Private Equity Acquisitions of Danish Voluntary Chains: A Multiple Case Study Approach

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Abstract

During recent years, private equity funds have acquired a series of Danish, voluntary retail chains with the purpose of transforming them into capital chains. Voluntary retail chains are in some aspects expected to be less efficient and agile than the centrally managed capital chains, due to the dispersed ownership by individual store owners. With the acquisition by private equity funds, ownership is centralized, and the funds are expected to contribute with operational, financial and corporate governance initiatives. Therefore, it was perceived a perfect match between private equity competencies and voluntary chains. However, the transformations proved challenging, and several cases have suffered from varying degrees of financial performance.

This thesis investigates four acquisitions of voluntary chains by private equity funds – Matas, PWT (Tøjeskperten), BabySam and IDdesign – from an explorative perspective, in order provide insights on the operational, financial and corporate governance initiatives, employed during the observation period of private equity ownership. The background for the analysis is a comprehensive investigation of 1-2 years' of data prior to acquisition and 5-6 years' of data during private equity fund ownership. Findings are controlled, using data for similar peer companies over the same investigation period.

In the majority of the observation period during private equity ownership, Matas and PWT generate positive free cash flows. In contrast, BabySam and IDdesign generate negative free cash flows, driven by poor EBIT performance. However, also the peers of BabySam and IDdesign experience negative free cash flows, suggesting that the cases are affected by industry-wide downturns. In general, return on common equity analysis reveals a similar conclusion. The acquisitions involve considerable amounts of goodwill, financed with external debt. Highly levered capital structures, lacking abilities to generate free cash flows and goodwill impairments result in the reconstructions of BabySam and IDdesign. Investigations of revenues indicate that both BabySam and IDdesign are relatively more exposed to macroeconomic downturns from having highly cyclical, higher-end durable goods constituting main parts of product assortments.

Focusing on operational performance, the private equity funds are able to improve core profit margins and net working capital components in the newly-established capital chains. The case companies employ similar initiatives for improving profit margins. The private equity funds attempt to improve revenues from rebuilding, relocation and expansion of store networks. In addition, the funds introduce online sales, loyalty programs and chain-wide employee training. All case companies put great effort in renegotiating terms and conditions with suppliers as well as merging infrastructure functions, suggesting that the funds find readily accessible rationalization and purchasing power potentials in the previous voluntary chains. Improvements in core net working capital are achieved from various sources in the case companies, but revolve around centralization of purchasing divisions, assortment adjustments and increased leverage of IT. Furthermore the pressuring of suppliers entail longer credit periods and thereby improved net working capital. Especially, Matas and IDdesign achieve improvements from this source, while BabySam improves inventory management and PWT shortens credit periods to wholesale customers.

An investigation of financial engineering shows how previous store owners are included in the new capital chains as minority shareholders. During private equity fund ownership, excess cash is applied for
repaying debt rather than paying out dividends. In the majority of cases, the private equity funds supply subordinate loan capital, presumably increasing flexibility in the capital structure, but also constituting an early return generator for the funds.

In all case companies, investments are lower during the period before private equity ownership compared to the period after. During private equity ownership, investments are increased, and are particularly high in the first period after the acquisition. In this period, investments are driven by add-on investments and extensions of store networks, suggesting that the private equity funds apply buy-and-build strategies.

The section on corporate governance engineering investigates active ownership and economic incentive alignment in the newly-established capital chains. It finds that the board composition is changed after private equity acquisition. The size of the board decreases and the degree of private equity representation increases. Furthermore, three out four case companies introduce independent board members with industry as well as functional experience. The functional experience revolves around concrete experience from similar transformations of voluntary chains. In addition to board changes, management composition changes in three out four cases. Especially, new CFOs with backgrounds from private equity owned companies are hired. In total, these observations suggest a high degree of active ownership, imposed by the private equity funds.

In all cases, management teams receive equity positions after private equity acquisition. In addition, most cases introduce warrant and bonus programs. The previous store owners possess high equity positions. This suggests that the PE funds align economic incentives with management and previous store owners, as many of these, presumably, continue managing local stores.

Concluding, the acquisitions of Danish voluntary chains by private equity funds have experienced varying degrees of financial performance. This is confirmed from both free cash flow and return on common equity analysis. Two cases are reconstructed due to unfavorable combinations of high leverage and goodwill impairments. However, in general, the funds have been able to impose operational improvements and corporate governance initiatives. Going forward, the comprehensive insight into the imposed initiatives could constitute the background for future private equity fund investments in Danish voluntary chains.
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1. Introduction

Private equity funds have since 2007 acquired a number of renowned Danish, voluntary chains with the purpose of transforming them into capital chains. While the transformation of Matas has been deemed, "quite a good investment" by CVC partner, Søren Vestergaard-Poulsen, with annual returns between 15-17% (Børsen, 2013b), acquisitions of BabySam and PWT Group by Polaris have arguably suffered from poor performance (Berlingske, 2014; Detailfolk.dk, 2014).

Private equity funds contribute with corporate governance initiatives, operational improvements and financial engineering (Achleitner et al., 2010; Cotter & Peck, 2001; Cumming et al., 2007). Voluntary chains are often negatively associated with free-riding behavior by chain participants; i.e. when a chain member tailors the product assortment to local demands and, thereby, disregards the prescribed assortment, offered by the central chain office (Rokkan & Buvik, 2003). Potentially, this increases earnings of the individual store at the expense of other stores, since the tailoring of assortments reduces the overall negotiation power towards suppliers. Furthermore, the dispersed ownership of most voluntary chains complicates investment decisions, potentially entailing underinvested operations (Konkurrencestyrelsen, 2005). In contrast, centrally organized capital chains have a less complex decision structure, since one management decides on strategic and investing initiatives without direct influence from store managers.

A combination of corporate governance initiatives, taken by private equity firms, and lacking coherence between chain members in voluntary chains could entail a perfect match between private equity firms and the chains. However, Danish examples of voluntary chains, being transformed into capital chains by private equity funds, have exhibited varying degrees of successful financial performance (Berlingske, 2013). The question whether this is due to that the majority of transformations have been performed within retailing during a financial crisis, the private equity fund lacking commercial knowledge, the private equity fund imposing too much financial leverage or other reasons, remains unanswered.

This thesis explores four cases in which private equity funds transform Danish, voluntary chains into capital chains in order to provide an insight into why the funds acquire the chains, the performance of transformed chains and how such transactions are structured.

2. Problem statement

The thesis aims at exploring the below main research question:

How do private equity (PE) funds transform voluntary chains into capital chains through corporate governance, operational and financial engineering initiatives?

The overall research question is accompanied by the below sub-questions:

- **Financial engineering**: Which financial initiatives do the PE funds impose during ownership and what are the consequences?
• **Operational engineering:** Which operational initiatives are employed by the PE funds and how are they reflected in operational performance?

• **Corporate governance engineering:** Do the PE funds introduce changes to the governance structure of the chains and how are interests of management and PE funds aligned?

The above investigations are conjoined with free cash flow and investment analyses. Free cash flow analysis provides an introduction to the overall performance and objective of the PE fund. Investments are treated in a separate analysis, since the activities have proven an integral part of the PE strategy when acquiring the four voluntary chains. Findings are continuously compared to relevant peer companies and the period before private equity fund ownership of the chains.

