2017). *Private Equity Demystified - The fundamentals of private equity deal structuring*. Retrieved from: https://www2.deloitte.com/content/dam/Deloitte/ie/Documents/Finance/Corporate%20Finance/IE_CF_PrivateEquity_0217_draft2.pdf

Demaria, C. (2010). *Introduction to Private Equity*. Wiley 1st edition.

Donnellan, A. (2018, October 11). Breakingviews - Pret's soured image puts fat returns out of reach. *Reuters*. Retrieved from: https://www.reuters.com/article/us-pret-a-manger-strategy-breakingviews/breakingviews-prets-soured-image-puts-fat-returns-out-of-reach-idUSKCN1ML248

Duff & Phelps. (2018). Restaurant Quarterly Update - June 2018. *Duff & Phelps*. Retrieved from: https://www.duffandphelps.com/-/media/assets/pdfs/publications/mergers-and-acquisitions/industry-inserts/consumer/restaurant-quarterly-update-june-2018.ashx

Ernst & Young. (2016). *A Harder Look at Value Creation by Private Equity.* Retrieved from: https://www.ey.com/sg/en/services/transactions/ey-a-harder-look-at-value-creation-by-private-equity.

Ernst & Young. (2013). *Are you ready to go public? Make sure you have your internal controls house in order.* Retrieved from: https://www.ey.com/Publication/vwLUAssets/Are_you_ready_to_go_public/%24FILE/EY-Are-you-ready-to-go-public.pdf

Felsted, A. (2018, May 15). Pandora's Box of Unsold Charm Bracelets. *Bloomberg*. Retrieved from:

https://www.bloomberg.com/opinion/articles/2018-05-15/pandora-s-box-of-unsold-charm-bracelets

Fifth Third Capital Markets. (2018). *Industry Spotlight - Restaurants Q3 2018*. Retrieved from: https://www.53.com/content/dam/fifth-third/docs/reports/industry-spotlight/2018/Restaurants_IndustrySpotlight_Q3_2018.pdf

Finans. (2017, March 24). Philip Finsteen opfandt "omsætningsknappen" i Joe & The Juice: Nu er han selv multimillionær. *Finans*. Retrieved from: https://finans.dk/erhverv/ECE9447859/philip-finsteen-opfandt-omsaetningsknappen-i-joe-the-juice-nu-er-han-selv-multimillionaer/?ctxref=ext

FinBox. (2019). *Return on Invested Capital for Restaurant Brands International Inc.* Retrieved from: https://finbox.io/QSR/explorer/roic

Franchise Times. (May 24, 2016). Fast-casual chains operate above average. *Franchise Times.* Retrieved from: https://www.franchisetimes.com/June-July-2016/Fast-casual-chains-operate-above-average/

Fraser-Sampson, G. (2010). *Private Equity as an Asset Class*. Wiley 2nd edition.

Fridson, M., & Alvarez, F. (2011). *Financial Statement Analysis: A Practitioner's Guide.* Hoboken, New Jersey: *John Wiley & Sons, Inc.*

General Atlantic (2016, October 12). *Joe & the Juice Announces Strategic Growth Investment from General Atlantic.* Retrieved from: https://www.generalatlantic.com/media-article/joe-juice-announces-strategic-growth-investment-general-atlantic/

Gillian J. and Wright, M. (2014). Private equity demystified: An explanatory guide. *ICAEW Faculty Guide*. Retrieved from: https://www.icaew.com/-/media/corporate/files/technical/corporate-finance/financing-change/tecplm12976_privateequityiii_full-edition.ashx?la=en

Goulet, N. (2012). Driving Organic Growth in Private Equity: A New Competitive Edge. *Copenhagen Business School*, Denmark.

Haas, R., and Pagani, R. (2014). *How PE Operations Teams Create Value*. Retrieved from https://www.atkearney.com/private-equity/article?/a/how-pe-operations-teams-create-value

Hambrick, D., & Mason, P. (1984). Upper Echelons: The Organization as a Reflection of its Top Managers. *The Academy of Management Review, 9* (2), 193-206.

Hamel G. (2001). *Leading the revolution*. Boston (MA): Harvard Business School Press.

Harris, R., Jenkinson, T., & Kaplan, S. (2016). How Do Private Equity Investments Perform Compared to Public Equity? *Journal of Investment Management, 14* (3), 1-24.

Harris Williams & Company. (2018). *Food and Beverage Industry Update - February 2018.* Retrieved from: https://www.harriswilliams.com/system/files/industry_update/food_and_beverage_-_february.pptx_.pdf

Harris Williams & Company. (2012). Food & Beverage Industry Update - March 2012. Retrieved from: https://www.harriswilliams.com/sites/default/files/industry_reports/FoodandBeverage_Industry_Update_8.3.12.pdf

Haskova, K. (2015). Starbucks Marketing Analysis. *CRIS – Bulleting of the Centre for Research and Interdisciplinary Study, 2015* (1), 11-29.

Hederstierna, J. and Sabrie, R. (2017). Evaluating Private Equity Returns from the Investor Perspective - are Limited Partners Getting Carried Away? *Stockholm School of Economics*, Sweden. Retrieved from: http://arc.hhs.se/download.aspx?MediumId=3822

Herkules. (2015, September 22). *Espresso House – a winning concept generating high returns based on a focused value creation plan.* Retrieved from: http://www.herkulescapital.no/case/united-by-success-4-2/

Hooley, G., Piercy, N., & Nicoulaud, B. (2012). *Marketing Strategy & Competitive Positioning*. Harlow: Pearson Education Limited

IbisWorld. (2019). *Juice & Smoothie Bars in the US Market Size 2003–2024*. Retrieved from: https://www.ibisworld.com/industry-statistics/market-size/juice-smoothie-bars-united-states

Ilmanen, A., Chandra, S., & McQuinn, N. (2019). Demystifying Illiquid Assets: Expected Returns for Private Equity. *AQR Whitepaper 1Q19*. AQR Capital Management, LLC

International Monetary Fund. (2019). *Real GDP Growth.* Retrieved from: https://www.imf.org/external/datamapper/NGDP_RPCH@WEO/OEMDC/ADVEC/WEOWORLD

Invest Europe. (2018). *About Private Equity.* Retrieved from: https://www.investeurope.eu/about-private-equity/

J. Breitenstein. (2019, April 11). Personal interview. See Appendix 12.2.

J. Breitenstein. (2018, November, 2). Personal interview. See Appendix 12.1.

Jensen, M.C. (1989). Eclipse of the Public Corporation. Harvard Business Review, 1989 (67), 61-74.

Joe & the Juice. (2003-2017). *Annual Report Joe & the Juice A/S.* Retrieved from: https://datacvr.virk.dk/data/visenhed?enhedstype=virksomhed&id=26589355&soeg=joe%20&%20the%20juice&openFiltertrue&virksomhedsform=null&virksomhedsstatus=null&antal_ansatte=null&type=Alle&sortering=default&virksomhedsmarkering=null&kommune=null&region=null&personrolle=null&language=da

Johnson, P., & Clark, M. (2006). *Business and Management Research Methodologies.* London, UK: SAGE Knowledge.

Johnston, M. (2011). Value creation in Private equity - How investors might spot high performing funds. *Copenhagen Business School*, Denmark.

Kailash Capital. (2018). Private vs. Public Markets - Identifying Potential Sources of Risk and Reward. *Kailash Capital LLC.*

Kaplan, S., and Strömberg, P. (2009). Leveraged Buyouts and Private Equity. *Journal of Economic Perspectives, 23* (1): 121-146.

Kaplan, S., and Stein, J. (1990). How risky is the debt in highly leveraged transactions? *Journal of Financial Economics*, 27 (1): 215-245.

Kitzmann, J., and Schiereck, D. (2009). A Note on Secondary Buyouts-Creating Value or Recycling Capital. *iBusiness,* 1 (2): 113-123.

Lee, X.E. (2018, August 29). No profit? No problem. Investors keep snapping up loss-making companies. *CNBC*. Retrieved from: https://www.cnbc.com/2018/08/29/no-profits-no-problem-the-economy-has-a-growing-appetite-for-unprofitable-companies.html

Linder J.C. & Cantrell S. (2000). Changing business models. *Accenture Institute for Strategic Change*.

Long, A., & Nickels, C. (1996). *A Private Investment Benchmark*. Presented at the AIMR [now ICFA] Conference on Venture Capital Investing.

Martin, B. (2018, May 29). Pret A Manger sold for £1.5 billion to Germany's deal-hungry Reimann family. *Reuters*. Retrieved from: https://uk.reuters.com/article/uk-pret-m-a-jab-holdings/pret-a-manger-sold-for-1-5-billion-to-germanys-deal-hungry-reimann-family-idUKKCN1IU017

McKinsey & Company. (2018). The rise and rise of private markets - McKinsey Global Private Markets Review 2018. *McKinsey & Company.*

McKinsey & Company. (2019). *Private-equity operations: Inside the black box*. Retrieved from: https://www.mckinsey.com/industries/private-equity-and-principal-investors/our-insights/private-equity-operations-inside-the-black-box

MacArthur, H. and Rainey, B. (2012). Bain - Global Private Equity Report 2012. *Bain*.

Marmer, M., Herrmann, B.L., Dogrultan, E., Berman, R., Eesley, C., and Blank, S. (2012). The startup ecosystem report 2012. *Technical report, Startup Genome*. Retrieved from: https://s3.amazonaws.com/startupcompass-public/StartupGenomeReport2_Why_Startups_Fail_v2.pdf

Modigliani, F., and Miller, M.F. (1958). The Cost of Capital, Corporation Finance and the Theory of Investment. *The American Economic Review, 48* (3), 261-297.

Morris, M., Schindehutte, M., & Allen, J. (2005). The Entrepreneur's Business Model: Towards a Unified Perspective. *Journal of Business Research*, 58(6), 726-735.

Morris, M., Schindehutte, M., Richardson, J., Allen, J (2006). Is the business model a useful strategic concept? Conceptual, theoretical and empirical insights. *Journal of Small Business*, 17(1), 27-56

Morrison, J. (2011). *The Global Business Environment - meeting the challenges*. London: Palgrave Macmillan.

Mulier, T. (2018, August 31). Coke Makes $5.1 Billion Bet on Coffee Market With Costa Deal. *Bloomberg*. Retrieved from: https://www.bloomberg.com/news/articles/2018-08-31/coca-cola-to-buy-u-k-s-costa-coffee-chain-for-5-1-billion

N. Retbøl. (2018, November 15). Personal interview. See Appendix 11.

Næss-Schmidt, S., Heebøll, C., & Karlsson, H. (2017). *Swedish Private Equity Market - A footprint analysis. Copenhagen Economics*. Retrieved from: https://www.svca.se/wp-content/uploads/2017/07/The-Swedish-Private-Equity-Market-A-footprint-analysis-Copenhagen-Economics-SVCA-July-2017.pdf

Newhart, B. (2018, November 6). US coffee market grows to $45.4bn in 2018. *Beverage Daily*. Retrieved from: https://www.beveragedaily.com/Article/2018/11/06/US-coffee-shop-market-grows-to-45.4bn-valuation-in-2018

Nicholson, H., Shepherd, D., & Woods, D. (2009). Mapping an Entrepreneurial SME´s Business Model: Applying and Extending the MSA framework. *Journal of Small Business Strategy*, 1-24.

Porter, M. E. (2008). The five competitive forces that shape strategy. *Harvard Business Review*, 86(1), January, 57-71.

Porter, M. (1987). From Competitive Advantage to Corporate Strategy. *Harvard Business Review*, 65(3).

Porter, M. (1979). How Competitive Forces Shape Strategy. *Harvard Business Review,* 1(1), 1-10.

Preqin. (2017). 2017 Preqin Global Private Equity & Venture Capital Report. *Preqin*.

Preqin. (2015). *Preqin Special Report: Public Market Equivalent (PME) Benchmarking*. Retrieved from: http://docs.preqin.com/reports/Preqin-Special-Report-PME-July-2015.pdf

Preqin. (2015a). *Nordic-Based Private Equity Managers – March 2015.* Retrieved from: https://www.preqin.com/insights/blogs/nordic-based-private-equity-managers-march-2015/11085

Preqin. (2011). *Private Equity Firms based in the Nordic Region.* Retrieved from: https://www.preqin.com/insights/blogs/private-equity-firms-based-in-the-nordic-region/3428

PricewaterhouseCoopers. (2018). *Private Equity Trend Report 2018: The Coming of Age.* Retrieved from: https://www.pwc.de/de/finanzinvestoren/private-equity-trend-report-2018.pdf

Randall, G. (1993). *Principles of Marketing*. London & New York: Routledge.

