

Private Equity & Digital Transformation

An European survey among 100 mid-to large-cap Private Equity houses on their views on the potential of digitisation.



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A Introduction

What we mean by digital transformation/digitisation

We mean transforming analogue and manual processes, functions and tasks into digital throughout the company, focusing on end-to-end digitisation of all physical assets and integration into digital ecosystems with value chain partners. Digitisation encompasses

digitising and integrating vertical and horizontal value chains, digitising product and service offerings as well as expanding the business model and customer access by offering disruptive digital solutions such as complete, data-driven services and integrated platform solutions.

The Digital Transformation has three main aspects:

1 Transformation of the market

2 Transformation of customer requirements

3 Transformation of value creation

Digital transformation describes a classic business transformation, which is characterised by a fundamental realignment of the business model on the basis of disruptive technologies. Digital transformation spans the instruments of the classical business transformation and furthermore uses and leverages the potential of new digital technologies.

In the following pages you have the chance to indulge in the detailed findings, which 100 PE houses throughout Western Europe with AUM of min €250m shared with us on their views on digitisation and the value it holds for PE houses and their portfolios.



B General Findings

Digitisation is very high up the PE agenda, being named as the most important mega trend influencing new investments of PE houses – having been rated 1.77 on the scale from 1 to 5 (1 being most important).

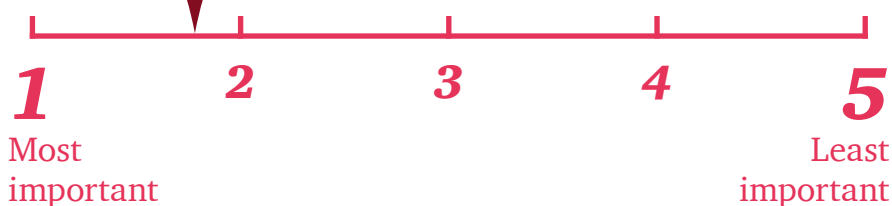
“Digitisation changes the way all products & services are produced, marketed and consumed. There is a transformation that is being witnessed. Internet has grown significantly over the past decade. [...] There are further changes that would take place in the coming years and this would increase the value of the companies significantly and with this our potential investments would have better returns.”

Managing partner, PE fund UK with AUM >€1bn

62% believe it can create sustainable value for a company and 88% have already either finalised the assessment phase or are in the phase of implementation. PE houses believe digitisation to mostly boost growth, decrease risk and decrease working capital and Opex.

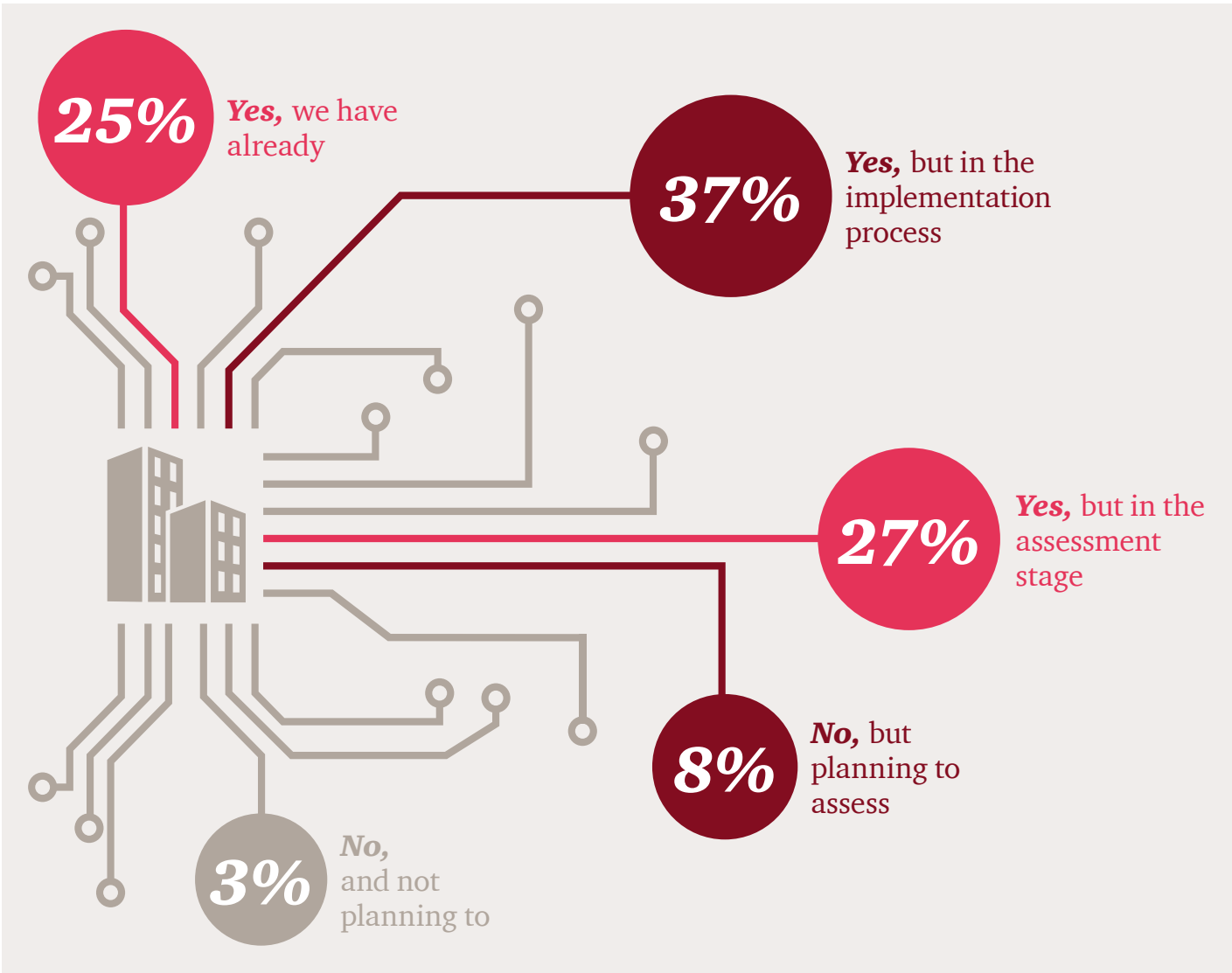
1.77

Digital Transformation/
Industry 4.0





Have you already assessed digitally transforming the organisation you work in and/or the portfolio companies you currently hold?