3. **Literature review**

PE funds are involved in a variety of transactions across different industries, business life-cycle stages and types of investments. Hasan (2014) perceives PE funds as investment vehicles active within venture capital (VC), growth equity, leveraged buyouts (LBO), distressed investments and mezzanine capital. Our study focuses on LBOs, performed by four PE funds, which based on their track record, are active within investments in mature and established companies. The length of holding periods differs across funds, investment types and macroeconomic cycles. However, Kaplan & Strömberg (2008) finds a median holding period of six years in their comprehensive sample of 17,171 LBOs in the period, 1970-2007.

LBOs are defined as acquisitions in which a high proportion of the acquisition price is funded with debt from financial institutions, while a smaller proportion is supplied as equity from the PE fund (J. P. Rosenbaum, J., 2011; Wright et al., 2009). The PE fund is expected to increase the enterprise value of the firm by improving revenues and/or imposing cost reductions. The enterprise value may be further improved from general increases in valuation multiples during the holding period. The financial leverage, applied at acquisition by the PE fund, is added to the balance sheet of the target company. The cash flows of the company services acquisition leverage through interest payments and repayment of debt (Rosenbaum, 2011). The debt repayments lower the relative proportion of financial leverage during the PE ownership, and thereby increase equity value, owned by the PE fund. Hence, the LBO model creates its return from the combination of debt repayment and an increasing enterprise value (ibid). An additional source for value creation stems from tax-deductibility of interest payments Kaplan & Strömberg (2008). The LBO model provides PE funds with an incentive to maximize the relative amount of debt involved in the acquisition. This is expected to increase the general risk profile and vulnerability of the target company towards economic downturns (J. P. Rosenbaum, J., 2011).

The generation of free cash flows is of crucial importance for PE funds, since cash flows cover the servicing of debt (Hasan, 2014). Besides the ability to produce free cash flows, Rosenbaum (2011), puts forward the below characteristics of a good LBO-candidate:

• **Leading and defensible market position** – Increases stability of free cash flows through strong customer relationships and economies of scale which the PE fund aims at further exploiting.
• **Growth opportunities** – A target having growth opportunities from further investments may provide the opportunity for easy access to revenue and EBITDA growth.

• **Efficiency enhancement opportunities** – Introducing cost reduction initiatives which directly increase enterprise value from net income improvements and increase free cash flows from net working capital reductions.

• **Low investment requirements** – Low capital expenditure requirements directly improves free cash flows. However, targets with high investment requirements may still constitute attractive investments, if having potential of high growth.

• **Strong asset base** – Assets are applied for providing security for external lenders. The higher the amount of marketable assets, the higher the amount of debt obtained and the lower the interest expenses.

• **Proven management team** – The higher requirements for growth and free cash flow generation during LBO-ownership requires a proven management team.

According to Hasan (2014), the LBO model was primarily developed during the 1980s and driven by a relaxation of pension fund investment restrictions, the rise of the junk bond market and the idea of breaking up conglomerates into individual divisions for the purpose of a resale. Since then, the PE industry and LBOs in general have experienced waves of development, introducing various investment focuses and degrees of activity. With the crash of the American junk bond market in the end of 1980s, the investment focus shifted towards “middle-market size” transactions in the 1990s, and later secondary buyouts, in which PE funds acquire companies from each other (Kaplan & Strömberg, 2008).

Voluntary chains are defined as cooperative business associations between independent retailers (Rokkan & Buvik, 2003), collaborating on i.e. purchasing, concept development and marketing (Konkurrencestyrelsen, 2005). Horizontal collaborations build on the establishment of a chain office function which supports the stores. Often, the chain office is dispersedly owned by the individual store owners, and the chain office function is compensated for supporting services through mark-ups. Due to the dispersed ownership, decision power is spread across individual store owners who decide to which degree the chain office dispositions should be followed (ibid). The cases of our investigations constitute horizontal, voluntary chains.

Capital chains are centrally governed by chain managements which manage the store portfolio, adjust store assortments, source products etc. (ibid). The central management and ownership of the stores enable the capital chains to exploit opportunities within staff training, IT-implementation and centralized purchasing with limited consulting of individual store owners (ibid).

Not much literature or empirical evidence exists on the combination of PE acquisitions and transformations of voluntary chains into capital chains. As a matter of fact, not a single word has been written on this specific combination. This implies a series of unanswered questions that have not previously been investigated. Due to the lack of academic literature and empirical evidence on this phenomenon within PE, the theoretical foundation for this thesis relies on general PE theory focusing on initiatives employed by the funds during ownership.
In PE deals, value creation takes place in three different phases: 1) acquisition phase, 2) ownership phase, and 3) exit phase (Berg & Gottschalg, 2003). Value creation in the acquisition phase involves screening of potential target candidates, due-diligence, valuation and negotiations. In the ownership phase, the PE fund implements operational, financial and corporate governance initiatives to enhance value creation of the acquired target. The exit phase is characterized with the sale of the target, to a strategic or financial buyer or through an initial public offering (IPO). This thesis in concerned with the ownership phase.

During the ownership period, PE funds apply three categories of initiatives to target firms (Kaplan & Strömberg, 2008):

1. Corporate governance engineering.
2. Financial engineering
3. Operational engineering

The three categories of changes constitute the main foundation for structural initiatives, investigated in this thesis. Thus, the aim of this part is to provide a general introduction to aspects of these initiatives.

3.1. Corporate governance engineering

Theoretical background on corporate governance engineering

The main purpose for imposing changes to corporate governance is to solve the principle-agent problem. The problem emerges when the principle (PE fund as owner) and the agent (the management team) act based on different interests (M. C. Jensen & Meckling, 1976). This implies agency costs in order for the principle to control the agent's actions and secure alignment between the principle's interests and the agent's actions. The PE fund can minimize the agency costs in two ways: 1) economic incentive alignment, and 2) active ownership (Kaplan & Strömberg, 2008). The former ensures that economic incentives are aligned between the agent and the principle, and the latter increases the possibility of control, surveillance and influence by the principle over the agent through active ownership and board participation.

Economic incentive alignment

When financial benefits of target management (agent) are aligned with financial performance of the target, agency costs between the principle (owner) and the agent (management) are reduced. This implies, that target management is often offered (or forced to take) equity positions or compensation through options/warrants in the target. When the agent becomes an owner, it increases the personal economic benefits of success, but also losses in case of failure. This incentivizes management to improve performance of the target (Smith, 1990). Management ownership not only provide a significant upside, but also an economic downside that ensures that management will make meaningful investments and take on profitable projects (Kaplan & Strömberg, 2008). Since the companies are private, the management equity positions are illiquid. This ensures that equity cannot be sold or options exercised until the value has been proven in a realization (exit) by the PE fund. Furthermore, the illiquidity ensures that the management is less reluctant to manipulate or optimize short-term results, but compensates long-term financial performance and value (ibid).
Active ownership

Active ownership refers to how PE funds control the board and management in portfolio companies. As opposed to publicly traded companies, where ownership can be dispersed and the control of management less effective, the PE fund obtains a more concentrated ownership. In this way, the PE fund reduces agency costs by being actively involved in the operations of the company. A more concentrated ownership structure with few owners increases the control of the management through a more actively participating board (M. C. Jensen & Meckling, 1976; Lowenstein, 1986; Smith, 1990). A more actively involved board can act quicker in case of ineffective management, and thereby further put pressure on the agent to act in the interest of the principle. Increased control through active ownership also entails better management of incentives and ensures that the agent is not compensated excessively at the expense of the principle (ibid).