Raphael, R. (2017, November 1). Coffee, Sandwich, And A Side Of Edgy: How Joe & The Juice Aims To Take Over The U.S. *Fast Company*. Retrieved from: https://www.fastcompany.com/3066489/coffee-sandwich-and-a-side-of-edgy-how-joe-the-juice-aims-to-take-over-the

Reuters. (2017, April 5). Panera buyout overeggs fast-food feeding frenzy. *Reuters*. Retrieved from: https://www.reuters.com/article/us-panera-bread-m-a-breakingviews/panera-buyout-overeggs-fast-food-feeding-frenzy-idUSKBN1772CX

Reuters. (2012, July 23). Germany's Benckiser to buy Peet's Coffee for $1 billion. *Reuters*. Retrieved from: https://www.reuters.com/article/us-peet-benckiser/germanys-benckiser-to-buy-peets-coffee-for-1-billion-idUSBRE86M0L820120723

Reuters. (2010, August 27). Jewellery firm Pandora's owners ready IPO - sources. *Reuters*. Retrieved from: https://www.reuters.com/article/pandora-ipo-bankers/jewellery-firm-pandoras-owners-ready-ipo-sources-idUSLDE67Q0SF20100827

Rivkin, J. (2000). Imitation of Complex Strategies. *Management Science, 46* (6), 824-844.

Robertson, J. (2009). Private Equity Funds. *New Political Economy, 14* (4), 545-555.

Ross, W. (2017, October 25). Meet the Ex-Karate Champ Who Built an International Coffee and Juice Chain Around a Cult of Bros. *Money.* Retrieved from: http://money.com/money/4984736/meet-the-ex-karate-champ-who-built-an-international-juice-chain-around-a-cult-of-bros/

Rouen, E., & Srinivasan, S. (2018). *Joe & the Juice Crosses the Atlantic* (Case Study No. 9-118-039). Harvard Business School.

Saunders, M., Lewis, P., & Thornhill, A. (2016). *Research Methods for Business Students.* Essex, UK: Pearson Education Limited.

Schein, E. H. (2010). How leaders embed and transmit culture (Chapter 14, E-book pp.235-258). In *Organizational Culture and Leadership*. San Francisco: John Wiley & Sons.

Schleifer, A. & Vishny, R. W. (1997). A Survey of Corporate Governance. *The Journal of Finance,* 52 (2), 737-783.

SEC. (2013). *Jury Trial Demanded Exhibit (a)(5)(L)*. Retrieved from: https://www.sec.gov/Archives/edgar/data/1332602/000119312513006947/d464556dex99a5l.htm

SEC. (2012). *Jury Trial Demanded Exhibit Exhibit 99.1*. Retrieved from: https://www.sec.gov/Archives/edgar/data/1332602/000119312512073012/d305571dex991.htm

Sifter. (2018, February 19). *Starbucks.* Retrieved from: https://sifterfund.com/wp-content/uploads/2018/04/Research-note-Starbucks-Corporation-19022018.pdf?fbclid=IwAR2vwPWEqYBKUkj9DRYmfT_Lu9IED9BiqWzajJhgn_en-trli0L0kmkzw3Y

Sinek, S. (2009). *Start with Why: How Great Leaders Inspire Everyone to Take Action.* London, UK: Portfolio Penguin.

Slee, R. (2011). *Private Capital Markets: Valuation, Capitalization, and Transfer of Private Business Interests.* Wiley 2nd edition..

Starbucks. (2018). *FY18 Annual Report*. Starbucks Corporation.

Sullivan, C. & Massoudi, A. (2017, May 10). Pret A Manger studies options for New York IPO this year. *Financial Times*. Retrieved from: https://www.ft.com/content/3ce676ce-3556-11e7-bce4-9023f8c0fd2e

Tice, C. (2013, November 24). Bootstrap Startup: Inside A $13K Restaurant Opening. *Forbes*. Retrieved from: https://www.forbes.com/sites/caroltice/2013/11/24/boostrap-startups-13k-restaurant-opening/#79e961f862c2.

Trienekens, T. and Zuurbier, P. (2007). Quality and safety standards in the food industry, developments and challenges. *International Journal of Production Economics*, 113 (1), 107-122.

Valedo. (2018). *Investments.* Retrieved from: http://www.valedopartners.com/en/investments/

Valedo. (2018a). *About Valedo.* Retrieved from: http://www.valedopartners.com/en/about-valedo/

Valedo. (2017, March 3). *Valedo III Invests in Cordel Norden.* Retrieved from: http://www.valedopartners.com/en/valedo-iii-invests-cordel-norden/

Valedo. (2013, December 2). *Joe & the Juice and Valedo in Partnership for Continued Expansion*. Retrieved from: http://www.valedopartners.com/en/joe-juice-valedo-partnership-continued-expansion/

Vækstfonden. (2018, January 16). *Joe & the Juice i Massiv Vækst: Åbner 60 Butikker i Udlandet i 2018.* Retrieved from: https://vf.dk/nyheder/2018/joe-the-juice/?fbclid=IwAR3mPKa6Et44UJwQ1TMca2Sd8UHr_9vUlLDan0kV81C1dlR3VZFZTlKG2kI

Yahoo Finance. (2019). *Starbucks Corporation (SBUX) Statistics*. Retrieved from: https://finance.yahoo.com/quote/SBUX/key-statistics/

Yang, Z. and Peterson, R. (2004). Customer perceived value, satisfaction, and loyalty: The role of switching costs. *Psychology and Marketing*, 21 (10), 799-822. Wiley Online Library. Retrieved from: https://onlinelibrary.wiley.com/doi/abs/10.1002/mar.20030

Yin, R. K. (2014). *Case Study Research: Design and Methods*. Thousand Oaks, CA: SAGE.

16. Appendix

Appendix 1: Interview Guide for Interviews

Interview Guide

Date: ______
Interviewee: ______
Topic: ______

Intro

- Hello, my name is _____ and this is my fellow researcher _______.
- *Give the interviewee more information about who we are, the project and the topic.*
- Thanks for talking with us today, the interview will take approximately 30-45 minutes.
- If there are any questions you are unable/do not want to answer, you are free to state that.
- You will be recorded for the sake of the research, the information will not be distributed.

Background of interviewee

- Now, would you please start off by telling us a bit about yourself.
- Name, age, country of origin, education, job/position, hobbies, family, life in general.

Potential topics to touch upon

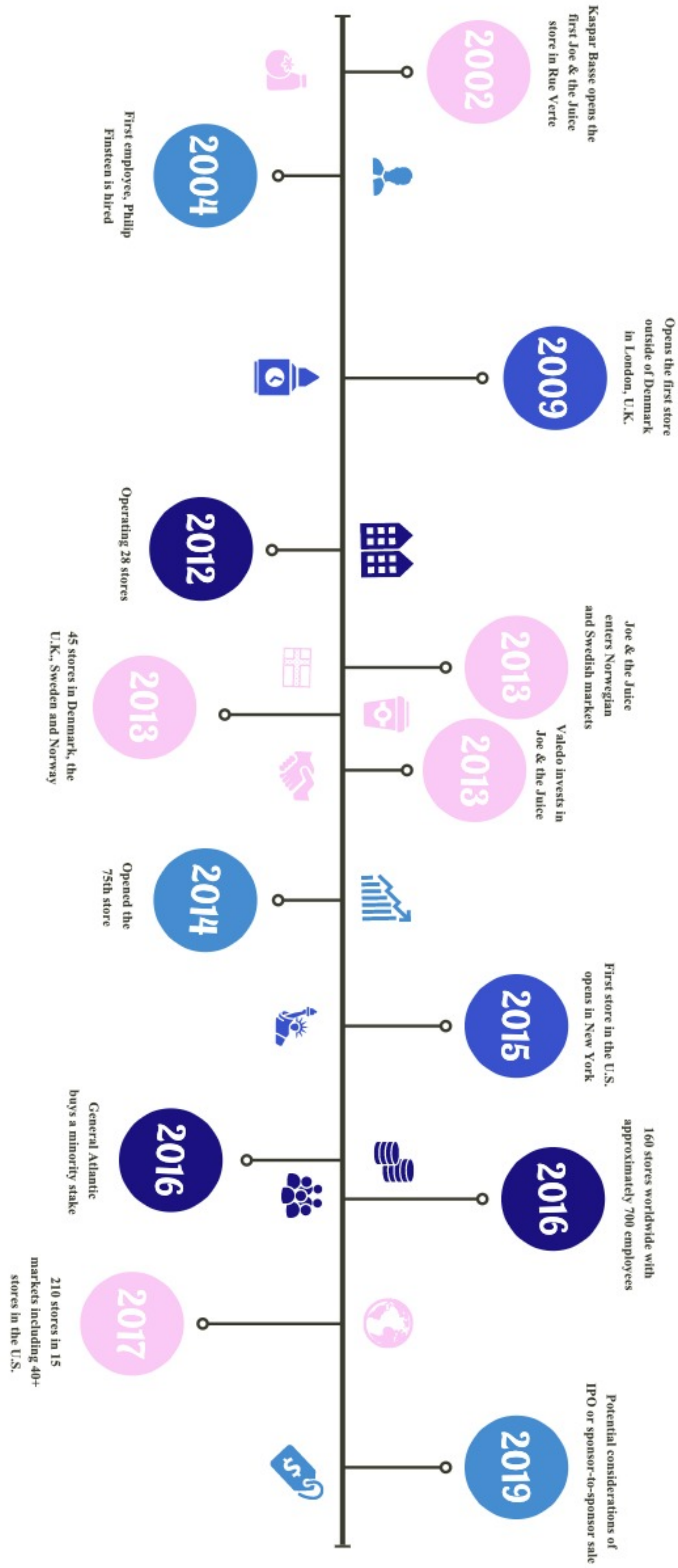
- What do you perceive as the most important drivers of value creation within the PE business model?
- What similarities and/or differences are there in the ways PE funds create value for 1) the investors, 2) the portfolio companies, and 3) the PE fund itself? => everything has been tied to each other
- In your perception, what has been the most crucial value driver historically?
- Can you describe if there have been any major changes to the trends of value creation in the PE industry over the decades?
- Today, in your perception, how does PE funds actually create value on an industry level?
- Considering LBOs, what criteria is used by PE funds to identify and select potential portfolio companies?
- Are you aware of any specific methods/tools/models used by PE funds in the selection process and can you describe them for us?
- How do PE funds measure and examine the performance of the portfolio companies during the holding period?
- How do PE funds measure and examine the performance of their investments into portfolio companies at the time of exiting the investments?
- In your perception, at what point has an investment been "successful"?
- Which benchmarks do PE funds make use of to evaluate the exit of investments and what implications do different exit scenarios have for the PE funds?

Appendix 2: Income Statement of Joe & the Juice for 2014-2017

Year (TDKK)	2014	2015	2016	2017
Revenue	**309.610,15**	**404.550,76**	**551.350,00**	**790.678,00**
COGS	-70.302,22	-78.487,20	-102.492,00	-148.626,00
Gross profit	**239.307,93**	**326.063,56**	**448.858,00**	**642.052,00**
Other operating income	3.897,68	6.633,27	18.079,00	13.059,00
SG&A	-102.364,43	-136.255,45	-179.964,00	-274.113,00
Other external expenses	-88.377,38	-127.397,91	-204.640,00	-265.446,00
EBITDA	**52.463,80**	**69.043,47**	**82.333,00**	**115.552,00**
D&A	-53.763,15	-47.073,98	-73.529,00	-110.156,00
EBIT	**-1.299,35**	**21.969,49**	**8.804,00**	**5.396,00**
Financial income		15,63		31.343,00
Financial expenses	-12.970,88	-14.670,23	-32.367,00	-72.252,00
EBT	**-14.270,23**	**7.314,89**	**-23.563,00**	**-35.513,00**
Tax expenses	-6.375,83	-4.278,94	8.430,00	8.172,00
Net profit/loss	**-20.646,06**	**3.035,95**	**-15.133,00**	**-27.341,00**

(Adapted from Joe & the Juice Annual Reports from 2014-2017)

Appendix 3: Timeline of Joe & the Juice



Appendix 4: Leadership Team of Joe & the Juice in 2016

Name	Role	Years in J&TJ	Age as of Nov. 2017	Tertiary Education?	Job Outside of J&TJ	Positions Held within J&TJ
Kaspar Basse	CEO & Founder	15	46	Yes	Roles at Magnetix and BBDO	N/A
Sebastian Vestergaard	COO/CFO	13	31	Yes	None	Juicer, HR, DOC & Supply Chain
Thomas Evald	Global Retail Director	9	35	Yes	None	Franchise Owner (owned first operating franchise store)
Philip Finsteen	Creative Director	14	37	No	None	Juicer, Bar Manager, Head of Store Opening, Head of Campus
Morten Lodal Askekilde	Director of Legal, Compliance/ Risk Management, and Brand & Communications	1	31	Yes	Former attorney-at-law, Kromann Reumert	Head of Legal
Tom Carney	Director (Campus & Operational)	9	32	Yes	High School teacher	Juicer (1 year), Bar Manager (1.5 years), Regional Manager (3 months), Supply Chain, DOC &HR (2.5 years), Country Director of Denmark (2 years)
Carl-Johan Helbo Andersen	Head of Business Intelligence	2 years, 3 months	24	Yes	None	Business analyst (1 year)
Sam Hasanpour	Director, Financial Operations (Business Intelligence, Finance, IT & HR)	5 years, 5 months	23	Yes	None	Juicer (1 year), Business Analyst (1 year), Head of Business Intelligence (1 year)
Mathias Nielsen	Director, Supply Chain & Capex	7	27	Yes	Tele-marketing & customer services (1 year)	Juicer (1 year), Bar Manager (1.5 years), Purchase & Waste Manager (1.5 years), Head of Purchasing (1 year), Head of Supply Chain (1.5 years)
Frederik Wulff	Head of Capex	7	28	Yes	None	Juicer (2 years), Bar Manager (1 year), Finance Associate (2 years)
Nicolai Schnack	Head of IT	6 years, 7 months	25	Yes	None	Juicer (1 year, 7 months), Strategic Information Officer (3 years), Head of IT (2 years)
Valdemar Halbye	Head of US Retail	2 years, 9 months	24	Yes	Management Consultant at Maersk (2 years), Account Manager & Consultant at Scalepoint Technology (2 years)	Juicer (2 years)