Please rate the following statements from 1 to 10 –
1 being “do not agree at all” and 10 being “fully agree”

“Digitally transforming a company will boost revenue and market position.”

8.30



“Technological advances have a multiplier effect and build on each other and amplify each other’s effects.”

8.04



“Digitisation makes companies ‘future ready’.”

8.04



“Digitally transforming a company will decrease redundancies and costs and boost profit.”

7.99



“Digitising a company is crucial for the company’s future success.”

7.96



“Digital transformation helps a company create sustainable value.”

7.70



“Digital transformation is the next big thing that can add great value to the businesses and it can increase the potential of earning returns on our investments as it helps improve business performances considerably. [...] so we are prioritising digitally transformed businesses.”

Partner & Managing Director, Germany,
AUM >€1bn

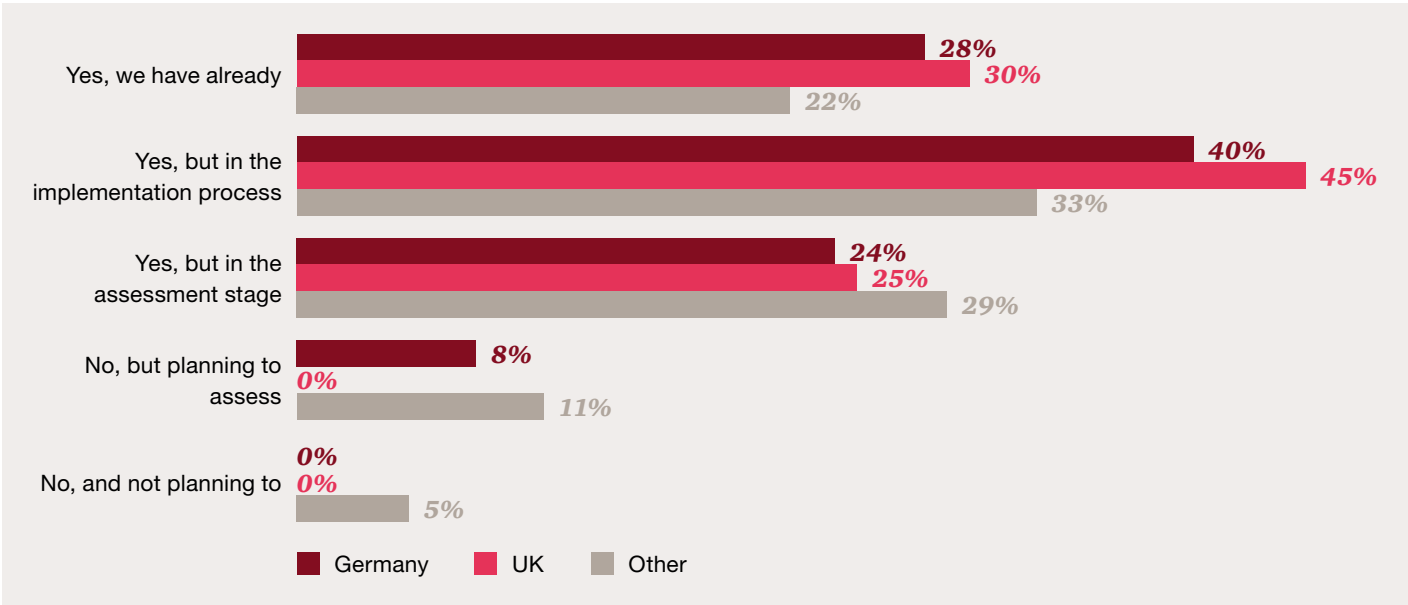
44% of PE houses named digital transformation/industry 4.0 as the highest impact trend to the way they view future potential investments. 35% of them were houses with AUM of €500m or higher.

Overall, digital transformation was given the rank 1.77 on the scale from 1 to 5 in importance and impact as a mega trend on future potential investments. 79% of PE houses rated with a 1 or 2 (out of 5).

89% of PE houses have started off on digital transformation. 62% have already completed the digital assessment and/or are in the implementation phase. Only 26% are still in the assessment stage. The UK and Germany are, however, forerunners in this field, with 75% of UK firms and 68% of German firms either in the assessment or implementation phase compared to 55% of all others.



Have you already assessed digitally transforming the organisation you work in and/or the portfolio companies you currently hold?