Empirical evidence on corporate governance engineering

Strömberg (2009) summarizes a series of empirical evidence on corporate governance engineering. It concludes, that PE portfolio firms have more robust corporate governance practices than non-PE owned firms. Singh (1990) provides some of the earliest empirical findings on active ownership. It investigates buy-out related changes, and finds a significant decrease in the proportion of board members, representing stakeholders other than the owners in PE buyouts. It attributes the findings to the PE fund’s interest of adding buyout specialists to the board. It concludes that the “engine” that drives operational changes in the buyout is related to radical changes in corporate governance structure of the acquired firm with a more focused board (Singh, 1990). Later empirical work finds evidence that boards of PE portfolio companies are smaller compared to boards of public companies, and have board meetings more frequently (Acharya & Kehoe, 2008; Gertner & Kaplan, 1996). This finding is in line with PE funds imposing active ownership in their companies. Acharya and Kehoe (2008) finds that PE portfolio companies on average have 12 formal meetings each year, and considerably more informal contact than comparable peers. It also reports, that one third of CEOs in PE portfolio companies are laid off within the first 100 days of ownership. According to Strömberg (2009) empirical findings do in general confirm that the boards in PE portfolio companies are smaller, meet more frequently and represent a smaller fraction of inside (management) board members than non-PE owned companies. These characteristics of the board have been associated with improved company performance (Cornelli & Karakas, 2008).

PE portfolio firms apply managerial compensation that is more oriented towards long-term performance with a significantly higher equity interest for management. Early research done by Kaplan (1989) finds that management equity stakes in PE firms going from public-to-private increased with a factor of four. In a more resent study done by Kaplan & Strömberg (2008), investigating 43 US leveraged buyouts in the period 1996-2004, finds that the CEO of a PE portfolio company obtains an average 5.4% equity upside in terms of stocks and options, and that the management team as a whole possesses 16% equity upside. Evidence of strong economic incentive alignment is also found in Europe where Acharya & Kehoe (2008) investigated 59 large UK buyouts in the period 1997-2004. It finds, that the median CEO obtains a 3% equity upside, and that the median management team as a whole possesses a 15% equity upside. According to Kaplan & Strömberg (2008), even though the stock and option based incentive schemes for
management have been more widely used since the 1980s, the utilization of this incentive alignment compensation method is more prevailing in leveraged buyouts than in comparable public companies.

3.2. **Financial engineering**

**Theoretical background on financial engineering**

Increasing leverage, which is obtained in relation to the PE transaction, reduces agency costs. Leverage creates pressure on management to invest funds at best effort, since it has to fulfill interest and principle payments on the loan, obtained by the PE fund to finance the transaction (Kaplan & Strömberg, 2008). Jensen (1989) finds that management within mature industries and with weak corporate governance often invest free cash flows in invaluable initiatives, rather than returning funds to investors. Introducing leverage reduces agency costs by mitigating this “free cash flow problem” Jensen (1989).

Furthermore, increasing leverage improves firm value from the interest tax shield. Empirically, it has been difficult to determine the general advantage, since it requires assumptions on the tax advantages of debt as well as the expected performance of the debt, and the riskiness of the interest tax shield (Kaplan & Strömberg, 2008). Increased leverage may also have a potential downside. Merton (1962) and Kim (1973) argue that the risk of incurring financial distress costs increases with the degree of leverage. If leverage becomes too high, the firm might not be able to meet its interest and principle payments, since these are considered inflexible relative to dividend payments that can fluctuate with performance. Baxter (1967) argues that the risk curve is exponential, since the risk of financial distress costs is limited when leverage is low, while exponentially developing with a high degree of leverage. The balance between the advantage of the interest tax shield and potential risk of financial distress is an important trade-off for PE funds (Kraus & Litzenberger, 1973).

The fragility of the buyout depends on the PE portfolio firm’s ability to pay its interest payments. This can be measured using the interest coverage ratio. When the interest coverage ratio is low, it means that the firm is more fragile and has less of a buffer for meeting its interest obligations. Hence, the risk of financial distress also depends on the volatility of the firm’s cash flows, since these are used to pay interest obligations. This implies that the optimal level of leverage is lower for firms with volatile cash flows than those with stable cash flows (Baxter, 1967).

**Empirical evidence on financial engineering**

The degree of leverage used in PE acquisitions has varied across time (Kaplan & Strömberg, 2008). In the late 1980s, when the PE environment was mainly dominated by US, Canadian and to a certain extend UK acquisitions, the proportion of debt was relatively constant around 85-90% (ibid). In the mid-2000s, when the PE industry again flourished, the share of debt used to finance leveraged buyouts had fallen to 70%. Kaplan and Stein (1993) explains this decrease as a result of the less favorable conditions for high yield bond investors compared to the first period.

In general, the empirical evidence on PE ownership and financial distress is mixed depending on period investigated (Gregory, 2013). However, the interest coverage ratio has increased in the period from the late 1980s to the mid-2000s. This is an indication that the deals in the later period are less fragile (Kaplan
Wilson et al. (2012) supports this finding on fragility. It finds that bought-out firms, in general, have a higher failure ratio compared to other companies prior to 2003. However, in the period after 2003 this is no longer the case, which indicates less fragile buyouts after 2003.

3.3. Operational engineering

Theoretical background on operational engineering

Corporate governance and financial engineering were prevailing in the 1980s. Since then, operational engineering has increased its prominence (Kaplan & Strömberg, 2008). Today, PE funds add operational and industry expertise to their portfolio companies in order to improve operations. These additions can be of permanent character or by using external consulting companies. This also implies that many PE funds are organized around certain industries (ibid). The industry knowledge further implies that the PE funds are able to identify attractive investment opportunities in which operational improvement opportunities exist (ibid). By the use of industry and operational know-how, the PE funds develop a value creation plan prior to acquisition and implement the plan post acquisition (ibid). The elements of the plan can include improvements of various aspects of the business, such as: productivity, strategic outsourcing, staff cutting, production optimization, improved working capital through stronger creditor, debtor and inventory management, strategic changes, acquisition opportunities or management changes and upgrades (Acharya & Kehoe, 2008; Butler, 2001; MacArthur & Gadiesh, 2008; Muscarella & Vetsuypens, 1990; Smith, 1990).