(Adapted from Rouen & Srinivasan, 2016)

Appendix 5: Guiding Principles of Joe & the Juice

5 WE BELIEVE IN INTIMATE SURROUNDINGS AND RELATIONSHIPS

6 WE DON'T WANT TO MAKE THINGS EASY

7 WE DON'T WANT TO DISCOUNT OURSELVES

8 WE ONLY WANT TO OFFER GOOD STUFF

9 WE PUT OUR PEOPLE ON THE STAGE, NOT OUR PRODUCTS

10 WE DON'T BELIVE IN SERVICE CONCEPTS

11 WE WANT TO NURTURE INDIVIDUAL INTIMATE RELATIONSHIPS

12 WE NEVER WANNA FOLLOW TEXTBOOK SOLUTIONS

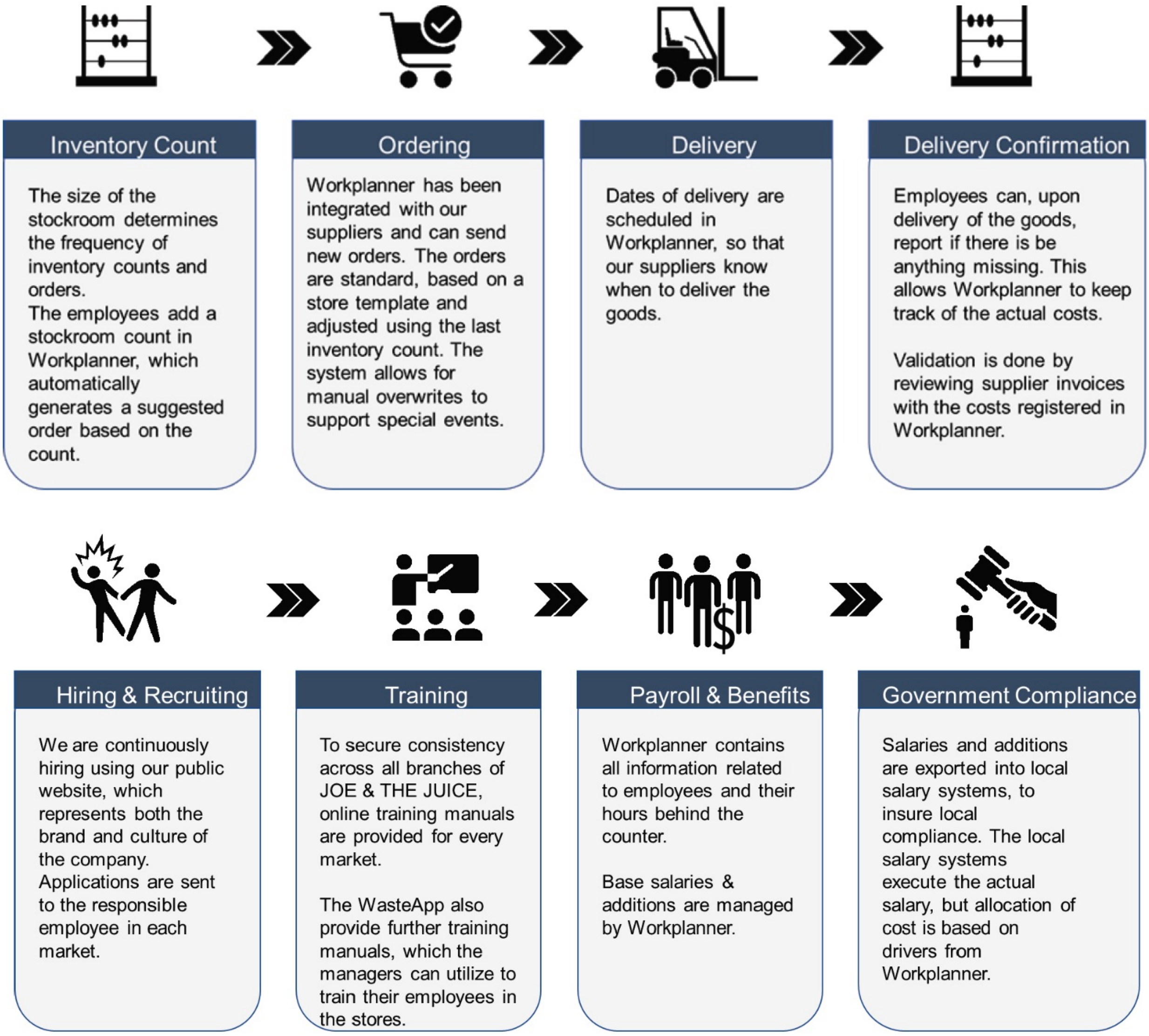
13 WE HAVE TO DO THINGS OUR WAY

14 WE SELL PRODUCTS TO FUND OUR YOUTH CULTURE

15 WE WANT TO BE SOCIALLY RESPONSIBLE, NOT POLITICALLY CORRECT

(Hansen & Basse, 2016)

Appendix 6: Supply Chain System Developed in Joe & the Juice



(Adapted from Rouen & Srinivasan, 2016)

Appendix 7: Product Offering of Joe & the Juice

(Adapted from Rouen & Srinivasan, 2016)

Appendix 8: Income Statement and Balance Sheet of Joe & the Juice

Appendix 8.1: Income Statement with Components as Percentages of Revenue

Year (TDKK)	2014	%	2015	%2	2016	%3	2017	%4	Average %	GAGR
Revenue	**309.610,15**	**100,00%**	**404.550,76**	**100,00%**	**551.350,00**	**100,00%**	**790.678,00**	**100,00%**	**100,00%**	**26,41%**
COGS	-70.302,22	-22,71%	-78.487,20	-19,40%	-102.492,00	-18,59%	-148.626,00	-18,80%	-19,87%	
Gross profit	**239.307,93**	**77,29%**	**326.063,56**	**80,60%**	**448.858,00**	**81,41%**	**642.052,00**	**81,20%**	**80,13%**	**27,98%**
Other operating income	3.897,68	1,26%	6.633,27	1,64%	18.079,00	3,28%	13.059,00	1,65%	1,96%	
SG&A	-102.364,43	-33,06%	-136.255,45	-33,68%	-179.964,00	-32,64%	-274.113,00	-34,67%	-33,51%	
Other external expenses	-88.377,38	-28,54%	-127.397,91	-31,49%	-204.640,00	-37,12%	-265.446,00	-33,57%	-32,68%	
EBITDA	**52.463,80**	**16,95%**	**69.043,47**	**17,07%**	**82.333,00**	**14,93%**	**115.552,00**	**14,61%**	**15,89%**	**21,82%**
D&A	-53.763,15	-17,36%	-47.073,98	-11,64%	-73.529,00	-13,34%	-110.156,00	-13,93%	-14,07%	
EBIT	**-1.299,35**	**-0,42%**	**21.969,49**	**5,43%**	**8.804,00**	**1,60%**	**5.396,00**	**0,68%**	**1,82%**	**N/A**
Financial income			15,63	0,00%			31.343,00	3,96%	0,99%	
Financial expenses	-12.970,88	-4,19%	-14.670,23	-3,63%	-32.367,00	-5,87%	-72.252,00	-9,14%	-5,71%	
EBT	**-14.270,23**	**-4,61%**	**7.314,89**	**1,81%**	**-23.563,00**	**-4,27%**	**-35.513,00**	**-4,49%**	**-2,89%**	**N/A**
Tax expenses	-6.375,83	-2,06%	-4.278,94	-1,06%	8.430,00	1,53%	8.172,00	1,03%	-0,14%	
Net profit/loss	**-20.646,06**	**-6,67%**	**3.035,95**	**0,75%**	**-15.133,00**	**-2,74%**	**-27.341,00**	**-3,46%**	**-3,03%**	**N/A**

Appendix 8.2: Common Form Balance Sheet of Joe & the Juice

Year (TDKK)	2014	%	2015	%	2016	%	2017	%
Short-term assets								
Cash and cash equivalents	33.284,00	8,16%	40.868,50	8,42%	56.376,00	7,94%	109.990,00	10,67%
Inventory	3.512,60	0,86%	5.558,00	1,14%	7.902,00	1,11%	12.715,00	1,23%
Accounts receivables	12.531,60	3,07%	5.163,00	1,06%	20.437,00	2,88%	23.478,00	2,28%
Receivables from group enterprises								
Other receivables							18.004,00	1,75%
Deferred tax assets	3.069,00	0,75%	6.198,00		17.335,00		33.858,00	3,28%
Prepayments	18.499,00	4,53%	9.633,00	1,98%	19.896,00	2,80%	14.589,00	1,42%
Total short-term assets	**70.896,20**	**17,37%**	**67.420,50**	**13,88%**	**121.946,00**	**17,17%**	**212.634,00**	**20,62%**
Long-term assets								
Trademarks and rights	11.036,00	2,70%	20.732,50	4,27%	52.479,00	7,39%	71.059,00	6,89%
Completed development projects							17.202,00	1,67%
Development projects in progress			7.999,00	1,65%	15.207,00	2,14%	17.164,00	1,66%
Property, plant and equipment	71.580,00	17,54%	149.698,00	30,83%	291.769,00	41,08%	462.610,00	44,87%
Fixed asset investments	2.718,00	0,67%	2.009,00	0,41%	5.303,00	0,75%	11.951,00	1,16%
Goodwill	251.844,80	61,72%	237.723,00	48,96%	223.601,00	31,48%	238.403,00	23,12%
Total long-term assets	**337.178,80**	**82,63%**	**418.161,50**	**86,12%**	**588.359,00**	**82,83%**	**818.389,00**	**79,38%**
Total assets	**408.075,00**	**100,00%**	**485.582,00**	**100,00%**	**710.305,00**	**100,00%**	**1.031.023,00**	**100,00%**

	2014	%	2015	%	2016	%	2017	%
Short-term liabilities								
Current portion of long-term liabilities								
Accounts payable	47.927,00	11,74%	104.194,00	21,46%	170.646,00	24,02%	214.222,00	20,78%
Other short-term liabilities	72.271,00	17,71%	44.460,00	9,16%	68.641,00	9,66%	82.824,00	8,03%
Total short-term liabilities	**120.198,00**	**29,45%**	**148.654,00**	**30,61%**	**239.287,00**	**33,69%**	**297.046,00**	**28,81%**
Long-term liabiliities								
Provision for deferred tax and other provisions			2.585,00	0,53%	5.681,00	0,80%	13.030,00	1,26%
Other long-term liabilities	99.027,00	24,27%	142.835,00	29,42%	569.268,00	80,14%	795.625,00	77,17%
Total long-term liabilities	**99.027,00**	**24,27%**	**145.420,00**	**29,95%**	**574.949,00**	**80,94%**	**808.655,00**	**78,43%**
Total liabilities	**219.225,00**	**53,72%**	**294.074,00**	**60,56%**	**814.236,00**	**114,63%**	**1.105.701,00**	**107,24%**
Equity								
Reserve for development costs								
Share capital	4.187,00	1,03%	4.187,00	0,86%	31.362,00	4,42%	32.486,00	3,15%
Retained earnings	- 20.900,00	-5,12%	187.321,00	38,58%	- 135.293,00	-19,05%	- 107.164,00	-10,39%
Additional paid-in capital	205.563,00							
Total owners' equity	**188.850,00**	**46,28%**	**191.508,00**	**39,44%**	**- 103.931,00**	**-14,63%**	**- 74.678,00**	**-7,24%**
Total liabilities and owners' equity	**408.075,00**	**100,00%**	**485.582,00**	**100,00%**	**710.305,00**	**100,00%**	**1.031.023,00**	**100,00%**

Appendix 9: LBO Model of Joe & the Juice

Appendix 9.1: Assumptions

Debt Assumptions (Thousand DKK)			
Equity equity purchase price	292.113,98	Advisory Fee	0,02%
EBITDA at Entry	36.514,25	Financing Fee	0,06%
EBITDA Entry Multiple	8x		
Debt Required	116.845,59	% Debt	40%
Equity Required	175.268,39	% Equity	60%
Sources		Uses	
Debt	116.845,59	Equity Value of Company	292.113,98
Investor Equity	175.502,08	Advisory Fees	58,4227968
		Financing Fees	175,2683904
Total sources	292.347,68	Total Uses	292.347,68