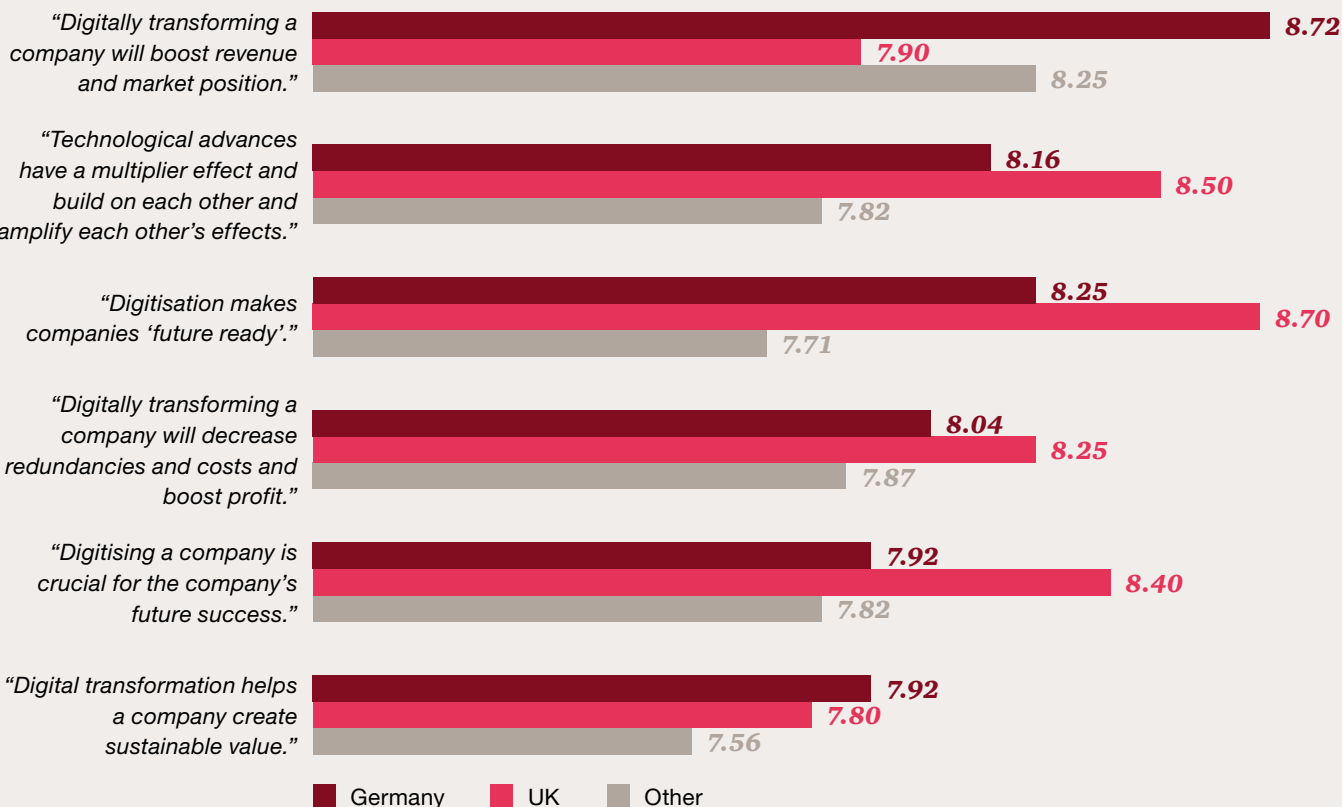


“Digital transformation has significant benefits added to it and our portfolio managers prioritise digital transformation as they understand the criticality of it in today’s business environment. We have initiated and completed a few digital transformation projects in our portfolio businesses and have seen the improvement in their market positioning which is driving our value considerably.”

Managing Director, Germany,
AUM €250–€500m

62% of all participants believe digital transformation helps create sustainable value. (Rated the statement with points 8 to 10, 10 being most important) 67% say it is crucial for the company’s future. 76% believe it will boost revenue and market position. 75% believe technological advances have a multiplier effect and build on each other and amplify each other’s effects. While German houses have given their highest rating to the statement “Digitally transforming a company will boost revenue and market position” (8.72 out of 10), UK houses have given above average rating to the statements: “Digitisation makes companies “future ready”” (8.7 out of 10) as well as “Digitising a company is crucial for the company’s future success” (8.4 out of 10).

Please rate the following statements from 1 to 10 – 1 being “do not agree at all” and 10 being “fully agree”

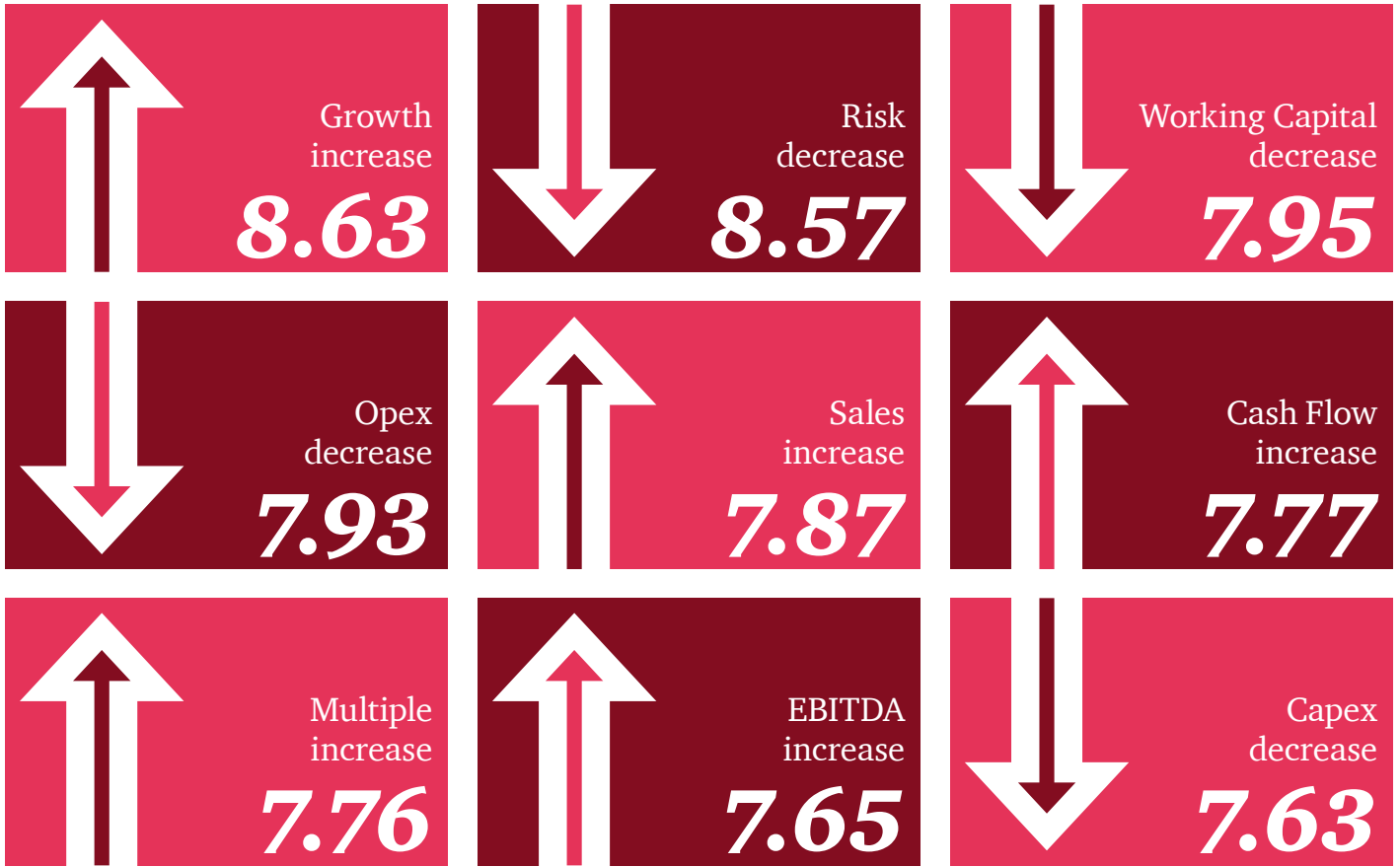


“Digital technologies are crucial for companies to remain competitive. Digital technologies will help companies reduce costs as well as improve efficiency. It will help companies become future ready as well as improving performance or functionality of a process through technology. These technologies are very important to companies to help them grow.”