Empirical evidence on operational engineering

The empirical evidence on operational performance across various methodologies, measurements and time periods is in general positive (Strömberg, 2009). Hence, PE funds do in general enhance operating performance in acquired targets. The improved operational performance is reflected in increased operating margins, productivity and capital efficiency (ibid). Table 1 below provides insights into some of the most relevant empirical evidence on operational engineering.
Table 1

Empirical findings on operational engineering

<table>
<thead>
<tr>
<th>Authors, Year</th>
<th>Country/Nature of transaction</th>
<th>Empirical Evidence post PE transaction.</th>
</tr>
</thead>
</table>
| (Kaplan, 1989) | US/Public-to-private           | • Operating margin improvements of 10-20% measured in absolute terms and relative to industry.  
• Cash flow margins improved by app. 40% measured as the ratio of operating income less CapEx to sales.  
• CapEx to sales ratio declined in time of ownership. |
| (Bruining & Wright, 2002) | Netherlands/Management Buyout | • Identifies the role of the buyout as keeping added value strategies on track, while assisting in new ventures and broadening market focus. |
| (Wright et al., 1996) | UK/Management Buyout           | • Using accounting data, firms experiencing a MBO generated significantly higher increases in return on assets than comparable firms in a period of 2-5 years after the buyout. |
| (Bergström et al., 2007) | Sweden/Leveraged buyout        | • Improvement in EBITDA margins and sales growth for firms experiencing an LBO in absolute terms and relative to industry. |
| (Cressy et al., 2007) | UK/Leveraged buyout            | • Operating profitability was found to be 4.5% higher for firms experiencing a leveraged buyout than comparable non-buyout companies over the first three years of ownership. |
| (Gottschalg, 2007) | Europe/Leveraged buyout        | • Outperformance of PE-backed buyouts to comparable publicly traded companies in terms of sales, EBITDA and profitability growth (measured as EBITDA to assets). |
| (Hoffmann, 2008) | Germany/Buyouts                | • Identifies 21 buy-and-build strategies for German buyouts in the period 1998 – 2003, where acquisitions were targeted to consolidate a particular sector (i.e. horizontal acquisition strategy) in order to generate value from synergies through the merger of two or more firms. |
| (Boucly et al., 2008) | France/Leveraged buyout        | • Operating profitability increased app. 6%.  
• Strong increase in sales, assets and employment. |
| (Goossens et al., 2008) | Belgium/Buyouts                | • Similar growth in sales and efficiency for PE-backed buyouts and non-PE-backed buyouts. PE-backed buyouts grew less in terms of assets. |
| (Leslie & Oyer, 2008) | U.S./Leveraged buyout          | • Weak or no evidence of greater profitability or operating efficiency for LBOs relative to public companies. |
| (Guo et al., 2011) | U.S./Public-to-private         | • No statistically significant difference between gains in operating performance for PE acquisitions and benchmark firms. |
| (Wilson et al., 2012) | UK/Buyouts                     | • PE backed firms perform better measured on: return on assets, interest coverage ratios, and gross margin than a matched sample of private and listed companies both before and during the recent financial crisis (2008 and onwards). |

Source: Own contribution.
4. Methodology

Due to the private nature of PE acquisitions, there is a lack of publicly available data. The lack of available data has constrained the academic literature within the field of PE. The majority of empirical research relies on secondary data from the US or the UK, and have an extensive focus on analytical research, quantitatively determining the relationship between various variables (Suman et al., 2012). This has largely superseded exploratory research, since case study methodologies are used in only 11% of the PE literature in the period 2005-2011 (ibid). According to Suman et al. (2012), there is a need for more case studies in PE literature to further understand the complexities of the industry. This thesis utilizes an exploratory case study methodology in order to enhance understanding of the initiatives implemented and their economic implications. This is done through a multiple case study of four PE acquisitions of Danish voluntary chains. The overall structure of the methodology is seen in figure 1 below.

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**Figure 1. Overall methodological structure of the thesis.**
The exploratory case study methodology is often used when investigating a distinct phenomenon that lacks detailed preliminary research, or when the environment limits the choice of methodology (Mills et al., 2010). This may force the researcher to apply a high degree of flexibility in the research design and data collection process (ibid). Hence, the applied research methodology of this thesis relies on a broad investigation of multiple aspects, which are regarded relevant, based on general PE theory, for understanding the structure of PE fund acquisitions of Danish voluntary chains. In the period before PE acquisition (1 in figure 1), individually-owned store and chain-wide purchasing companies report independently. For the purpose of analysis, these are consolidated and the sampled data is extrapolated and corrected for internal transactions to reflect the structure after the acquisition (2). This establishes an improved foundation for comparison of the time before and after the acquisition. Additionally, the case companies are compared to similar peers in order to control for industry and macro effects (3). The cases and their peers have irregular financial periods, but are matched to cover the same periods in the most optimal way possible (for detailed information on period matching, see section 4.7). The cases are analyzed with an offset in academic literature on financial, operational and corporate governance engineering. These areas are combined with investment and free cash flow analysis, and are investigated both quantitatively and qualitatively. The conclusion of the total analysis is put into perspective through application on the out-of-sample case, Indeks Retail.

Investigations of the period before PE fund ownership rely on consolidation and reformulation of more than 180 annual reports from 62 store and chain companies, spread across four chains. The PE ownership period includes reformulation of more than 56 annual reports from the new capital chains and peers. Combined with an extensive investigation of management commentaries from annual reports, the thesis relies on a comprehensive foundation of annual report data. In order to sufficiently document findings and methodological choices, an extensive appendix and data CD accompany the report. Table 2 below provides an overview of the applied methodology for the exploratory research.

Table 2
Overview of the methodology applied

| A) Sample selection                                                                 |
|----------------------------------|----------------------------------|
| 4.1) Selection of cases          | 4.2) Selection of peers          |
| B) Data collection               |
| 4.3) Data collection for cases prior to PE acquisition | 4.4) Data collection for cases after PE acquisition |
| 4.5) Data collection for peers   |
| C) Consolidation of case data prior to PE acquisition                          |
| 4.6) Principles of the consolidation                                       |
| D) Period matching principles    |
| 4.7) Principles behind period matching of cases and peers                        |
| E) Quantitative treatment of data according to Penman framework, 2013          |
| 4.8) Principles of the DuPont framework and reformulation of financial statements |
| F) Qualitative treatment of data                                             |
| 4.9) Principles of coding qualitative information                              |

Source: Own contribution
4.1. Selection of cases

The cases investigated are identified based on searches in the Danish media database, Infomedia, on the words: “Frivillig kæde” (Voluntary Chain) and “Kapitalfond” (Private Equity Fund) in the period 2005 to 2014. The period is selected to investigate the most recent acquisitions.

Initially, eight PE acquisitions of Danish voluntary chains are identified (table 1 in appendix 1). We exclude four, since they do not provide five consecutive years of available data under PE ownership or do not transform into a capital chain. The criteria on available data is imposed to best reflect the median holding period of 6 years identified by Kaplan & Strömberg (2008), and is important for investigating the initiatives taken as well as the subsequent financial implications.

The analysis includes the following cases:

- **Matas** acquired by CVC Capital in 2007.
- **PWT (Tøjeksperten)** acquired by Polaris in 2008.
- **BabySam** acquired by Polaris in 2008.
- **IDdesign** acquired by Axcel in 2007.

4.2. Selection of peers

To control for macro and industry effects as well as to establish a benchmark for analysis, comparable peers are identified. The selection of peers focuses on finding comparable companies operating as capital chains. This provides an opportunity for analyzing the transformation of the case companies towards becoming capital chains. To secure comparability, the peers are selected based on the following six criteria:

1. **Region**: Denmark, Sweden or Norway (similar geographical markets).
2. **Operating revenues**: At least DKK 100 million the past four years (certain size).
3. **Industry codes**: Similar to that of the respective cases (SIC, NAICS, DB07 etc.).
4. **Available financial reports**: For the same period as the case company (period comparability).
5. **Capital chain**: The peer must operate as a capital chain in the majority of the observation period (compare transformation to existing capital chains).
6. **Similar products**: The peer must sell similar products (similar product markets).