Appendix 9.2: Forecasted Revenue Growth and Other Components

	Historical				Projections		
	FY2014	FY2015	FY2016	FY2017	FY2018E	FY2019E	FY2020E
Revenue Growth	N/A	30,66%	36,29%	43,41%	36,79%	36,79%	36,79%
COGS % revenue	22,71%	19,40%	18,59%	18,80%	19,87%	19,87%	19,87%
Other operating income % revenue	1,26%	1,64%	3,28%	1,65%	1,96%	1,96%	1,96%
SG&A % revenue	33,06%	33,68%	32,64%	34,67%	33,51%	33,51%	33,51%
Other external expenses % revenue	28,54%	31,49%	37,12%	33,57%	32,68%	32,68%	32,68%
D&A % revenue	17,36%	11,64%	13,34%	13,93%	14,07%	14,07%	14,07%
Financial income/expenses % revenue	4,19%	3,62%	5,87%	5,17%	4,71%	4,71%	4,71%
Tax rate	44,68%	58,48%	35,78%	23,01%	22%	22%	22%
Change in working capital % revenue	-20,12%	-15,22%	-8,86%	-4,52%	-3,61%	-2,88%	-2,30%
CapEx % revenue	23,12%	26,39%	36,53%	34,27%	32,16%	30,17%	28,31%

Appendix 9.3: Historical and Forecasted Income Statement

	Income Statement (thousand DKK)						
	FY2014	FY2015	FY2016	FY2017	FY2018E	FY2019E	FY2020E
Revenue	309.610,15	404.550,76	551.350,00	790.678,00	1.081.539,92	1.479.399,44	2.023.617,13
COGS	-70.302,22	-78.487,20	-102.492,00	-148.626,00	-214.940,74	-294.009,68	-402.165,24
Gross profit	**239.307,93**	**326.063,56**	**448.858,00**	**642.052,00**	**866.599,18**	**1.185.389,76**	**1.621.451,90**
Other operating income	3.897,68	6.633,27	18.079,00	13.059,00	21.169,05	28.956,38	39.608,39
SG&A	-102.364,43	-136.255,45	-179.964,00	-274.113,00	-362.455,79	-495.790,20	-678.173,53
Other external expenses	-88.377,38	-127.397,91	-204.640,00	-265.446,00	-353.458,20	-483.482,72	-661.338,57
EBITDA	**52.463,80**	**69.043,47**	**82.333,00**	**115.552,00**	**171.854,24**	**235.073,22**	**321.548,18**
D&A	-53.763,15	-47.073,98	-73.529,00	-110.156,00	-152.142,70	-208.110,51	-284.666,86
EBIT	**-1.299,35**	**21.969,49**	**8.804,00**	**5.396,00**	**19.711,54**	**26.962,71**	**36.881,31**
Interest expense/income	-12.970,88	-14.654,60	-32.367,00	-40.909,00	-50.984,54	-69.739,91	-95.394,70
EBT	**-14.270,23**	**7.314,89**	**-23.563,00**	**-35.513,00**	**-31.272,99**	**-42.777,20**	**-58.513,39**
Tax	-6.375,83	-4.278,94	8.430,00	8.172,00	6.880,06	9.410,98	12.872,95
Net profit/loss	-20.646,06	**3.035,95**	**-15.133,00**	**-27.341,00**	**-24.392,93**	**-33.366,22**	**-45.640,44**

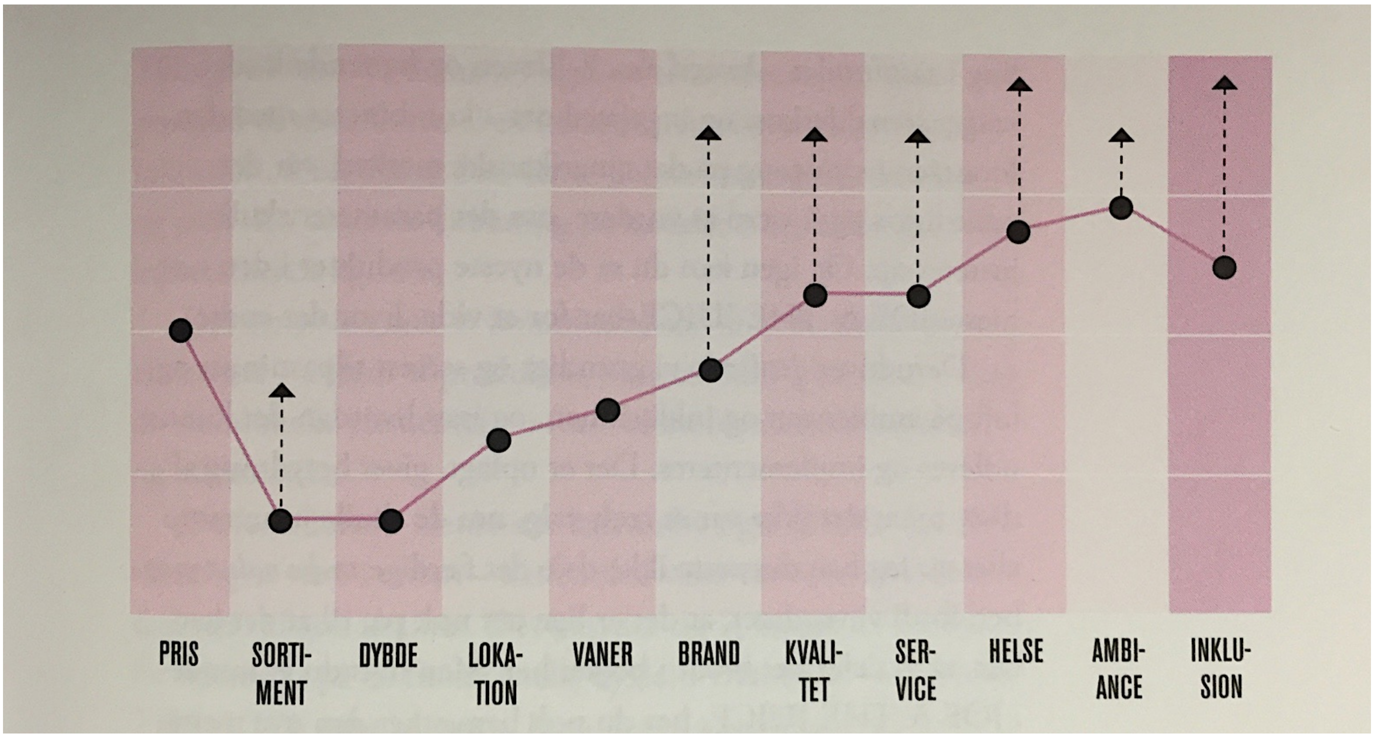
Appendix 9.4: Historical and Forecasted Cash Flow Statement

	Cash Flow Statement (thousand DKK)						
	FY2014	FY2015	FY2016	FY2017	FY2018E	FY2019E	FY2020E
Operating activities							
Net income	-20.646,06	3.035,95	-15.133,00	-27.341,00	-24.392,93	-33.366,22	-45.640,44
D&A	53.763,15	47.073,98	73.529,00	110.156,00	152.142,70	208.110,51	284.666,86
Decrease (increase) in WC	62.283,00	61.590,20	48.834,00	35.722,00	39.015,27	42.612,15	46.540,64
Cash flow from operations	**95.400,09**	**111.700,13**	**107.230,00**	**118.537,00**	**166.765,03**	**217.356,45**	**285.567,05**
Less: CAPEX	71.580,00	106.750,94	201.396,00	270.988,00	347.792,25	446.364,60	572.874,62
Free Cash Flow	**23.820,09**	**4.949,19**	**-94.166,00**	**-152.451,00**	**-181.027,22**	**-229.008,15**	**-287.307,56**

Appendix 9.5: Estimated Investor Returns

	Investor Returns (thousand DKK)							
	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018E	FY2019E	FY2020E
EBITDA	36.514,25	52.463,80	69.043,47	82.333,00	115.552,00	171.854,24	235.073,22	321.548,18
EBITDA Multiple	8x							8x
Enterprise Value	292.113,98							2.572.385,40
Investor equity	-175.502,08	0,00	0,00	0,00	0,00	0,00	0,00	1.540.349,17
Gross IRR	**36%**							
Money Multiple	**8,78**							
Management Fee	2%							
Carried Interest	20%							
Investor equity	-175.502,08	-3.510,04	-3.510,04	-3.510,04	-3.510,04	-3.510,04	-3.510,04	1.423.282,63
Net IRR	**34%**							

Appendix 10: Value Map of Joe & the Juice



Appendix 11: Interview with N. Retbøl, 2018 November 15th

[Interviewers introduce themselves]

N. Retbøl: We are happy to help as we have also been students at different business schools once upon a time and the learning never stops as it is a lifelong journey. But please could you give a little background to the project?

[background to the project is given by the interviewers]

N. Retbøl: I expect that you are aware of where private equity made value in the past in the 80s or 90s and that is sort of more or less gone, or it is not appreciated by theinvestors.

Interviewer 1: Yes that is the part that we have been writing to provide the background for what is going on today.

N. Retbøl: This is important because it depends on what you can do with portfolio companies and this is a bit more tricky, how do you get around the risks before making the investments. Sometimes this can be very complex and how can you put that into the valuation model, through more markets, more products, or how. If you are looking at listed equities, the portfolio manager has to be better than the benchmark and if he/she is better then that is good. However, this is not the case in private equity, you have to be much better than the average, otherwise you end up in management fees and a lot of other fees.

Regarding the most important drivers in value creation is actually if there is a strategic rationale for the company, do they have an X in their market or in the subsector compared to their competitors, or is there sort of room for operational improvements. We used to do GDP, maybe GDPx2 growth and then smooth ride. There need to be an angle to how can you improve, or how can you work in another way, or how can you consolidate. It could also be that, for instance, we invest in a lot of family-owned businesses and they are performing well but they are not super professional. So, there are a lot of things that could be improved, for example, processes, reporting, it could also be that they are underinvested in supply chain or in R&D, so there is a natural course from the outsider perspective that you can work with. It could also be, even though it is very rare, that you don't have to change anything but help financing more markets or products. Also acquisition price is important, if you start paying too high price it will be hard to make a strong return. Sometimes you can be more lucky than anticipated and everything works in the right direction and you have not modeled it and you didn't price it in when you started but suddenly it takes off and the strategic buyer knocks on the door and says we have a lot of synergies so it is more valuable than standalone. Because all models from the outsider are standalone valuations. However, it could make sense if it is a strategic buyer that there are some synergies – they will not pay for all of it but some of it – so how can you develop a portfolio company to be a good fit for a strategic buyer? We always try to do that, but it is difficult to predict who is going to be the ultimate buyer, but in some cases you can.

Interviewer 1: At what point of the process would you start seeking for strategic buyers or does it happen throughout the process?

N. Retbøl: Before we go in, we have an idea and a list and if it is difficult to find out who is the natural buyer then you can turn it down. If it has been around for many years

without finding a natural buyer it is also a signal that it could be difficult. If we are looking to invest now we prefer to do a lot of exclusive processes, which is very time consuming, but it is only us and we have to pay a fair price and cannot get huge discounts or anything. However, if it is a very competitive process with 10-20 bidders where some of them are industrial and they are not willing to pay up at this stage, then what is the likelihood that they are willing to pay 5 years from now? It could be that they have no interest or it could also be that they are busy with other projects, but we have to be careful because if they do not have appetite now it is very likely that they will also pass next time. So, it is actually before modeling.
You have to develop the company strategically or operationally to have a role. You cannot only try to buy at low prices and sell at higher multiples. It can also be that this year the prices for companies are actually quite high in terms of multiples and it could be that 2-3 years from now they would be lower. If you buy at 10x EBITDA and when you exit it is 8x EBITDA then you have to have a lot of growth just to make up for the loss of multiple.

Interviewer 1: So would it be the strategic aspect, operational aspect, or jointly as the number one [key driver]?

N. Retbøl: In most cases it is not us, it is sort of the market and cases come to the market through corporate finance advisors and so on. In most of the cases, the top line will grow to double size and a bit on the margin and so it will be 2x to 3x the money [initial investment] that's what the most people are looking for. The tricky part is actually that in a lot of cases they are unrealistic in their outlook for the next 5 years. The easiest way is to say if they have increased margins they will stay at historical high level for rest of that we can see and then we can say at least GDP growth, or double up of that. The tricky part here, as we speak, is actually that we expect lower economic growth in a couple of years, which has been postponed a couple of times, but over a 5 year period there will be one hard year – so how will the company that you are looking at actually respond to that on the top line and what can they do on the cost side. Some can actually manage to get around and some are stuck with a lot of fixed costs. So, it is before and it is also what numbers do you put in to the valuation model, so it is actually the qualified thinking of that. Ideally we would get a lot of information and then we would talk to others in the team but also industrial experts, look at old cases and see if we can build up the case from the bottom. If we do not have these number then we can look at what is the expected growth rate in the markets and look into for example, if it is difficult to gain market share, do they have a profile where that is likely, have they shown that in the past, do they have sort of innovations, do they have a pipeline of new things that could conquer the world, and/or what is the probability that they will succeed in that. From this, you can sort of build up and see if they are underinvested on people side or systems etc. and put that cost in and see what the journey is here. It could also be what we can increase, so if they are not super professional in sales to international markets then can we do that in a more systematic way and so is there a potential that is not in their numbers because they are maybe expecting to continue what they are doing. Another thing is if it is actually a management/owner expectation or is it the advisor's expectation because their fee is a function of transaction value so the more sexy the journey looks the higher will the price be and the higher will their fee be. So, they [advisors] are really experienced and professional, but it is also a sales situation and they get their fee and then they are out. However, the management we have to work with they are stuck with the expectations. So it is very interesting to figure out what can we do with this company, what are the future going to be, and do we have the right organization because we can also work with that. We also have to consider how long it will take to identify a new strong profile, implement it and there might be some delay from the decisions to the results.