Most participants name “growth increase” and “risk decrease” as the two strongest effects of digitisation on a company. These two achieve 8.63 and 8.57 out of 10 respectively. They are followed closely by “Working capital decrease” and “Opex decrease” with 7.95 and 7.93 points out of 10 respectively. Germans are more optimistic than others – giving “growth increase” 9.12, risk decrease 9.04 and working capital decrease 8.64.

Partner, France, AUM >€1bn

Rate the following (potential) effects of digitisation on a Company from 1 to 10 (10 being strongest effect).



“Digitally transformed companies can get more business in the market today as the firms are in search of target firms that are digitally strong. The success of the companies today largely depends on the digitisation that they have done. Technology changes the working of the companies and makes them more effective and efficient.”

Partner, Netherlands, AUM €500m–€1bn

However, an important point is made by Senior Partner in Sweden, managing AUM of above €1bn:

“Digital transformation is very expensive as technological systems and technicians come at high prices and so not all businesses are able to apply digital strategies to their growth and this will give advantage to the businesses who have the capability to invest in new digital technology that will boost revenue and market position.”

As such PE portfolios are in the right hands – as obviously PE houses acknowledge the importance and implications of digitisation – and have the capital in order to invest in their businesses and boost revenue and market position.

“Digitisation helps improve the businesses connectivity throughout the market; it has potential to tap new markets and has the ability to increase product and service penetration in the market that has a positive impact on the cash flows of the business.”

notes a Partner from Denmark, AUM >€1bn.

C View on new Targets and Potential Investments

European Private Equity houses have increased focus on digitisation. 88% say that they consider the level of digitisation already in the due diligence phase when considering new investments and 70% say that the level of digitisation plays either an important or a very important role in the investment decision. 76% say it has changed the way they look at new investments and digitisation is incorporated into their equity story already at the start.

88% they consider the level of digitisation of the target company in the due diligence phase.

88% of all participants say that they consider the level of digitisation early in the investment process – during the due diligence phase of looking into a new investment. Only 12 % say that this is not a point of consideration for them.

German houses show most commitment with 96% saying they consider the level of digitisation, followed by the UK with 90% stating the same and the rest of Europe with 84%.



Do you consider the level of digitisation of a target company when you are in the due diligence phase?

Yes ✓



“We are very digital oriented and we always look for targets that have digital capabilities or opportunities for transformation as we can add greater value by fully leveraging technology within our portfolio businesses in order to drive our return multiples as we intend to eventually exit our portfolio businesses and to derive good valuations we need to make sure it is digitally sound as compared to other similar businesses in the market.”

explains a German MD, AUM €250–€500m. To further underline the importance of digitisation, another MD from Germany adds:

“We stress on asking the right digitisation questions as we understand the value it can bring to our investment. We also pay premiums for digitally transformed targets as they are ahead of the rest of the businesses in their market and the potential growth opportunities for these businesses are high.”



How important is digitisation of a target company for your investment decision today?



Very important

32%



Neutral

29%



Important

38%



Not important

1%





70% of all participants say that the level of digitisation of a target company is either important or very important for their investment decision. Astonishingly, 40% of German houses, responded that the level of digitisation of a target company plays a neutral role to their investment decision. 45% of UK houses say it is important and 35% very important vs. 32% and 28% of German respondents respectively.

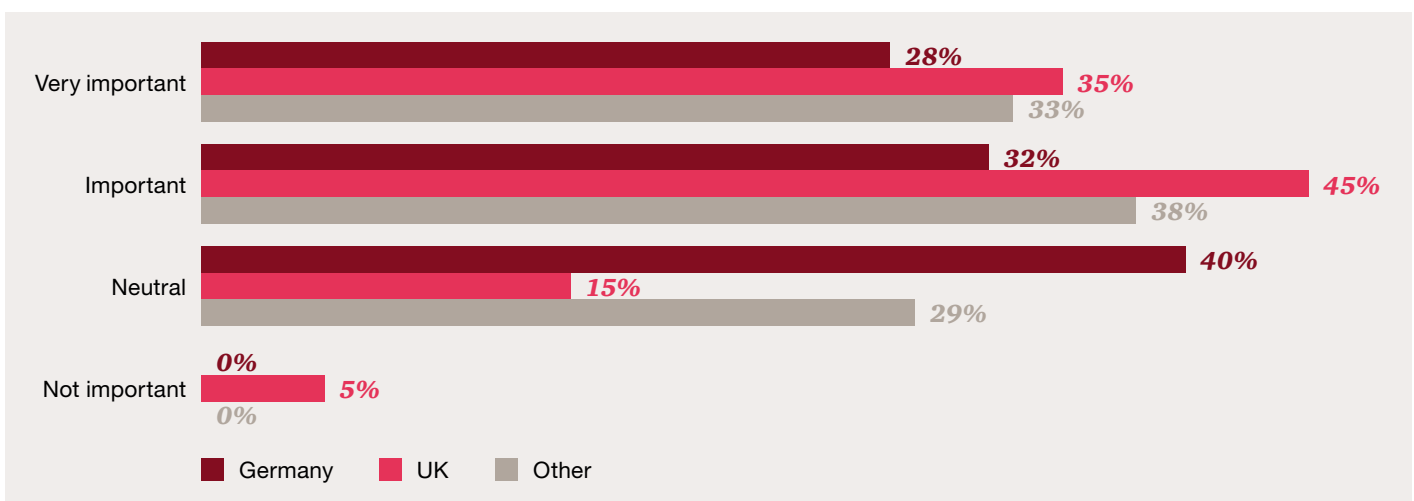
However, as it seems, many houses prefer buying businesses, which are not too digitally advanced, as this **German MD** points out:

“Investing in already digitised businesses lack the opportunity to gain significant returns as the target having high level of digitisation will be more expensive in terms of valuations and therefore the capacity to earn returns will be reduced but on the other hand choosing a target and then applying digitisation strategies to its operations will help gain more value as the valuations on these businesses are generally low.”