Based on the employed selection criteria, four peer companies are identified:

- **Kicks Norge** (Matas peer).
- **Dressmann Norge** (PWT peer).
- **BH Nordic** (BabySam peer).
- **Chilli** (IDdesign peer).

A detailed description of the process identifying peer companies, based on the six employed criteria, is provided in appendix 2.
4.3. Data collection for case companies prior to PE acquisition

Prior to PE acquisition, the case companies do not report as consolidated units, due to the dispersed ownership structure of the voluntary chains. However, a consolidated group overview is achieved, based on collected data from a series of individual store companies and the respective purchasing companies. Merger plans provided in CVR’s database are investigated to identify the purchasing company and individual store companies, acquired by the PE funds. The merger plans reveal the identification code of the acquired companies. Based on the identification code of each acquired company, three consecutive annual reports are downloaded in PDF-format, and the raw data is transferred manually into Excel format for subsequent consolidation and reformulation.

A full list of all companies acquired and included in each case is provided in figures 1–4 in appendix 3.

4.4. Data collection for case companies after PE acquisition

After PE acquisition, the case companies report as consolidated units. Based on company identification codes, and by investigating annual reports, the ownership structure is identified on a year-by-year basis (see appendix 4). The annual reports of all companies in the new ownership structure are downloaded from CVR’s database in PDF format. The financial reports, including consolidated accounts, are identified and manually entered into Excel format for subsequent reformulation.

4.5. Data collection for peer companies

The annual reports for peer companies are identified by their respective company registration codes. The annual reports are obtained for the same periods as their respective case companies and purchased from Swedish and Norwegian company databases. For the Swedish peer, Chilli AB, the annual reports are purchased through Proff.se, while for the Norwegian peers, Kicks Norge AS, Dressmann AS and BH Nordic AS, annual reports are purchased from forvalt.no. The data from the annual reports are manually transformed from PDF format to Excel format for subsequent reformulation.

4.6. Principles of consolidating case company data prior to PE acquisition

As the case companies do not report on a consolidated basis prior to PE acquisition, we perform a manual consolidation of data from individual store companies and the purchasing function. The consolidations rely on an extrapolation of sampled data as well as a series of corrections for internal transactions. Adjustments for internal transactions are necessary for achieving a representative picture of a consolidated voluntary chain prior to transformation. The principles of the extrapolation can be found in appendix 5, while the principles of corrections are found in table 3 below.

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1 The Danish Central Company Registration Office (Det Centrale Virksomhedsregister)
2 Individual stores that do not provide three consecutive years of 12-month period data are excluded due to seasonality issues. Seasonality in the case industries is evident from appendix 7. IDdesign is an exception, since its purchasing company only has two consecutive years of data.
3 The peer companies that do not report on a consolidated basis have been subject to corrections for adjusting income, expenses and investments in subsidiaries. This is done to distinguish activities related to the peer company and those related to other portfolio companies. For more information on the corrections imposed see appendix 8 and attached CD.
Table 3
Overview of corrections imposed to consolidate case company data prior to PE acquisition

This table provides an overview of the process of consolidation. The first column illustrates the correction imposed. The second column provides a short description of the correction. The third column shows an appendix reference for technical explanations of each individual correction.

<table>
<thead>
<tr>
<th>Corrections</th>
<th>Overall explanation</th>
<th>Technical explanation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Store company: Corrections for shares in the purchasing company</td>
<td>When individual store companies have shares in the purchasing company, these are removed on the asset side. Liabilities and equity are brought down according to their respective ratios in each period.</td>
<td>Appendix 6</td>
</tr>
<tr>
<td>Adjustment for internal trade receivables and payables</td>
<td>The consolidated company includes internal transactions, since the store companies purchase goods from the purchasing company. These are corrected for based on the assumption that trade receivables in the purchasing company represent trade payables in the store companies.</td>
<td>Appendix 9</td>
</tr>
<tr>
<td>Adjustment for internal dividend payments</td>
<td>If the store companies receive dividends from the purchasing company these are corrected for since, they are internal. The purchasing company's dividends paid are excluded, while dividends from the store companies are included. The cash account is decreased with the purchasing company's dividends paid.</td>
<td>Appendix 10</td>
</tr>
<tr>
<td>Estimation of revenues, COGS and other external expenses</td>
<td>COGS in the consolidated company equals COGS in the purchasing company. Revenue in the consolidated company is deducted from the equation: Revenue = COGS + external expenses. When exact data is not available, external expenses are estimated using goal-seek and a relevant ratio to sales based on either available data for a store company or the first annual report under PE ownership.</td>
<td>Appendix 11</td>
</tr>
</tbody>
</table>

Source: Own contribution.

4.7. Principles behind period matching of cases and peers

The annual reports for cases and peers cover different financial periods, for which reason it is impossible to obtain exact matches for comparison purposes. However, the financial data for the case companies and their peers is matched to the best possible extend. Since the cases operate within the retail industry, that experience seasonality in sales (see appendix 7), it is prioritized to include annual reports covering a 12-month period to avoid seasonality biases in comparative figures. This implies, that the first full 12-month annual report, constitute the first observation period under PE ownership (denoted as p1). An overview of the matching periods during PE ownership is found in table 4 below.

In the period before PE ownership, the annual reports of the case companies overlap due to differences in reporting periods across store companies. However, these are consolidated into “chunks” based on 12-month annual reports. This implies no seasonality in each annual report included, but overlapping time periods. For detailed insights on the period matching for consolidated case companies prior to PE acquisition, please see appendix 12.
Table 4

Matching of financial reports for case companies and their peers

This table provides an overview of the matching of financial years for the case companies and their respective peers. The P’s in the left hand side, indicate full 12-month periods prior to and subsequent of PE acquisition of the voluntary chains. The periods prior to PE acquisition for Matas, PWT and IDdesign constitute 12-month reports covering a larger nominal period than 12 months due to differences in reporting periods. Additional insights on the methodology are provided in appendix 12. Any holes in the reporting periods prior to and subsequent to PE acquisitions are due to non-12 month financial reports and are due to seasonality issues and comparability neglected.

<table>
<thead>
<tr>
<th></th>
<th>Matas fiscal year (Peer fiscal year)</th>
<th>PWT fiscal year (Peer fiscal year)</th>
<th>BabySam fiscal year (Peer fiscal year)</th>
<th>IDdesign fiscal year (Peer fiscal year)</th>
</tr>
</thead>
</table>

ACQUISITION OF THE DANISH VOLUNTARY CHAINS BY THE PE FUNDS

<table>
<thead>
<tr>
<th></th>
<th>Matas fiscal year (Peer fiscal year)</th>
<th>PWT fiscal year (Peer fiscal year)</th>
<th>BabySam fiscal year (Peer fiscal year)</th>
<th>IDdesign fiscal year (Peer fiscal year)</th>
</tr>
</thead>
</table>

Source: Own contribution.


This section suggests a method, based on the DuPont-framework and associated key metrics, for structured decomposition and measurement of how operational initiatives are reflected in operational performance. The framework relies on reformulated accounting data. The DuPont-framework yields relative key figures – i.e. relative to revenues, assets, net financial obligations – which, therefore, can be compared across companies within the same industry.