Interviewer 1: And all of this takes place before entering the investment?

N. Retbøl: It is not always the case that we have all the answers, but we have to get an idea and also write papers about what we can do. We make our own but also get help from an external on the financial due diligence, the legal, the commercial, the market, the customers, and also management assessments. Sometimes it can be a tricky, but it's not to see if they are overrated or not very professional, but to assess who got the development potential in the organization and to go through the second layer. 9 out of 10 cases we will start with changing the CFO, or maybe head accountant will stay, but they cannot discuss with management about decisions or develop new systems. It could also be that the management team is performing very well to a certain size. For example, we have seen many cases with 300-600 billion in turnover where they [the management team] work well and suddenly it becomes too complex and the normal way is not sufficient anymore and that is really tricky. Sometimes we have to find new profiles who have tried it before or have tried a larger company and know what to do.

Interviewer 2: So these are a lot of examples of the operational improvements, and you also mentioned strategic – is that different from operational or is it kind of the same?

N. Retbøl: It is related of course. Strategic could also be one of our portfolio companies that is a traveling agency that is planning trips to South America, Africa and Asia with some excursions. It is a sharp price but it is a significant amount for most people to travel. When we looked into that company, first of all we were not that keen on traveling businesses because most of them are struggling, but this one was born digital and had a lot of experienced people. They had on the strategic plan also North America as a potential market. We said that before going in we have to look more into this, but sort of first impression from our side is why spend your time and effort on North America when everyone can book a trip and a place to stay. However, if it is about Africa or South America, you are not sure if the cabin is actually there or are you stuck without any service, so maybe it makes a sense there. Actually it is computer-driven calculations about the prices and you cannot do it cheaper yourself. So it is both quality and price, so it was just an example of a geographical strategic focus that we changed from 4 to 3 and they agreed right away. Then you can say "hmm why didn't they come up with that by themselves?" because in many of these entrepreneurial businesses they want something should happen, "we need to grow", "there is an opportunity to grow there and there" and you go for everything.

Interviewer 2: It makes a lot of sense if you think about the optimism bias where people are always very optimistic about their own businesses or traits, so it makes a lot of sense that you as an external party would have more rational opinions.

N. Retbøl: Yes and I would say more focused. You asked about strategy compared to operations. We have a lot of other companies where the founder or the CEO has 20 ideas every year that we also could do. Then we from the start agree about what is the most 4-5 things that we need to win to make this journey happen and all initiatives should support that. That really helps the thinking because now there is also this market and this and that and the client wants something that is not really ideal for the production – so it is a strategic focus. They know best about how to evaluate this, but actually – it sounds simple but it is not that simple – being able to select what are the focus areas instead of doing everything for everybody. There is lot of that in the real world. Some of them are able to do things that most people would say are not realistic, it cannot be pulled off, but they have actually done it for 10 or 20 years, so they are used to taking huge risk and doing things that are a little bit crazy.

So, bullet 2 on relevant topics. Some funds will say we will only do investments in very large, very professional companies because in that way our life will be easier. Quality management and quality business so we will pay a little bit of a higher price but then we have a smooth ride and then a lot of leverage and make a good business great. That also works, there are lot of different models that work, some will focus on the strategic, some on the operational, some on the leverage aspect. So, sort of find your team's profile in the market, and when we [MajInvest] talk to investors we also need to have a differentiation when compared to other funds, so there is also a bit of storytelling. Some are very sharp on the financial side and we are little bit more hands-on, low key.

Interviewer 1: So different funds specialize in different things and market these to the investors?

N. Retbøl: Yes, so if the company is looking for 100% sale, 100% of the equity, then it is not us. We are probably not the highest bidder, but we will pay a very good and fair price for 60%, 70%, and also 45%, where most funds will have majority. However, we actually have good experiences also starting a little bit below 50%, not below 40%, we have not been below 45% and in many cases we end up over time being controlling.

Interviewer 2: Do you perceive yourself as focusing on a specific industry or aspect?

N. Retbøl: It is sort of a development that has been going on for some years that in larger markets you need to focus on maybe 3-5 sectors, or some will focus on distressed companies, or very early stage companies, or whatever. Our focus constraint is actually that the headquarter of the company has to be in Denmark, so it is lower mid-market in European terms, a single market fund. So we have to leave some room to go across different sectors, but there are some sectors that we have selected not to go into. So it is a function of where do Denmark have some clusters within different sectors, we will be exposed to that.

Interviewer 2: Do you think if there are differences or similarities in the value creation created for the different stakeholders, for example, fund managers get the fees and carried interest, portfolio companies gain earnings and EBITDA growth and higher market cap, and the investors get the returns?

N. Retbøl: I think all PE funds are trying to make alignment of interests so if the CEOs are performing well, they are incentivized, and in all cases own part of the business. If they do not have a large investment possibility, we will put some warrants on top so that they are very incentivized. So if they do a good job they will get something out and our investors can get something out on that specific investment. Then if the fund is performing strongly then there will be carry, which will be distributed across the team – of course the more senior the more you get. However, you also have to put up capital when you are starting a new fund, so it is not a sort of "let us take some risk and hopefully it goes well", you are being hurt if it is not good returns. So we also have significant investment personally in the fund, not compared to a pension fund of course, but compared to a normal economy for individuals then it is not a good idea to make bad investment decisions. Recent years there have also been more interest on the LPs, which is the investors, for being asked about co-investment opportunities so they make a commitment to the fund and pay a fee for that. Then if we see a large company that is a little bit too large for the fund we can ask the investors if they want a direct co-investment and in many cases they will not pay any fee or carry on that – it is not always the case but in many cases. So on average they will get a discount on the whole investment, but they will also get a larger exposure to one specific company, so if that company is not performing then they are hurt more than just by being in the fund, which is very logical, and they also need to have a specific team to work on co-investments.

Interviewer 2: Just to clarify, so this potential co-investor would have put in capital into the fund and then besides that also become a co-investor in the investment?

N. Retbøl: Yes, otherwise we could just say that it is a third party and some LPs they do it because of lower average fees and also to have risk dispersion. Also, if it is a bad investment the relationship will be hurt for the next fund, so we are on the same boat. They have to select which funds to go into and it is a decision they make now and it is at least 10 years we are together. If you hire a manager for listed equities, you can change whenever you like, you have the portfolio and you can take it to another manager making the portfolio management. It is difficult to do here, you can do it but it is expensive. Also, for example, if you buy 100 million DKK of Novo you can make a reverse transaction next week. However, in private equity companies it is very expensive to go in and it is expensive to go out, but you can actually influence what is going on in the company, which is very satisfying, if you have a good idea it will be implemented.

Interviewer 2: Along the same line, what do you think has been the most important value driver over time?

N. Retbøl: It is different from investment to investment. We sold a company around New Year's time a year ago where one of the growth drivers was actually to go into the US markets – and it was our idea and we helped them prepare for that. It is not that it is easy to just find and buy the companies and then you have to wait to see how it will perform. There are funds that will say "please do not interfere with the good quality management" so they will have a more passive role. So there are many different types of things that could perform. It could also be that if you are very aggressive and like to take risk then in a good economical growth period you will look like a superstar, but when the crisis hits everybody knows that you do not have any clothes on. So when we are talking about modeling, both the different kinds of evaluating companies but also what numbers do we put in, if you have experienced a financial crisis where the numbers are shrinking every time and the management in the portfolio company, which you are considering investing in or actually own already, they believe in the numbers but they will just be lower everytime. So if you have seen that and you are going to banks and they want more security and new money in then you are a little bit more skeptical the next time somebody says they can conquer the world.

Interviewer 2: Considering buyouts you mentioned how you look into and analyze different companies. Can you wrap it up in a more direct sense what criteria you use to identify and select companies, and if you have any specific methods or tools that you apply?

N. Retbøl: Yes, we have a whole book, a book on the way we work, a book on how to work with strategy in portfolio companies. You can say that the company needs to do something for their customers, so if it is Stein Bagger then nobody is benefiting from any products and there is no chance to do an investment here. So they have to do something for their customers. It has to be that the price could be very high or very low, but it has to make sense in the environment they are in, and they have to have economical track records over some years, showing that they can perform ideally both in upturns and downturns. Regarding the quality of the management, they need to have a sort of an edge within their industry, so that it is not a "me too" company. If there are 12 companies that do more or less the same then there are no buyers that are willing to pay a strategic price for that. So if it is a "me too" company then we say "hmm, why should we use the capital and the time on that?"

Interviewer 1: You were saying that most of this is done in-house, but that there might be externals so is there a timeline or at what point would take in third parties?

N. Retbøl: As soon as possible to give ideas and do we know anyone in the network that could open doors to relevant information, not only nice presentations but from the inside, for example former employees or whatever. So we have a pretty large network in Denmark and that is also why we are not going to Sweden or Germany as we do not have the network there so we would be a foreigner.

Interviewer 2: Do you also reach out to investment banks or do you mostly get the ideas of potential target companies yourself?

N. Retbøl: I think we are, it is a little bit of marketing of course, but we are by far the most proactive in Denmark looking for new investments and in last portfolio 35% were sourced only through dialogue with us. Sometimes they will ask another fund at the end, but then we will have the relationship. So we make a list every year regarding if everything was for sale then what are the top 50 companies that we would like to buy within our size. We also look into the segment a little bit below that will grow into our scope within a couple of years. Then we try to open the door with the network and sometimes they say it is not right timing but maybe in two years and then they could call us and say if you have a fair price we will go with you and if you are too low we will start an auction. We have seen that many times. It could also be that it is actually a good timing but we are considering who to go with. So we are little bit unnormal in that area as it is time consuming and when we start the dialogue we do not have the right numbers and do not have any kind of prepared material or data room, so we have to dig everything. So it is a cheese with a lot of holes, but we can get around with that because the way reduces the risk. If you see an auction you have one meeting that is a management presentation and maybe a Q&A session, so maximum two times you can meet management and they are rehearsed in that process. However, if it is a one-on-one dialogue you can have 20 meetings and see them [the management team] in different locations, and also meet the second layer, so we can get a better feeling if this is rehearsed or if this is actually the way they are. Also the other way, of course you have to pay a fair price, but it is a partnership so they also select you between different buyers considering who to work with going forward. So price is very important and in most cases it will be the deciding factor, but in some cases we or another PE fund can win the deal if the management thinks that it will be a good working relationship going forward, also considering how will the fund react if there is a problem, if it is just getting cash of the table, or if we want to make long-term good investments.

Interviewer 1: So it is a more personal relationship?

N. Retbøl: Yes, if it is only excel and debt then many of these entrepreneurs are not looking for that.

Interviewer 2: How many companies are you considering from the beginning?

N. Retbøl: We get hundred every year and we shoot them down as fast as we can by being very critical between colleagues so most of them will not be any transaction. So maybe we will spend serious time on 15-20 and then in a good year we will complete 3-4, it could also be 2. It could also be quiet for several quarters and then 3 transactions parallel at the same time. We also have a network of industrialists that we will take in considering who is the best one for this specific company.

Interviewer 2: In regard to evaluating businesses would you do that for the 15 you focus at or for all of them?

N. Retbøl: 40 maybe. It is quite easy, we can the management presentation and put in the numbers, or the company's three year outlook and put them in to see if we believe in this growth, yes or no, and how should we change it, what about the margins, and has it been underinvested. Normally we will look at three models and the most important one is actually what we talk about now, what is the reality we think is going to happen and how much of the capital would we like to borrow from the bank, and then we will see if we can sell it at the same multiple that we think we can buy it at – that is sort of the first level. Then we see what is the return here and if the return is too low then we cannot pay that price but we have to reduce it. So without showing any price indications we analyze internally what are the price levels that we are comfortable with. So it is actually a LBO model taking into account the expected cash flow, the investments, the debt financing, and exit multiple equal to entry multiple, to see what will the journey be for us and our investors. That is the most important model. Then there are other transactions that are not exactly the same company but within an industry we can look at 10 transactions and see if there is a sort of normal level here, is there some that are particularly strong in patents or brand value, or it could also be size – you have to take that into consideration. It can also be listed peers that you can look at and if they are very large and not exactly the same we have to get some reductions for that. The good old DCF will always come out with a too high price. If you have a portfolio company that is struggling a little bit and you think what is the value and how you can justify it, if somebody says you can use DCF you know you are on thin ice. If you look at listed equities using DCF, in many cases 80% of the total market cap is justified by the after-10-years long-term growth rate, i.e. the terminal value. Back in time maybe listed equities were cheap at 10x P/E, if high growth it could be 15x or 25x. 10-12 years ago we bought at 6x one years earning on EBITDA so it is not as expensive as listed equities. Then from 2013 to 2018, the numbers grew up so when we find a strategic buyer we have sold to 14x or 15x EBITDA, so some is strategic, some is operational, and some is luck you can say – just that if you buy at 6x and sell at 15x, is that the alpha or just the window you can do that right now and the next one will go little bit the other way. So right now is an easier background and in terms of what multiple you actually apply to a company is a little bit tricky. If we do not like it because it is too cyclical we will not put up any price. Maybe the right price should be 4x but everybody will be offended by that so we will not show that so to say we pass on that. And if you are going to pay 8x or 10x it has to be sustainable, the market position, the growth rates, and there should be more in the pipeline. Just to give an indication, forget about the DCF model, it is about the reality you believe in and what is the return going to be. Rule of thumb should be 25% IRR before costs, management fees, and so on.