Others counter, however, such as this **Partner from the UK AUM >€1bn**:

“As these technologies are highly demanded and have made businesses very efficient we prefer investing in them. We have modeled our strategies to use these technologies to get returns.”

How important is digitisation of a target company for your investment decision today?



76% of respondents say that digitisation has changed the way they look at new investments and they model the digitisation aspect into their equity story already at the start. For 19% there has been no change.



Has digitisation/industry 4.0 changed the way you look at new investments and do you model it into your equity story already at entry?



D View on the current Portfolio and Investment Realisation

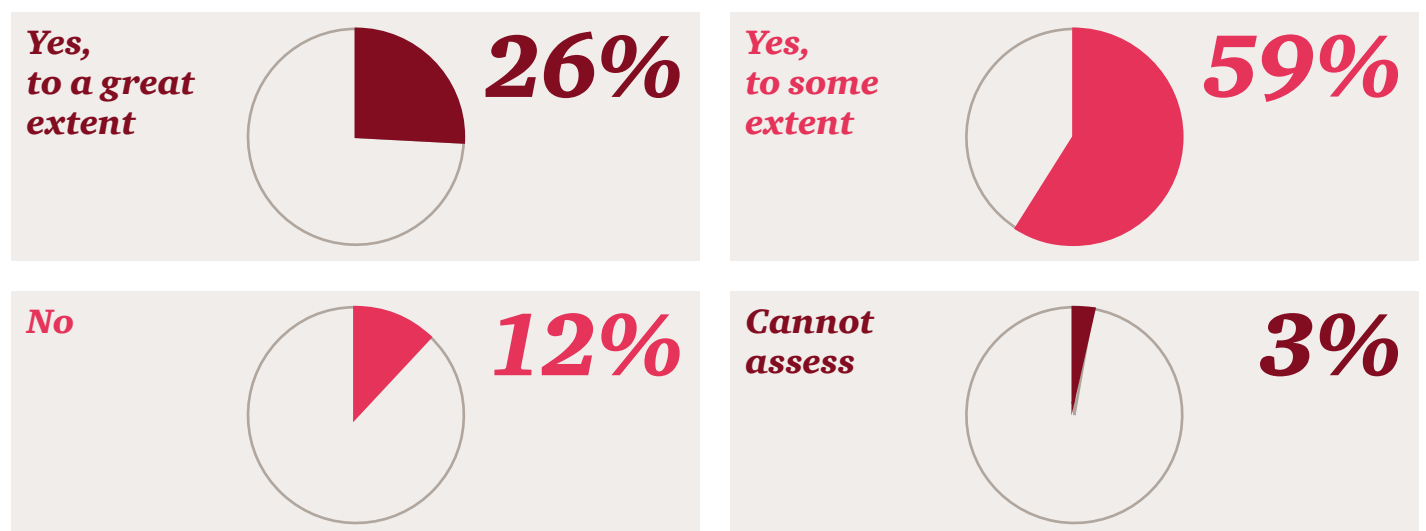
European PE houses are in the starting blocks and ready to get going in digitising their portfolio companies. Only 22% have already started implementing measures and 56% are planning to do so soon. Bets on digitisation are high as well – 59% believe it will speed up the realisation of the equity story and decrease holding periods, in these difficult times for returns for PE. 26% believe it will to a great extent. German PE houses show above average confidence in the positive impact of digitisation and more of them have moved already into the implementation process of digitising portfolios compared to their other European

counterparts. Respondents expect highest results in the marketing, sales and customer service departments, followed by R&D and innovation, supply chain and logistics and purchasing and production. In terms of singular technologies – Blockchain, AI and IoT are the technologies to focus on the most in digitising portfolios. 68% of all respondents believe that through digitisation they will prepare for a quicker and better exit and increase returns on their investment. UK funds place an above average focus and importance on digitisation in terms of future exits and returns on investment.

59% of funds believe that digitisation will to some extent speed up the realisation of the equity story and decrease holding periods of the portfolio. 26% of them believe it will to “a great extent”. German PE houses are most optimistic about this effect – 92% have agreed to some or to a great extent vs. 75% of UK houses and 86% of all other.

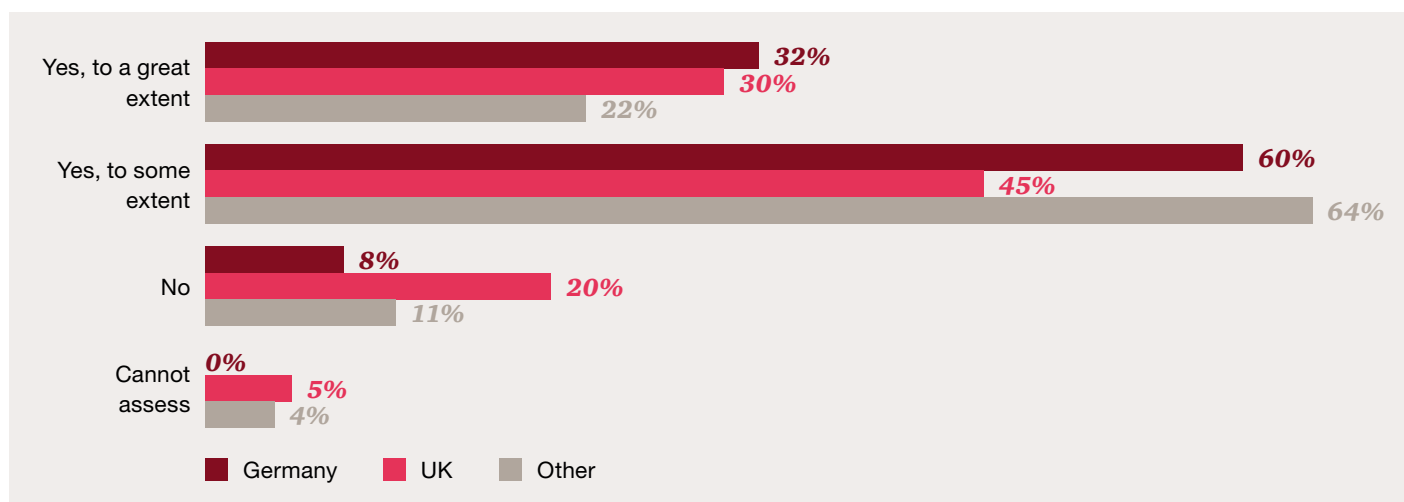


Do you believe that digitising portfolio companies will speed up the realisation of the equity story and thus decrease the holding period of the portfolio?