Figure 2 provides an overview of the DuPont-framework and associated key metrics, exemplified by decomposition of Matas performance in 2010/11. Appendix 13 includes formulas for all metrics applied.
Figure 2. **ROCE decomposition based on the DuPont framework.** This figure shows the applied DuPont framework with an exemplification in the dotted rectangles of Matas 2011/2012. *Source: Own contribution based on Penman, (2013).* 

The analysis yields two overall performance metrics – return on common equity (ROCE) and return on net operating assets (RNOA). These returns provide the background for further decomposition and are derived from operating and financial drivers. All calculations, which include balance sheet accounts, are performed on average values, as suggested by Penman, (2013).

ROCE and RNOA are estimated as shown below.

\[
ROCE = \frac{\text{Comprehensive income}}{\text{Average common shareholders' equity}}
\]

\[
RNOA = \frac{\text{Operating income after tax}}{\text{Net operating assets}}
\]

ROCE denotes the total return to common shareholders, while RNOA constitutes the operating return from net operating assets (Penman, 2013). Hence, the difference between the two metrics represents the impact from financial leverage/gearing. Therefore, ROCE is regarded the levered return, while RNOA the unlevered return from operating activities (Penman, 2013). The leverage perspective is included in the analysis of operational engineering in order to reflect how and to which extent, operating activities are levered by the PE funds.

In **level 1** of figure 2, the return to the PE fund (ROCE) is divided between the operating and financial components. In the case of Matas, 64% of total ROCE stems from operating returns, while 36% is derived from the leveraging of operational returns. In **level 2**, the components of ROCE are decomposed into the underlying drivers of operational and financial returns. In **level 3**, the drivers of RNOA are further
decomposed into core profit margin analysis and investigation of cash conversion cycles. Both provide a detailed insight into the impact from PE fund initiatives on operational performance. As seen from figure 2, operating and financial drivers add up to a total ROCE of 9.9%.

The reformulated financial statements, seen on the CD, are built on principles from Penman, (2013) and Petersen & Plenborg (2012). Since the thesis assesses the impact from operations and financial activities separately – i.e. through the DuPont-framework and free cash flow analysis – these are to be separated before further analysis. Income statement adjustments rely on an overall distinction between operating and financing items, correction for non-recurring/special items, and inclusion of other comprehensive income (OCI). Balance sheet adjustments are concerned with isolating operational and financial assets and liabilities for the purpose of calculating net asset and liability measures. Main corrections are:

**Income statement**

**Overall separation between operating and financing income/expenses:** The separation of operating and financing activities, directly affects the structure of the reformulated income statement. “Earnings before financial items after tax” marks a transition in the reformulated income statement from operating activities to financing items.

**Special and non-recurring items:** Of transitory nature and not expected to affect the income statement on a continuous basis. As suggested by Petersen & Plenborg, (2012), the reformulated income statement on the attached CD includes separate line items for special items in both the operating and financing sections. For instance, non-recurring income from disposal of tangible assets, “hidden” in depreciations, are reclassified to the operating special items account. When information is explicitly available, non-recurring re-organization costs incurred at the acquisition by the PE fund are also reclassified for comparability in later sections.

**Other comprehensive income:** Income reported directly in the statement of shareholders’ equity but not reported in the income statement (Penman, 2013). In order to assure that income statements reflect total income generated, OCI is incorporated into reformulated income statements. Common OCI items are unrealized gains on securities, foreign currency translation gains, and gains on derivative instruments such as cash flow hedges.4

**Tax allocation:** In annual reports, taxes are stated as net figures, including both effects from operating and financial activities. Since the reformulated income statement separates operating and financial activities, the tax advantage of net interest expenses is added to operating taxes in order to reflect the higher operating taxes before the positive impact from tax-deductible net interest expenses. Reformulated data utilizes official company tax rates depending on country of origin.

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4 Cash flow hedges: Instruments which hedge cash flows from future, expected transactions (Penman, 2013) such as foreign exchange hedging of revenues from contract which will be effectuated during a subsequent fiscal year (KPMG, 2011). Changes in current value of a cash flow hedge instrument are temporarily encountered in the statement of shareholders’ equity until the future transaction is realized and the current value is transferred to the income statement. In this thesis, changes in current value of cash flow hedges are immediately incorporated into the reformulated income statement in order to calculate comprehensive income. Reversals during subsequent periods due to realization of transactions are not incorporated due to lack of information on relationship between this year’s adjustments and subsequent realization amounts.
**Balance sheet**

**Operating assets and obligations:** Directly related to the sale of company products. Except for financial cash reserves and other investments, all assets are regarded as operating assets. Non-interest bearing debt which "supports" operating activities such as prepayments received from customers, trade payables and other payables\(^5\) are classified as operational liabilities.

**Net operating assets = operating assets-operating liabilities:** The amount of net assets employed in operations. Applied for calculating RNOA and asset turnovers in the DuPont-framework.

**Financial assets and obligations:** The financing of operations through fund raising (equity and debt) and disposition of excess cash (investments). If a given asset or liability is interest bearing, it points towards classifying the asset or liability as a financial item. Financial obligations include debt to credit institutions, mortgage loans, lease obligations, subordinate loan capital, other long-term obligations and current portions of non-current liabilities. Inspired by Penman (2013), financial assets include a 1% fraction of sales, representing excess cash\(^6\), and marketable securities.

**Net financial obligations = financial obligations-financial assets:** The net amount of financial liabilities, financing the operations. Applied for calculating financial leverage metrics in the DuPont-framework.

**Shareholders' equity:** The reformulated shareholders' equity includes no adjustments compared to the reported equity. According to Penman, (2013), non-controlling interests should be treated as separate line items which share with common equity in assets and liabilities. Since the annual reports apply this approach, no minority shareholder adjustments are incurred. The shareholder's equity is applied for calculating ROCE and leverage metrics in the DuPont-framework.

The classification of operating and financial assets and liabilities has to be synchronized with the separation of operating and financial accounts in the reformulated income statement. This is necessary for the analytical tools in the DuPont-framework to calculate qualified return measures discriminating between operating and financial impacts.

### 4.9. Principles of coding management commentaries

The following section is intended to explain the categories used to identify information in management commentaries in the annual reports.

To extract and structure qualitative information in the management commentaries\(^7\) of the case companies and their peers, these have been coded according to the below primary, secondary and commentary codes. The entire coding of management commentaries for all companies is found in appendix 14.

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\(^5\) Other payables: According to Rosenbaum (2011), current other payables include employee obligations and other operating liabilities for which reason the account is treated as operating of nature.

\(^6\) If less than 1% of revenues, the entire cash account is considered operating.

\(^7\) Management commentaries is the only part of the financial reports that are qualitatively coded with the purpose of structuring textual information. For the purpose of identifying specific financial and corporate governance engineering initiatives, more specific sections and notes from the respective financial reports have been used without prior coding due to its less textual nature.
Table 5

Coding categories utilized for structuring management commentaries

This table shows the four primary coding categories and the secondary codes used to structure qualitative information in management commentaries of the annual reports. The commentary category is used to segregate expectations from results.

<table>
<thead>
<tr>
<th>Primary codes</th>
<th>Secondary codes</th>
<th>Commentary codes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operations</td>
<td>Revenue</td>
<td>Expectations</td>
</tr>
<tr>
<td></td>
<td>Profitability</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Investment</td>
<td></td>
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<tr>
<td></td>
<td>Net Working Capital (NWC),</td>
<td>Results</td>
</tr>
<tr>
<td>Financial</td>
<td>Capital structure</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Debt structure</td>
<td></td>
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<tr>
<td></td>
<td>Foreign Exchange Rates (FX)</td>
<td></td>
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<tr>
<td></td>
<td>Credit risk,</td>
<td></td>
</tr>
<tr>
<td>Corporate Governance</td>
<td>Incentive alignment</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Active ownership</td>
<td></td>
</tr>
<tr>
<td>Macro</td>
<td>External factors</td>
<td></td>
</tr>
</tbody>
</table>

Source: Own contribution.