Interviewer 2: That leads to the final question regarding how do you measure and track performance during the holding period and at the exit where you are going for an IRR of at least 25%?

N. Retbøl: So that is the starting point, predictable cash flows, market position, and so on, it might drift towards 20% but then there is no room to hit any bumps or problems in a year or two and then get back. What was the last part?

Interviewer 1: So once you have invested in a company how do you monitor it?

N. Retbøl: We participate in a lot of dialogues, also between board meetings, directly with the management members. Across the whole team we are very transparent every month we see all numbers on all portfolio companies. One good thing is to look at the LTM (last-twelve-months) earnings so you cannot say it was Easter but no it was 12 months and you have a full year and if that is developing the top line then the whole team can see that. So we meet here and the team responsible for the investment need to explain what are we seeing what can we expect and what can we do. And then we also make projections for the whole fund bottom-up on each portfolio. As we speak now, what are the expected return on each portfolio company how will the performance be what will the exit multiple look like and who are the potential buyers and then you can sort of see what's the whole fund return going to be. So there is close follow up and for the deal teams, three people on a specific portfolio company, the dialogue is every week with the portfolio companies.

Interviewer 1: And then at the exit you obviously get the return what it is at that point, which could be 25% or above or below. If you could elaborate on the exit channels, you already mentioned the strategic buyers?

N. Retbøl: We try to develop the the portfolio companies to being a good fit for a strategic buyer but in some cases the buyer will be a financial buyer. In some rare cases the financial buyer are actually making a consolidation where your company is important so you can get a higher value than standalone. The last two exists that we have made have been to strategic buyers, one was from North America and the other one Danish and one of these processes was a full-blown auction that was prepared after all textbooks and the other one was one on one dialogue where they knocked on our door and said that we would like to pay up for the company and pay for the earnings also. So we like to buy outside of auctions and sell in auctions but we can also do the opposite depending on the situation.

Interviewer 2: When you say auctions you mean different PE funds bidding on the company or?

N. Retbøl: Auction is that the owner of the company hire a corporate finance house, could be PWC, Deloitte etc. and they prepare the materials and some data room and show it maybe to 25 and asks if they have appetite and how much would they be willing to pay in the early stage. Then they select maybe 10 or 8 for the management presentation and give more information before getting firm bids. And then take 3-5 through data room and legal and then whose most aggressive on the price in the end. It will be about price and normally in that case is 100% transaction and then management will reinvest. Even though we have some experiences, in this house we don't think we are that smart if all the insiders want to get out, should we be that confident that we can do it better and buy them all out. We actually prefer that they stay in with 25%-30% and then over the next 5 years we will develop the company and then make a full exit, that's sort of what we would prefer to do. But some of the larger prefer to have full control and kick out the management if the performance is not there and that is easier in a large company. But if it's a local entrepreneur then they know something about the company and the market that we would like to keep on board.

Interviewer 1: So it seems like it's also about the relationship and making sure that the PE fund and management are on the same page as they will be on the same boat

N. Retbøl: Yes and if they get too much money out up front most will continue working but some will say that they want to go hunting and that also happens sometimes one day 1 sometimes after the first year they got new friends and new taste and left out (?01:00:48)

Interviewer 1: How will the performance of one fund might impact the others, if you could give us some insights?

N. Retbøl: So it is a standard 10-year horizon where the first five are the investment period and when that ends we need to have the successor fund to be ready to make the investments so in the market you are active all the time. It could also be that the last part of fund will take longer than expected and then you would extend the lifetime, it could be 12 years. So that's just on-going and then there is a natural drift of making bigger and bigger funds if you can. But then some investors will say is it the same competences that are working in the smaller area than in the larger area or is it being too large. We've seen that in Europe, Scandinavia and North America and some of the larger ones are 10 billion dollar funds and then are they thinking about the management fee or the performance or carry. That is sort of what you should be focusing on as an investor, is it repeatable returns or are they drifting to another strategy. How was the leverage was it strategic or operational or was it through buying/selling and what specific impact has the fund had on that portfolio company. So we also have to disclose that.

Interviewer 1: Could you elaborate, what do you disclose?

N. Retbøl: Was it is was it the CEO who was driving the business, and he is of course the most important – but it could also be, as the example I gave earlier, that we suggested North America to the portfolio company in our older ownership period.

Interviewer 1: Would this be something you let the investors know when setting up the new fund?

N. Retbøl: Yes, in regard to were you lucky all around all the way, could you be more specific on why you paid that price, did you change the management too late, etc.

Interviewer 1: And is this done through a formal procedure or in the discussions with the LPs?

N. Retbøl: It is formal discussions but it is also data driven and who has been involved from the team in that specific company so you can calculate each individual contribution to the overall performance and if it's only one or two guys running the show then that's a negative. You want the sort of diversified and not depend on one or two people.

Interviewer 1: Within the fund or the management?

N. Retbøl: Within the fund. So it is hard work but it is really interesting. And then of course without any investors you don't have any funds, you have to get capital and you have to be polite and then you have to find companies and you have to be polite and then develop the company and then exit so that it is cash on cash to say that it is actually a return.

Appendix 12: Interviews with J. Breitenstein

Appendix 12.1: Interview with J. Breitenstein, 2018 November 2nd

Interviewer 1: Basically, where we are right now is that we have started to look into the PE industry, which is quite large on its own. Hereof, more specifically, what are the value creation drivers and then the PE business cycle, as well as how you decide on which targets you go after and how that entire process takes place. So it is pretty much still theoretical and does not look into what one PE fund is doing, but rather what the trend is in the market in overall.

J. Breitenstein: Let’s first look at the demand for the project

Interviewer 1: In your words, if you could explain, PE firm and the different stakeholders and how the interplay between them plays out in real life?

J. Breitenstein: I think if you start to look at the demand for the products, then if you go back 10-20 years especially in the Nordic area the focus was on traditional asset classes like listed stocks, a lot of real estate and those were really the main categories. And then people started to look for more return and looking outside of the traditional asset classes. Back in mid 90s our category emerged and we were established in 1995 and we were among the first firms starting of in the region. Offering the investors, mostly provisional investors investing into unlisted equities and packaging it in a form where they do not get the risk of investing only in one or two investments but invest in a fund with multiple investments and maybe also more funds so they can get a portfolio of indirect investments into unlisted equities so that is the whole idea. Based on the thesis that if you buy into unlisted company, take the majority and put in some leverage then you can achieve a higher return than you can achieve with XX. But of course high return comes with high risk so we do a lot of risk management on our side to make the risk as low as possible. That is the main driver for the development of the whole industry and then over time we have seen a lot of other alternative investments emerging from the whole category of private equity like fund-of-funds structures,one step up where there is a fund collecting investors and then invest in a number of private equity funds so if they invest into 10 funds and each fund has 10 investments then you get exposure to 100 companies and if you do not have the resources in a pension fund to invest in all 10 funds then you can invest in the fund-of-fund structure. We have seen a lot credit funds, real estate funds, infrastructure funds and direct investment funds so the whole alternative category has really grown a lot and you can find a lot of statistics of how much money has been coming in over the last 20 years.

Interviewer 1: How would you classify and differentiate different types buyouts and other investments (like investment buyouts, management buyouts etc.)?

J. Breitenstein: Some funds will have more business lines like EKG will do traditional buyout compared to Techno??? (06:10) that do credit funds, infrastructure and so on. Axcel and Valedo and other funds we are doing traditional buyouts so buying unlisted companies, developing those companies and exiting in next 5-10 years. That’s how we normally define leveraged buyout but then you have all the other categories that can be buyouts in many different forms or shapes but I think that is completely different story. It works the same way though investors will put money into fund structure, the management will invest on behalf of the fund and then when the investments are realized then you pay the money back to investors and calculate the accumulated return for the past 5-10 years.

Interviewer 1: We are limiting our paper to leveraged buyouts so focus is on that.

J. Breitenstein: The structure is basically so you will have here the fund and in terms of a Danish fund that would consist of several (XXXX) (08:00) it is a tax transparent company so it is very efficient and we will normally use this structure to set up a fund. So each of these KS will consist of some LPs so we have them up here and they will come with money into the fund and the fund will then invest into a number of companies and that will be done by the manager. So the fund in itself is a structure where we have any economic interest at all, we have just made an agreement with the limited partners who will put in the money, we have a small fee for managing the fund and everything is outsourced to us. So we will basically decide what we will invest in then we will do it and then exit, so [the LPs] these have no influence on how the fund is run. It is our decision and when we have sold the company the money will go back into the fund and it will flow all the way back up to the LPs so that's how they are putting in the money. Here it is commitment plus fee and other costs and this is provisions. The manager will then be owned by some partners in Axcel it's 8 partners that will control management company and we are all employed in the management company including investment (XX) (10:10). And then in Danish setup if you establish KS you will have to have a this is a GP controlling, so it is a company where GP will be liable for all the capital in the company so if this go down it will be the GP that pays. So the GP here is not the same as General Partner but by Danish law you need to have one but it is more technical. We have a Danish structure so all Danish companies these will be local structures so if it is a Danish investment we have Top-Co and then the operating company and in between some other companies so maybe Mid-Co and a Bid-Co and the reason why we have different companies is because sometimes if the investment becomes too big then we can invite LPs and co-investors.

J. Breitenstein: We're called onshore structure that applies to many PE funds because then it is completely transparent in terms of what we're doing with taxes. There is no way we can avoid paying taxes, but we can optimise the structure. The structure works with the limited partners, the LPs, bringing in commitments to the funds, and the fund is a separate entity that has made an agreement with a manager who will manage the fund and for that he will get a fee. The fund manager will have full control of all investment decisions in terms of which investments to invest in and when and how to exit. We do of course have some limitations in the documentation, this is probably important to mention that everything here is a limited partnership agreement that will cover every possible scenario. It is a very big document and we agree with all the investors on looking into what they will pay and we have agreed on the terms on what will happen if they cannot pay the capital recording, what about costs, how do we split the returns into carrying and their returns. So everything will be covered and it is a really important document.

Interviewer 2: I know that the GPs are personally liable if something were to happen and that in this sense you can create a limited liability company?

J. Breitenstein: We will not be personally liable, the manager has signed a management agreement with the fund, which describes the terms we are managing the investments on and if something goes wrong it is the fund that will lose the investments. We will of course have the opportunity to remove the manager either for cause or no cause. Cause is more if we take money out of the company or do something very stupid, then they can remove us for "cause"? Otherwise, they will have to pay us if they remove us. In principle, you can think of the scenario where the LPs in control of the fund will remove the manager and put in a new manager, but the managers will not be liable for what they do in the investments. We will have a board position at the board of directors in the investments and of course what we do in the investments will have to live up to normal standards.

Interviewer 1: To align the interests of the GPs and the LPs, the GPs put in some money in the investments as well?

J. Breitenstein: Yes, and it is twofold. So, there is the carried interest that will normally be 1% of the fund, whereas the LPs will fund 99%. Most LPs would like the managers to be a little bit more involved, so they will ask us to invest more which can be anything from 1-5% and in some funds it is up to 20%, so it can be quite a significant amount. For Axcel 5, our latest fund, it was €16,5 million so it was close to 3% of the fund. So, the partners and the rest of the investors have the same interest. With the carried interest it is a bit different, if we say that the GP commitment is 3% then 1% would be the carried interest program and the 2% would be additional commitment. The 1% will get, I think market standard is 20%, so what happens when they have sold all the companies, the LPs will get all their investment costs back, they will get a preferred return mostly it is 8%, and they will get all their costs back, also 8% per annum interest, and then after that we will start to share the proceeds of the investments. So if we have an investment proceed of a 100 then 80 will go to the investors LPs and 20 will go to the GP. So, 1% will get 20% return and 99% will get the 80% return, so there's a big difference. However, it is all agreed before we enter into the fund and it is to make sure that we are fully aligned with the LPs.