Do you believe that digitising portfolio companies will speed up the realisation of the equity story and thus decrease the holding period of the portfolio?



“We are able to focus on driving the business activity by digitising its processes and this will certainly increase its growth pace and will speed up the realisation of the equity story and thus we can plan our exit strategies much faster which will be beneficial to the businesses in our portfolio.”

points out an MD from Germany (AUM €500m–€1bn). First experiences and exits have been made and PE houses stand firm behind digitising their portfolios as it helps with the current PE market challenges, as this Partner MD in Germany (AUM €250–€500m) points out:

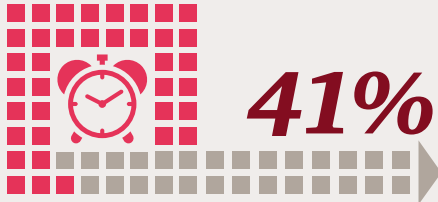
“There would be a decrease in the holding period with digitisation taking place. The digitisation would enhance the business position add value, generate market position and ultimately boost the capital growth. With this the holding period would significantly reduce. We are saying this all the more so confidently because we have experienced it and so we know this does take place.”

41% are in the process of assessing digitising their portfolio companies. 56% are planning to do so short term. German houses seem to be most active – 52% are already in the process of assessing how to digitise their portfolios. 45% of UK houses have planned to start assessing but are not yet in the process.



Have you assessed digitising one or more of your current portfolio companies?

Yes,
currently in
the process



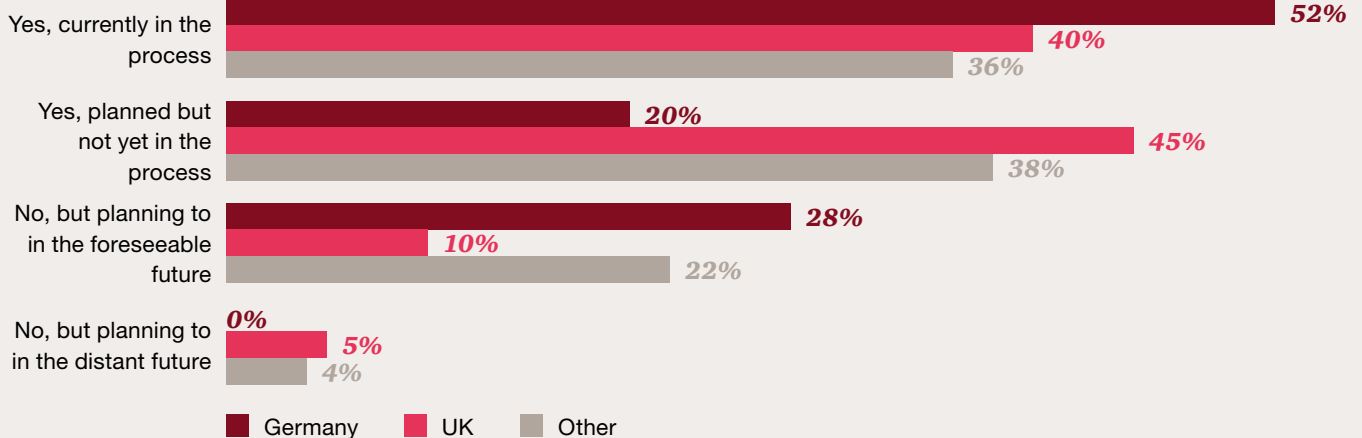
No,
but planning
to in the
foreseeable
future



Yes,
planned but
not yet in
the process



No,
but planning
to in the distant
future



“We ensure that all our companies are digitised to ensure they can compete against competitors efficiently. We have also made sure our companies are digitised to increase their value to fetch us larger amounts at the time of sale. Digitising our portfolio has reduced costs and it is simpler keeping an eye on our companies and their performances.”

says a German PE Partner, AUM >€1bn.

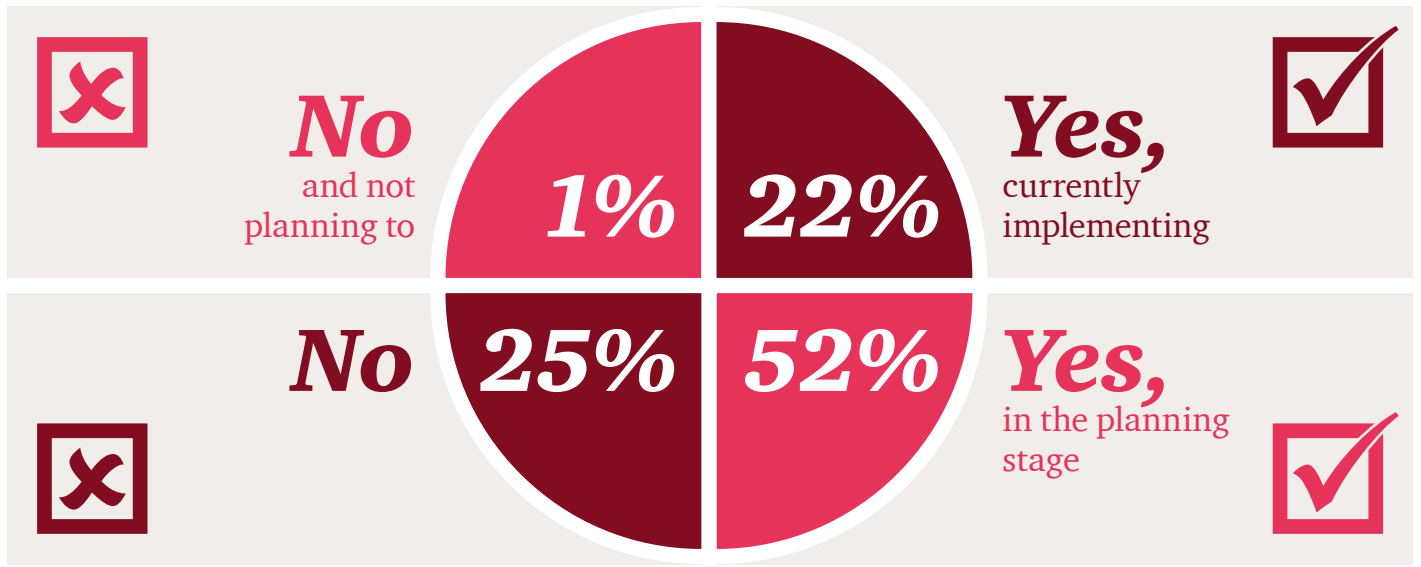
Only 22% of all respondents are already implementing digitisation measures in their portfolio companies, while 52% have admitted are still in the planning stage. Within German respondents, activity is higher with 32% pointing out that they are in the implementation stage and 44% are still in the planning stage.