The primary codes are used to structure information in the management commentaries based on the overall topics of investigation - namely: Operational engineering (operations), financial engineering (financial) and corporate governance engineering initiatives (corporate governance). Additionally, a primary code is used to identify external factors, affecting the companies (macro). The primary codes are mutually exclusive. Secondary codes are used to further structure the information categorized in the primary codes. These codes are not mutually exclusive. The commentary codes are used to identify whether a textual piece of information is related to realized results or expectations. A definition of the primary and secondary codes is found in appendix 15.
5. Delimitations
The investigation includes comparisons across time and companies. Ensuring that peers and case companies are comparable, and constructing a consolidated voluntary chain during the time before PE ownership entails a series of adjustments and approximations, causing necessary delimitations.

Adjustments and approximations are explained in section 4 on thesis methodology. Due to the excessive amount of accounting data, being treated both quantitatively and qualitatively, differences in accounting standards, due to the companies having different accountants, are not equalized.

The thesis investigates different initiatives taken by the PE funds and the associated impact. It is impossible to fully isolate and distinguish the effectiveness and influence from each individual initiative. However, the comprehensive investigation of management commentaries and estimation of initiative impact provide an insight into how PE funds in general perceive the potential of transforming voluntary chains to capital chains, and how such transformations are structured during the holding period. The information in the annual reports is provided in retrospect and under audit responsibility – therefore, it is expected to provide a reasonable and fair image of the companies’ activities.

The investigation is restricted by the lacking availability of store data. The consolidation of purchasing and store companies during the period before PE ownership relies on publicly available accounting data. However, a more thorough data foundation, including insider knowledge on each individual store, would enable a deeper investigation of i.e. store level performance and store level corporate governance initiatives during PE ownership.

Investigation of operational performance relies on a peer-compared development from the first observation period under PE ownership to the last. According to section 4 on case and peer company selection, great effort has been put into the selection of comparable peers. Ensuring comparability of concepts, capital chain characteristics and Nordic presence can compromise the comparability of company size. Thus, peer comparisons of performance development may to some degree be sensitive to differences in size and performance levels. When data is available, non-recurring costs in the first year of PE ownership are reversed in order to correctly reflect the actual development in case company performance across the holding period.

6. Introduction to case companies
The introduction of case companies takes its departure in PE fund press releases at the time of acquisition. Thus, it reflects the structure, seen by the private equity funds at the beginning of the transformation towards becoming capital chains.

Matas
CVC Capital Partners acquires Matas on the 28th of February 2007. Matas is a leading personal care retail chain in Denmark selling a variety of branded and private label goods through its network of 292 stores. At the time of acquisition, Matas employs 2,300 people, of which 85% are trained cosmetologists. The
assortment varies across stores, but consists of four overall product categories: beauty, over the counter pharmaceuticals, house hold products and vitamins and supplements. CVC acquires 206 stores from 125 store owners, and enters into an option agreement of acquiring 45 stores in the subsequent three years (CVC, 2007).

**PWT - Tøjeksperten**

Polaris Equity acquires Tøjeksperten on the 24th of January 2008. Tøjeksperten is the largest menswear chain in Denmark with 119 stores and a chain head office, Eksperto a.m.b.a. The chain head office is in charge of design and production of private labels, and coordinates activities between suppliers and Tøjeksperten stores. Furthermore, it supports individually owned stores with administrative systems and shop interior. The acquisition of Tøjeksperten is an addition to the strategy of Polaris to consolidate the menswear industry. Four months earlier, in August 2007, Polaris acquires another menswear chain, Wagner/Texman⁸, consisting of the whole sale division Texman with own brands and export to independent clothing stores in 11 countries, as well as of Wagner stores in the Nordic region, including 40 in Denmark. The two chains operate under independent concepts. Tøjeksperten focuses on quality clothing to fashion-concerned men in all ages with own and foreign brands, while the Wagner chain focuses on "value-for-money", primarily, by selling own brands. Polaris acquires 67 Tøjeksperten stores and offers franchising agreements to store owners, not initially willing to sell their stores (Polaris, 2008a).

**BabySam**

Polaris Equity and AAC Capital Partners acquire BabySam on the 29th of January 2008. BabySam is Denmark’s leading baby equipment retailer with 31 independent stores and the purchasing company, BabySam a.m.b.a.. Furthermore, it constitutes the premium quality pram producer Odder Barnevognsfabrik A/S. The retail brand is generally recognized for its high quality product offerings for newborns and young children. This includes products within the categories: baby prams, pushchairs, nursery, safety and feeding products as well as baby and children’s clothing. Polaris Equity and AAC Capital Partners acquire all 31 independent stores, the purchasing division and Odder Barnevognsfabrik A/S (Polaris, 2008b).

**IDdesign**

Axcel acquires IDdesign on the 9th of December 2007. The chain consists of 39 stores, owned by 25 different owners operating under the IDEMøbler concept in Denmark, as well as stores in the Faroe Islands, Greenland and Iceland. Furthermore, the chain consists of 15 stores, operating on a franchise basis in the Middle East⁹, under the name IDdesign with Scandinavian inspired furniture design. IDEMøbler and IDdesign are administrated through the purchasing company Inbohome A.m.b.a. IDEMøbler operates within the middle-price segment of furniture and interior design. Axcel acquires 32 of the 39 Danish stores. The remaining 7 Danish stores, the franchise concept IDdesign and the stores in the

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⁸ Wagner/Texman is acquired through the company Hansen & Pedersen I/S.
⁹ The stores are located in: Cyprus, United Arab Emirates, Kuwait, Saudi Arabia, Oman, Tenerife, Bahrain and Qatar.
7. Free cash flow analysis

Free cash flows are of great importance to PE funds when executing leveraged buyouts (J. P. Rosenbaum, J., 2011). The free cash flows support the relative high debt levels and associated financing expenses. From an analytical perspective, free cash flow calculations provide an insight into the PE fund strategy, since it includes measures on operational performance (EBIT and changes in net working capital) and investment levels (capital expenditures).

This section includes a free cash flow analysis of each case company. Free cash flows to firm (FCF-F) is further decomposed in order to investigate the impact from individual cash flow components. When comparing FCF-F across companies, the free cash flows are normalized in order to account for company size differences. While Guo et al. (2011) applies sales for normalization, Gul & Tsui (1998) and Agrawal & Jayaraman (1994) suggest balance sheet figures such as total beginning assets and book value of equity. Kaplan (1989) applies sales and assets for normalization of individual cash flow components such as operating income and capital expenditures. In accordance with Guo et al. (2011) and Kaplan (1989) we apply normalization with company sales. Appendix 16 provides the formulas applied to calculate FCF-F, while appendix 17 includes the absolute FCF-F values.