I brought one slide explaining very generic how a fund works when the investment period has started, which will run for five years and the fund term is 10 years. So, basically you have five years to invest the fund and five years to exit investments. After 10 years the fund will hopefully have excited all investments, in most cases we can extend the life of the fund with 1-3 years. Usually we will invest in two companies each year the first five years so that will be 10 companies after five years, which will have a lot of negative cash flow impact and here investors will put in money. Investors will put in €20 million euro in the first year, so €10 million for each investment, they will do that for the first five years and then we will assume that in year five we realize the first two investments at 3x and then starts the positive cash flows. That represents a typical cash flow for investors so they really have to make sure that they can pay when we ask for them to pay in capital. So the €100 million commitment up front is basically just a commitment which then will be drawn over several years. We will use all these cash flows to calculate the net IRR and also a KPI that we call TVPI, what is the total value to paid-in capital, i.e. how much they have gotten out after costs and fees etc. compared to how much have put in. I think for a mid-cap fund like Axcel more or less always underwrite new investment at 3x so for us if we buy a company with the equity of 100 we will get 300 back within five years and that will translate into a IRR gross of 25%. After costs and everything it will probably be 3x for the fund and around 2,5x after costs for the investors. If you can deliver that the investment is really good. Most investors would accept 2x and some cases maybe 1,6-1,7x net after costs. We have many investors that will have different views on how much they would like to get back. However, in general, they're looking for a relatively high return, as we discussed, as there is a higher risk in this business model due to putting in more debt than you will see at a listed company and also due to liquidity risk, as we may not be able to sell the company again after the holding period.

Interviewer 1: How would one bad investment affect the investment?

J. Breitenstein: So, if we made 10 investments and excited all at 3x then the fund would have a total return of 3x. If one investment is lost then the remaining nine will have to cover that so either you end up at below 3x or you have to get more than 3x in some of the others. In this industry, a loss ratio of 10% is kind of normal. The main reason is that when we make an investment, then the LBO model works in the way that we will agree on a price for a company. For example, if the EBITDA is 100 then we will pay EV to EBITDA multiple of 10 then the enterprise value of the company will be 1000. That's the total value we agree to pay to the seller and then we will finance that 1000 by taking on some debt and putting in some equity. In the past, we have been leveraging up to around 4x EBITDA so in this case we will put in debt 4x 100 = 400 and then we will put in equity of 600. A rule of thumb is 50/50 debt and equity. I think at the moment you will be able to find banks that will provide you with debt of 7-8x EBITDA on average so you have to put in less and less equity and more debt. The idea is if you only put in a little bit of equity then the upside of the enterprise value will go to the equity and you will get a higher return on equity. So, we are leveraging the business to make sure that we can increase the return to investors and putting more debt of course increases the risk of the investment so we have to find a balance between debt and equity.

Interviewer 1: So it can be anything from 50/50 to??

J. Breitenstein: Yes, higher or lower. In some cases it will be our decisions, for example, if a business is more risky we will put in less debt than we will with a stable business with a stable revenue. In some cases it will be the bank that will say "we like the case but we think it is too volatile so we can only give you 3x EBITDA and then we have to put in the rest with equity.

Interviewer 1: How does the performance of one fund affect the fundraising for the next fund?

J. Breitenstein: If you have a lot of loses, let's say you invested in 10 and lost 5, then the banks will at some point probably say "we're not very confident with the way you are doing business, so we cannot give you any loans anymore", and then we have to go to another bank. However, the problem will be bigger regarding investors because it is extremely competitive at the moment. In the Nordic area there are maybe 30 small cap funds, 5-6 funds in the same size as us, and then we have the very large funds as TPG, TVC, and Primera as European funds, and we are all going to the same investors asking for money. So then we will do a benchmark and we are probably 150 funds every year fundraising, and each investor will maybe only allocate commitments to 5-8 funds. So we are bidding for the same capital and if you have bad performance then you will just not get the meeting and if you have good performance it is much easier to just go back and raise capital for a new fund. Banks are also taking on more and more risk, there is a lot of competition among banks, so we will always 2-3 banks to finance the transaction and then we will pick the one with the best terms. I think you should really have fucked up if you cannot get any finance from the banks. Regarding the fund structure, the structure of fund 2 would be the same structure as fund 1, it would be a copy paste with the same manager, but the two funds completely separated, there is no relationship between the two funds except that some of the investors could be the same. So, if something happens in fund 1 it will not affect the investments in fund 2.

Interviewer 1: Except from the fundraising?

J. Breitenstein: Yes.

Interviewer 2: Can you clarify the term LBO?

J. Breitenstein: I think the top category is LBOs. So, it basically means that you are buying a company and you are putting in leverage to get the leverage effect on the debt to improve return on equity. Below that you will find traditional buyouts, this is just what we are doing, what most of the traditional buyout funds in the market will do, so that is FSN, Polaris, EQT, all the common names. Then there is a lot of other things, for example, if an investor would like to make the buyout themself then they can ask the management to do it. So they will ask the management to put in a lot of money and then put leverage on top of that, that we call a leveraged management buyout or buy-in. It is not that common, we do not see a lot of that. It could also be the management itself that want to buy a company if, for example, we are going to exit one of our investments and the management team believes this is a very strong case then they will stay in they will simply just buy our shares and sell it to someone else and do the same leverage structure as a new investor would have done it.

Interviewer 1: How do you pick investments?

J. Breitenstein: When we went out doing marketing we had a lot of documents describing how we were going to invest the investors' money, so the focus of the fund, the investment strategy. We said we will invest in the Nordic countries, we have a preference for some different industries, industrials, consumer goods, service, IT tech, maybe a little bit of finance. So, we have narrowed down both in relation to geographies and sectors and then we have said that we will not do small cap or large cap, so our preferred range will be companies with an enterprise value €75-200 million, we can go a bit higher. So that will put some limitations on the size. Then we have basically narrowed the base into a broad group of companies and then we will start to do some analysis on that group and then we have some criteria. If we look at industrials companies we would like a clear market leader or a company with a strong niche position, preferably someone who produce a critical component to someone else. We would prefer asset light company, so not with a huge balance sheet, we would like someone who has maybe outsourced the production simply in order to boost the return on the invested capital in the company and, therefore, also the cash flows. So, we have some things we would like to look for and then we look at the sub-industries and sectors and see where we can find some attractive opportunities. In IT we would normally like to see some recurring revenues so maybe a subscription type of business, a company with a very broad group of customers we know will come back every year, so not a project business. So there is a lot of different things that we put together and that will give a group of potential companies that we can invest in. In some cases we will approach the companies in that group or we can go to investment banks and say "we look for something in this area, what do have of contact or interest?".

Interviewer 1: And what are the approximate numbers?

J. Breitenstein: Several thousands, but in the Nordic it is very transparent so you can get annual accounts for all companies more or less, so that helps you a lot in the screening. You can take away all the small companies, you can take away the non-profitable companies and do a lot of criterias and then end up with a group.

Interviewer 1: And you were saying that most of that is taking place in-house?

J. Breitenstein: In some cases we will go directly to the companies and we prefer to do that. Then we can engage with an advisor in the process, but having a one-to-one dialogue with the seller is what we prefer. We will normally ask the sellers to reinvest together with us that could be anything between 20-40%.

Interviewer 2: How often do you reach out to external advisors and where would you find those?

J. Breitenstein: The advisors that we use are all the investment banks, Carnegie, Nordea, Danske, EPG, some of the large London-based banks. In some cases, they will have approached the company. Before we engage in a dialogue, they have been hired in as an advisor for the company so they will go out and find a group potential buyers, it could be private equity or industrial buyers and then test the interest. If we are interested we will get some material or access to a data room and based on that we will put in a bit and then it is a contest who will put in the best price compared to the others. Short for what you can offer on top of the price, what is the relationship, and how are you going to develop the business.

Interviewer 2: Is that when you use a letter of intent?

J. Breitenstein: Yes, in the first round maybe an investment would have been invited, so now we're talking about a situation where the company has engaged an investment bank to go to us, so there is an intermediate institution between us and the target. So they will go to maybe 10 different buyers and we will put in an indicative offer based on our first impressions. Then they will probably narrow that down to 4-5 and then they will invite us to a management presentation, we will get access to more material and then we will put in a confirmatory bid and then they will continue with maybe 1 or 2 and at that time you will agree on a letter of intent. We will normally try to do that as early as possible to get rid of the rest, so we will speak about our processes and engage in a dialogue about terms as early as possible.

Interviewer 1: So, could it also be the target company reaching out to the investment bank and asking for the offer?

J. Breitenstein: Most of the cases of today, at least in our segment and especially for the last companies, the target company will go to an investment bank, engage them and let them run the process inviting in private equity. The other situation is that we go directly to the company before he have considered a sale of the company and say "we like the business and we think you can grow much faster if you get in more capital and access to our network and we can help you with a new management. He starts thinking "okay that's maybe a good idea, I'm 60 years old, I can take off some money off the table. I can still be involved, maybe on the board and invest, but I can let these guys run the business." In that case, we can either agree on the terms one-to-one or he can say "I really like that you're approaching me, but I think I will have to get an advisor to help me," but then we're already in the dark lock and then it is a more proprietary track than participating in the more auction-like initiaries.

Interviewer 1: And you said that it would be prefered or?

J. Breitenstein: We really prefer to have the dialogue directly with the company. It is fine that they bring in an advisor, but we will prefer to avoid the very hot auctions that you see in the market because that will bring up prices.

Interviewer 1: Is one more common that the other or?

J. Breitenstein: It is very common these days with an advisor. In some cases they will say "okay, we are fine with a direct dialogue but we need an advisor and we also need to talk to maybe one or two others to test that the price level is right." So, in most cases today you will see an advisor helping and maybe also a smaller group of bidders. If you go down in the very low-end of the market at the small caps I guess it is more common that you will avoid the auctions.

Interviewer 1: Once you have acquired the company, how is the performance initially assessed and measured with all the changes made?

J. Breitenstein: If we go one step back and assume now we have completed the transaction and then we have taken ownership, we will put in a new chairman - we always use an external chairman for the board -, we will have one or two people from Axcel as deputy chairman and board member, and then we will get maybe two or three of the board members in and normally people we have used as industrial advisors in the process. So, we start with the board, we will conduct some management assessment to make sure that the quality of the management is right to deliver on our plans. Then we will sit down with the management in the first period after we have acquired the company and create a new strategy plan. I think most funds will do it in different ways, but we have developed our concept or book called "accelerating value creation" which is basically a long list of questions that we will ask to the company to make sure that we get to the right strategy. It is based on the concept where we ask where to play and how to win basically following the overall strategy concept, then we will have another workstream covering all short-term gains/operational leverage, for example, can we do something about pricing and cost structure or working capital, and then the last workstream will be on the backbone, for example, do the company have the right managers below top management or if they have the right IT system, yes everything about the backbone of the company.

Interviewer 1: You mentioned the book being one of the tools - are there any other models or methods that you utilise?

J. Breitenstein: We will always do the strategy work together with an external consultant but based on our principles but they will run the workstreams with the company and we will of course be attending. So the strategy work will cover the strategy and what we need to do in terms of improving the business and secure that they have the backbone to deliver on the two other workstreams. Then we will take the conclusions or must-win battles from these different workstreams and put into a one page must-win battles paper and that will go into our operational review committee. Then every quarter there will be an internal review in Axcel where each team has to go through where they are with the goals and what needs to be done. So if we have agreed that the management is going to be changed they have to provide an update on the search process for the manager, or if we need to reduce the net working capital by 20% they will give an update on where they are and how to get to the target. So that is how we follow up on the initial work and that will be done every quarter until we exit the business.

Interviewer 1: And that will be done for each acquired company?

J. Breitenstein: For each investment, yes. So that is how we follow up on investments.

Interviewer 2: You mentioned work streams, will you very clearly state the different workstreams?

J. Breitenstein: Most funds will operate with somewhere around a 100 workstreams and you can break that down into several different tasks. We have three so it is the strategy, it is the operational, and it is the backbone, and each will be broken down in different workstreams where we will sit with the management and the next layer and discuss the strategy in details.

Interviewer 1: And is anyone of these three where you see the most potential value creation?

J. Breitenstein: It varies a lot, but if we look at what we have achieved in the past, so all our realized investments, then around 60% of the value we have created will come from operational improvements, so higher revenue and higher margins, 10% will come from lower debt through cash flows and the reason is that in many cases we reinvest some of the cash flows back into the business, and then 30% will come from a higher exit multiple, so if we buy a company at 8x EBITDA and sell it at 10x EBITDA then we will get an uplift in the value from that. However, it is very difficult to break the value creation further down, it will all be mixed together.

Interviewer 1: So measure of success for a portfolio company is that 3x?

J. Breitenstein: Yes, 3x over 5 years will give you 25% IRR so that is where we start. If it is a very established business with less risk we can go a little bit down and if we believe it has a higher risk than the average investment then we will underwrite at a higher expected return or a lower price so it gets the same.

Interviewer 1: In terms of benchmarking, where do you get the 3x from?