“We digitise all the companies that we invest in as we feel it is crucial in the development of companies. We have a strong operations teams that assess the companies under us and accordingly helps in carrying out our digital strategies.”

says a France based PE partner of a AUM >€1bn fund.



Have you already digitised one or more of your portfolio companies?



Most funds believe that “marketing, sales and customer service” is impacted most by digitisation, having received 9.1 out of 10, followed by R&D and innovation (8.6), supply chain and logistics (8.4) and purchasing and production (7.9).

However, the effects of the digitisation affect the whole company and all parts of the value chain. As a UK based partner of a >€1bn fund adds:

“These technologies will help improve research and development and will help companies innovate. As companies will target customers more efficiently they will be able to develop their products accordingly and will be able to market themselves better, as well as improve their customer services. These technologies will help improve production as well as purchasing channels as well as help companies source better.”



**Which part of the company business model do you think is impacted the most from digitisation?
(Rate from 1 to 10, 1 impacted least)**

Marketing, sales
and customer
service



9.08

Supply chain
and logistics



8.39

R&D and
innovation



8.55

Purchasing &
production



7.86

Blockchain believed to be the most important digitisation technology to focus on, with 79% of participants naming it. It is followed by Artificial Intelligence (64%) and the Internet of Things (63%). German funds focus mainly on Blockchain (92%) and Robots (72%). 70% of UK funds rate IoT impact on digitisation, compared to ca. 60% of their European counterparts. All these technologies affect businesses through all sectors.

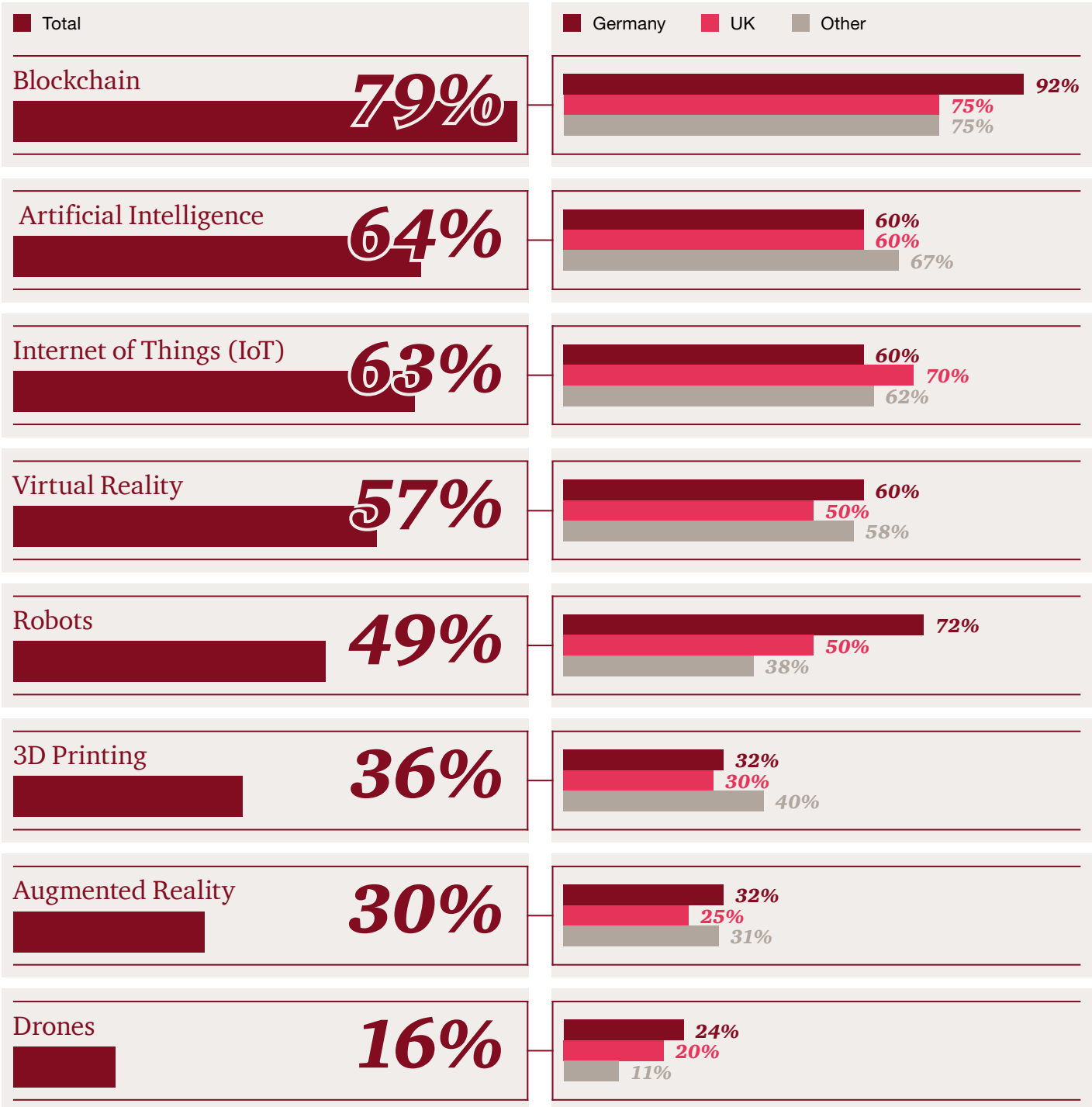
“The way customers are managed changes quite a bit with new technologies, which help improve customer service, sales and marketing techniques. These technologies help improve the supply chain and improve logistics, R&D is also positively affected with better tools and techniques to help us develop our businesses and products more efficiently while reducing costs.”

says a France based partner at a >€1bn PE fund.