J. Breitenstein: It has been the industry standard and you will not find many who has delivered on the 3x but we have to start somewhere to say to investors that "if you are investing into private equity through Axcel then we will do whatever we can to give you the 3x, the 25% before costs and that will translate into maybe 15%. Then we compare the 15% to the expected return for listed equities which over time is probably closer to 5-6%. It goes back to their own asset allocation so if they can get 15% from private equity then they will maybe allocate 10-15% to that category.

Interviewer 2: Is it true that it is very tough to deliver on the 3x and that it is not too often that fund managers receive their carried interests?

J. Breitenstein: You will most often see that the manager starts to receive the carried interests. You will not see a 3x fund that often but around 2,5x you will see relatively often, which is quite a high return and even if you deliver 2x you will still be very well off as an investor.

Interviewer 1: What are the different exit strategies for the investments?

J. Breitenstein: At the time of investment when we put in our offer, we will put in some assumptions on the operational improvements so the revenue growth and the margins potential and cash flow generation and then you apply an equity multiple on that based on what we believe would be the interests. If you believe in a high interest from both financial sponsors, like other private equity funds, it could be industrial buyers or maybe an IPO then you can put in a higher multiple. I think it is fair to say that at the moment we are at the high-end of a price cycle so it is difficult when we buy a company now to put in a higher exit multiple than what we are paying for the investment. In most cases we will actually put in a lower exit multiple. However, the exit multiple will depend on who is buying. When we come to the conclusion that now our job is done we will start to exit, we will start a process, in most cases we will hire investment banks to help us, and then we will do a very detailed search on the exit route that can give us the highest return. So we will invite in private equity funds, maybe industrial buyers, and test the appetite for an IPO.

Interviewer 1: What happens if you have held a company for 4 years and you start to see trouble? Do you extend the period?

J. Breitenstein: In principle we can hold the company up to 10 years if we bought it in the first year and sell it in last year. In Axcel 3 we had companies for around 10 years holding period, in Axcel 4 we had exited two businesses at 18 months ownership. So, in some cases the holding periods are very long and in other cases very short. It depends on the case. If something turns out we will have to decide if it is something we can fix also and if yes we will keep it for another 2-3 years, but if we believe that it is something of a structural problem in the industry and we cannot solve it, they need to consolidate and we will not be the facilitator of that we will try to exit it.

Interviewer 2: On average, how many companies do you think each fund would consist of?

J. Breitenstein: We have a limitation in our LPA stating that we cannot invest more than 15% in one investment so that will give you 6-7 investments. However, we will never go up to the 15% because we have to reserve some capital if we have to get more money so we will start out around 8-10% that will get you 11-12 investments. Then we also need to have some sort of diversification and we will also try to invest over several years across multiple industries, several countries, and different sizes, so we will basically try to spread out the risk so we do not end up with a concentration risk on geographies for example.

[Interviewers say thank you and finishes off]

Appendix 12.2: Follow-Up Interview with J. Breitenstein, 2019 April 11th

J. Breitenstein: In theory, you a few drivers of value creation in an LBO. It is earnings, it is multiple, and the debt level, and of course linked to the earnings level is how much cash do you get out of the EBITDA. So, what is the cash conversion. If it is a very capital intensive company, so you invest half of the EBITDA in CapEx then it is a different situation because you will not have much debt option.
[...]

J. Breitenstein: In the fund you will have costs for lawyers, structure, management fees, and carried interests, and then you get the net IRR, but you cannot do that for single investments, because you will not be able to split the costs of the management fees. It is probably more than 1%. After all the costs, this is what the investors will get and that is the most important IRR.
PME you can only use on the whole fund, as you take the cash flows from the entire fund and say this is what the investors will get back. If we assume they had invested in a listed index fund how does it compare based on the timing of the cash flows? In the end you will not be able to compare as the leverage ratio in the

portfolio companies will probably be higher than in the index fund so it is not comparable.

Interviewer 1: Forecasting multiple expansion are there tools and methods for that or do you solely look at the arguments that you have? If you want to increase the multiple from 10 to 12, is that a calculation or is it taking that we have added value here so that's why…

J. Breitenstein: We will normally, when presenting the investment case or the LBO, try to hold the entry multiple up against the five- ten-year average for the peer group. So if you take a peer group how has that peer group traded over five or ten years. Then we will get a starting point and then we say okay if we are significantly below the average and believe that we can build a stronger company then we can argue that the exit multiple would be closer to the average. And, if the market today is trading below the 10-year average then it would suggest that the market is at the bottom or at least not at the top and then you can argue that it can also go up. On the other hand, if the peer group is trading higher than the historic average then there is a valid argument that it might go down again. You can't look it up in a book, you have to make your own assumptions. As a starting point most people would say that we should be the same as a peer group. If you start with a very small company, like a Danish local company, and you can see that you are going to add a lot of additional businesses in Denmark, the Nordics, and maybe in Europe, the next buyer will probably be ready to pay a higher multiple for that.

Interviewer 1: With Joe & the Juice when Valedo entered in 2013 they had around 45 bars in Denmark mainly and bit in Scandinavia but now they are in Asia and the US. And in 2016 American PE fund came along but we have no idea about the multiples, which is a bit tough. Now they are planning for an IPO probably in 2020 so how could we assess the potential exit price that they could get from that?

J. Breitenstein: My best guess is that they have chosen the U.S. because it is a bigger market, it is probably a proof of concept that they have established themselves in the U.S. as it has huge potential and people would probably pay more for that. Basically in US you can get more investors to invest, so they will probably get quite a significant uplift on the multiple compared to what they paid. But if you have a peer group of some names then we can help looking up the current multiples, we can take that out of our system if you have the 5-10 relevant names then you can get an indication of how they trade and they probably trade and they'll probably trade more or less on average.

Interviewer 1: So why would they go for an IPO? Because they already kind of did a small sponsor-to-sponsor with the American PE fund and if valuations and multiples are record high these days then wouldn't an IPO give them a lower exit?

J. Breitenstein: In principle there are three routes so one is to find another financial buyer, so another PE fund for example, find an industrial buyer or an IPO. It's probably difficult to find an industrial buyer for a company like Joe & the Juice. So they probably have been looking at other private equity funds or an IPO. In some cases IPO is not relevant because the company will not be ready, they do not have the backbone, they cannot live up to all the reporting requirements and related things so then they just look at a financial buyer. They will just start an auction and sell to the highest bidder. But if they have the option of doing an IPO, most will run a dual track where they search for financial sponsor and the listed market. The listed market will usually pay a higher price than what you see in peer-to-peer or equity to private equity fund.

Interviewer 2: So you would opt for an IPO as long as you are ready?

J. Breitenstein: They would choose it because they get the highest price. The flipside is that with an IPO you can only sell maybe 50% so you will have to keep 50% and you will then be exposed with that 50% to the fluctuations of the share price.

Interviewer 1: So they are not able to exit completely immediately?

J. Breitenstein: Exactly. And say something happens after three or six months and they issue proper warning then they can be forced to hold the shares for a very long time if they don't want to sell at lower level. If it goes well then just sell at two to three placements afterward and then they will be completely out. So IPO will in most cases get the highest price but also make you hold on to your shares for a longer time.

Interviewer 1: Also because you get locked in?

J. Breitenstein: Yes maybe for 180 days and then they can sell afterward but if something major happens before they can sell it will be difficult to go back and setting the vibe.

Interviewer 1: Last twelve months how is that used to forecast?

J. Breitenstein: The problem is really if you are going to buy a company from me now then we are in April then we are at 18 realized EBITDA let's say it is a 100 but then if I'm doing a good job then the LTM is probably 110. So, you take the first 4 months of this year and last 8 months of last year so it's last 12 months on a rolling basis, which will give you slightly more accurate detail of the earnings.
You can also agree to look at the 2019 forecasts if I put in 10% growth then the growth will be 110 for the full year. But you are probably more interested in looking at the performance in 12-month time so in a year from now, so it is a bit different in what people prefer: last reported or realized twelve months, next forecast full year or next twelve months.

Interviewer 2: Now considering Joe & the Juice, what would have been your considerations in 2012 from an investor perspective?

J. Breitenstein: I think there would probably have been two very important issues one is of course being a juice bars does the company have in Denmark and what is the maximum penetration, so what is the upside in Denmark. If the penetration potential is 42 [juice bars] and they have 40 then it's probably not that interesting. In relation to this, how is performance of the existing bars. So, for the bars that have existed for more than 1-2 years, what is the organic growth in those bars, and can they continue to grow. When you open a new juice bar it will probably take you maybe 12 months to become profitable. Also, can you continue to grow revenue and get more customers in, and can you sell more in addition to the juice so maybe some coffee and snacks which create value for customer and can also drive organic growth. So those kinds of things, the potential for new bars in the country and the estimated organic growth for existing bars will be very important.

Interviewer 1: If you would have gone with the investment where could you see potential value creation coming from?

J. Breitenstein: That's the other thing, so the local market is very important and the proof of concept going outside of Denmark. So, in the bars in Sweden and Norway, how many bars? Is it only 2, 3, 4 or is it 10 or 20? How are they doing, are they profitable? Can they reach the same revenue potential as in Denmark? So is the concept easy to export. Especially when going into the UK or US there are a lot of concepts so why should Joe & the Juice be able to penetrate the market. So, I guess most funds will look at proof of concept in new markets. They don't have to have 100 in London but even if they have 5 and they are all performing, then we believe that there is a market for Joe & the Juice in London and can project what would happen if they opened 50 or 100 stores in London. That's value creation, so it will come from organic growth and new stores and new markets.

Interviewer 2: Would the exit strategies that you talked about be a consideration at the time of investment and what role would they play?

J. Breitenstein: I guess we all do [consider exit strategies at the point of entry] and it will change all the time. For Joe & the Juice my best guess is that they want to get in and expand the platform, show that they could justify the export strategy and then find a new private equity chain. But maybe it is going faster than they expected with more success and then they probably started to think that it is really big so now they can go for an IPO.

Interviewer 1: How could we assess the entry price?

J. Breitenstein: Of course with PE funds if you make a simple LBO model in excel and put a starting point and some assumptions. So, sales that will be volume and price and price can be for one product or average revenue per customer. Volume will be the organic growth in the existing stores and the opening of new stores in or outside of Denmark. That will give you topline forecasts and then you can make assumptions on the margin. If they have an aggressive roll out strategy then they have to invest in new stores meaning that they won't be profitable in the first years so will probably put pressure on margin first year but then when the new stores start to become profitable then you will experience an increase in your margins. I can't give you any forecast on how it looked but I think you just have to make your own assumptions. On the multiple I have no clue what they put in or I do but I don't think I can share that. However, the exit multiple is probably higher than at entry and then making assumption on the level of debt starting point 5 times is not too far off could also be 4 times. Then you can get a feeling and calculate the increase in equity. EBITDA you have to do a cash flow on the side so with EBITDA you will have some changes to the net working capital and CAPEX. You probably need to develop short P&L, balance sheet, and cash flow statement and then from the cash flow you should be able to forecast the new debt level and therefore the new equity. Then you will get what multiple, if it's 2 here you have done something wrong here. It should probably be something like 4 or 5 times. The price they have paid this is the best test. If this is 3 or 4 times, then you are probably not too far off and if you are sure about this then you can work on how much they paid in the offset. Because when you have the model in place, if you change that 8 here then this will obviously go up because that will go down, debt will be the same, that will go down, it's still 1100 here so maybe 400 compared to 1100 so it's around 3 times.

Interviewer 1: Where as a PE fund would you looked for operational improvements in Joe & the Juice?

J. Breitenstein: If you recall the DuPont model so that would be return on invested capital so that's the return on invested capital and if you take away the capital side of that then the breakdown of the margin is actually pretty good. You have topline to begin with so what is the revenue at Joe & the Juice, that is volume x price and as I said the price you can break down the price from the juice can we increase that from 30 to 35 (DKK) then that's more than 10% increase. The cost of doing the product is the same so we have a very significant impact on the bottom line. Then if you can sell both the juice and the water to the same customer then your fixed cost is the same so you can do a lot of pricing and up-sale. Then you can look at the cost base so probably quite high rental costs at some locations so would it make more sense to move to another location. If you can reduce your rent which is a significant cost in retailer that's a possibility. Also, if you normally have four guys but you can do the same with three guys then there is a big upside. Or if you have three guys for most of the day but then cut it to two at some point then there would also be an upside. Of course, on the juice if you can use a bigger volume and find a supplier that will provide more apples or whatever then you can reduce your cost of goods sold. It is on principle very basic things on the cost structure and revenue side.

Interviewer 1: Would you use consultants to analyze the three work streams that you mentioned?

J. Breitenstein: The way we do it is to look at the strategy from the beginning on, so where are we going, why are we going that way, and how do we want to do it. We will sit down with the management and run some workshops with an external party to facilitate that discussion based on our input. Then on the value levers that's exactly what we talked about the pricing, cost structure, and you can also look at the capital base which is probably not that significant if you have some juice machines and that's it. The last bit is on the backbone do they have the right reporting system, right management, right levels of management? If they do not have a sales officer who is in charge of rolling out the new stores? So we go through that as well to make sure they have the right structure to deliver on the strategy.

Interviewer 1: And the external party is that someone from your network?

J. Breitenstein: It's a consultancy.