Which of the following technologies do you think should be in the centre of efforts, which companies should focus on when digitally transforming?



An UK partner at a >€1bn fund shares his perspective on IoT:

“Internet of Things is a great enabler to growth in businesses across the market. It helps retail sectors identify new opportunities to communicate and attract customers, it helps manufacturing businesses improve their productivity and production lines, it helps the Pharma sector in R&D and so on and these drivers are becoming increasingly important for businesses which is driving the level of digitisation across the globe.”

Sensors and IoT are also the top trend according to a Senior Partner in Norway AUM >€1bn:

“Sensors enabled by Internet of Things are able to drive production abilities for the businesses in our portfolio. They are able to fasten the pace to market and also create an effective and efficient supply chain for businesses which helps improve operational and financial performance of the business.”

Respondents show, however, their in depth knowledge of technology and are fully aware of all of its impacts. As this UK partner (AUM >€1bn) here points out, there are pitfalls along the way and with technology helping companies develop, it also brings new challenges, which also need to be addressed:

“Adopting these technologies can be difficult and there will be problems that will arise. Security needs to be managed well and efficient and if it is not data can be hacked. These technologies need to be integrated with the company well to ensure they work well with the business and can create new opportunities for businesses.”

68% of all participants believe digitisation is important or very important (18% thereof) to the future exit of current portfolio companies and the subsequent return to be achieved. UK funds stand out with 25% saying that digitisation is “very important” to the exit and the returns on investment.



To what extent do you believe that the level of digitisation is important to the future exits out of your current portfolio companies and the subsequent return to be achieved?

Very important

18%



Neutral

26%



Important

50%

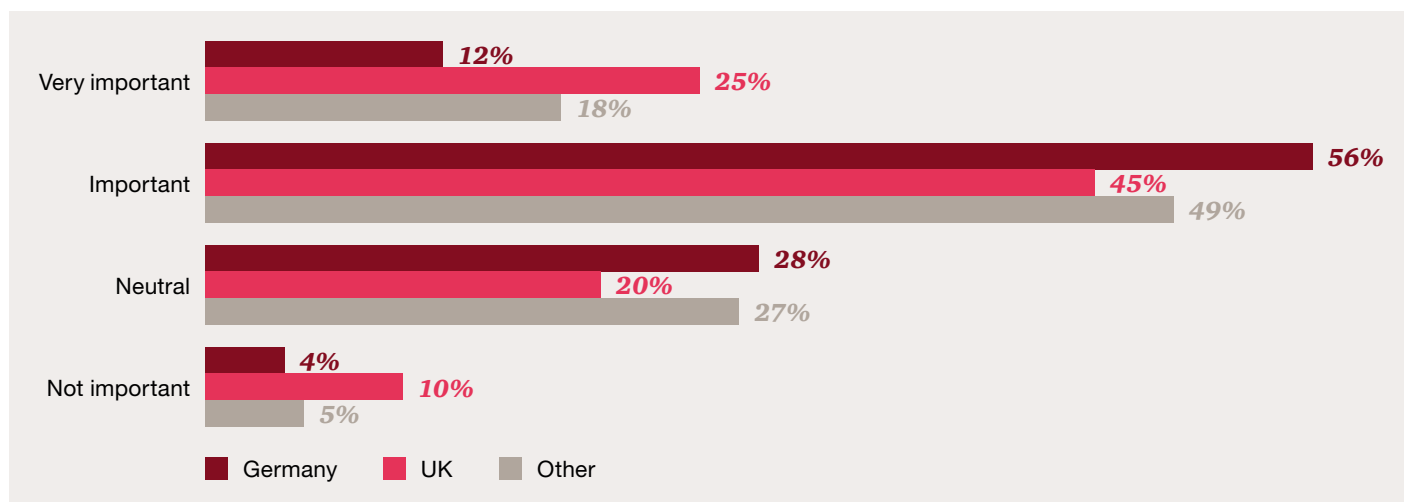


Not important

6%



To what extent do you believe that the level of digitisation is important to the future exits out of your current portfolio companies and the subsequent return to be achieved?



As this UK partner (AUM >€1bn) concludes:

“Technologically capable business valuations are significantly high as their potential to grow is significant and they can reach industry dominance which will put several other businesses out of demand. In order for subsequent return to be achieved we do streamline some of the business processes and align in with technological drivers for better growth of the business.”

“We believe in improving the company and invest in a company to help it grow, we believe digital technologies have a lot of potential, they will help improve operations and make the company more attractive to investors as well as buyers, we plan on carrying out digital transformations in our portfolio companies to help us achieve stronger growth in the future.”

CIO of Luxembourg based PE fund with AUM >€1bn

Respondents are not only confident that digitising portfolio companies will increase valuations and have a positive impact on costs and revenues, but these returns on investments in digitisation come quickly:

“We have invested in companies in this sector as we have been able to get very strong returns from these companies. Digitisation is important to us as we have managed to generate strong returns from our companies using these technologies in a short amount of time.”

MD & CFO of a Portugal based PE fund with AUM between €500m–€1bn

E Conclusion

We believe that digitisation is not only a hot topic, but should also be used as an instrument for value creation, exponential growth and further business model optimisation, which PE houses need to embrace and the sooner they do, the quicker they will reduce holding periods and increase returns, while also reducing risk. On the contrary, if they don't, they risk losing to the competition as digitisation

is also facilitating a faster paced competitive environment, and destroying value in their portfolio company's market position if nothing is done. Only companies with a corresponding "digital fitness" that react quickly and become more nimble through digitisation will be able to successfully accomplish the next phase of the digital era and emerge as winners in this time of digital disruption.



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