The aim of the following section is to investigate the following research questions:

1. **Do the voluntary chains generate FCF-F before the acquisition by a PE fund?**
   *This provides an idea of the degree of attractiveness towards the PE funds.*

2. **What is the ability of case companies to generate FCF-F after the acquisition by a PE fund?**
   *This provides insights on the crucial ability of the case companies to generate FCF-F during PE ownership.*

3. **Which free cash flow components drive the development of FCF-F in the case companies?**
   *This provides insights into the underlying causes of FCF-F development during PE ownership.*

7.1. **Matas**

Matas generates stable FCF-F during the period before PE ownership. According to Rosenbaum (2011) strong, predictable and stable cash flows are crucial for PE funds, potentially increasing the attractiveness of Matas.
During the first period after PE acquisition, Matas faces negative FCF-F, followed by five periods of positive free cash flows. Matas grows cash flows from 6% of sales to 18% of sales during four consecutive periods. During the total observation period, Kicks Norge experiences quite unstable performance with negative FCF-F in five out of eight periods.

The non-cash expense of depreciations (red) accounts for a positive impact on FCF-F of app. 20% across the observation period. EBIT (blue) is positive, but fluctuates after the transformation to capital chain. In the last period, it is restored to the pre-acquisition level. Improvements in net working capital (green) add positively to FCF-F in later periods, p3, p5, and p6. During the entire observation period, capital
expenditures (orange) have a negative impact on FCF-F, but investments are remarkably higher in the first year of PE ownership.

Figure 35 in appendix 18 shows the equivalent of figure 4 for Kicks Norge. Except for p3 and p4, FCF-F is negatively affected by increases in net working capital (NWC). The impact from EBIT is steadily decreasing from a positive influence of +20% in p2 to a negative impact of -10% in p4. The negative impact from EBIT is to some degree restored in later periods. In general, the development in NWC and EBIT drives the unstable FCF-F for Kicks Norge. Like Matas, the peer experiences high capital expenditures (CapEx) in the first period after PE acquisition of Matas.

In four out of six periods, Matas generates higher FCF-F as a ratio of sales compared to its peer. The ability to generate FCF-F is mainly driven by positive impact from EBIT. However, CapEx affects FCF-F negatively during the first three observation periods.

7.2. **PWT**

PWT generates positive FCF-F, fluctuating in the range 2%-12% of sales. Except for p1, Dressmann experiences positive FCF-F in the range 6%-15% of sales and outperforms PWT in all periods.

![Figure 5. FCF-F as a ratio of sales for PWT and Dressmann Norge (Peer).](image)

Figure 5. FCF-F as a ratio of sales for PWT and Dressmann Norge (Peer). This figure shows free cash flow to firm measured as a ratio of sales for the case company PWT and its peer Dressmann Norge. The black dotted line represents the time of acquisition of PWT (Tøjeksperten) by Polaris. Source: Own contribution.

Depending on the size of capital reserves and strategy of Polaris, one would expect the relatively lower ability to generate FCF-F to negatively impact the ability to repay debt. The high FCF-F of 6% in the first period of PE ownership could provide the background for repayment and servicing of debt in periods of
lower FCF-F.

Figure 6. FCF-F composition for PWT. This figure shows the percentage impact from free cash flow components on FCF-F for PWT throughout the observation period. The black dotted line marks the acquisition of PWT (Tøjeksperten) by Polaris. The category, depreciations, includes depreciations, amortizations and impairment costs. Source: Own contribution

During the period before Polaris ownership, EBIT drives the positive free cash flows of PWT. After the acquisition, EBIT fluctuates and in three out of five periods influences FCF-F negatively. Also the influence from changes in NWC fluctuates between positive and negative impact. Adding back non-cash depreciations has the highest single impact on FCF-F in the PE ownership period. Especially, impairment of goodwill drives the impact from non-cash depreciations. PWT invests throughout the observation period, reflected in a negative impact from CapEx. The highest impact of investments is observed in p3.

Figure 36 in appendix 18 shows the equivalent of figure 6 for Dressmann. Compared to PWT, Dressmann seems to experience a considerably higher and more positive impact on FCF-F from EBIT in the range 40%-65%. Adding back non-cash depreciations for both companies, net operating incomes of PWT and Dressmann converge. This suggests that if accounts are adjusted for considerable goodwill impairments in the case of PWT, operating income has a comparable impact on FCF-F across the two companies. Like PWT, Dressmann experiences a fluctuating impact on FCF-F from changes in NWC, and both companies invest throughout the observation period.

In four out of five periods after acquisition, PWT generates lower FCF-F as a ratio of sales compared to its peer. However, FCF-F remains positive through the observation period. PWT’s ability to generate positive FCF-F is mainly driven by positive impact from adding back depreciations. Both companies invest throughout the observation period, which is reflected in a negative impact from CapEx.

7.3. BabySam

In contrast to its peer, BabySam generates positive FCF-F in the period before the acquisition by Polaris.
Figure 7. FCF-F as a ratio of sales for BabySam and BH Nordic (Peer). This figure shows the percentage impact from free cash flow components on FCF-F for BabySam throughout the observation period. The black dotted line marks the acquisition of BabySam by Polaris. Source: Own contribution.

The acquisition marks the beginning of a six-year period of initially positive and later negative FCF-F for both companies. Especially, the peer company experiences unstable FCF-F with a positive FCF-F in p₁, followed by five consecutive years of negative FCF-F. During the same period, BabySam experiences positive FCF-F in p₁ and p₂ followed by three consecutive years of negative FCF-F before generating slightly positive FCF-F in p₆.

Figure 8. FCF-F composition for BabySam. This figure shows the percentage impact from free cash flow components on FCF-F for BabySam throughout the observation period. The black dotted line marks the acquisition of BabySam by Polaris. Source: Own contribution

During the period before Polaris ownership, BabySam experiences a negative impact on FCF-F from changes in NWC. After the acquisition, the negative impact is succeeded by relatively large improvements in FCF-F from positive changes in NWC. This could indicate that the PE fund before acquisition observes a readily accessible potential for improvements which is realized shortly after the acquisition. Large CapEx may finance the improvements in the first year of ownership.
The positive impact from EBIT during the period before acquisition is replaced by a negative impact during the entire period after acquisition. Especially, p5 is highly affected by negative EBIT and high deprecations. This could indicate a reconstruction scenario.

Figure 37 in appendix 18 shows the equivalent of figure 8 for BH Nordic. Like BabySam, BH Nordic is negatively affected by EBIT. Furthermore, the peer experiences a comparable transformation from negative NWC impact during p-2-p-1 to a positive impact in p1.

In five out of six periods, BabySam generates higher FCF-F as a ratio of sales compared to its peer. However, FCF-F fluctuates and amounts to negative or small ratios in several periods during PE ownership. BabySam’s lack of ability to generate positive FCF-F is mainly driven by negative impact from EBIT. Despite the seemingly poor operating profitability, BabySam invests heavily during the first years of PE ownership. The same is the case for its peer BH Nordic.

7.4. IDdesign

After the acquisition by Axcel, IDdesign experiences negative or at best neutral FCF-F. Especially, the first period of Axcel ownership stands out with negative FCF-F of -11% of sales.

![Figure 9. FCF-F as a ratio of sales for IDdesign and Chilli (Peer). This figure shows free cash flow to firm measured as a ratio of sales for the case company IDdesign and its peer Chilli. The black dotted line represents the time of acquisition of IDdesign by Polaris. Source: Own contribution.](image)

The peer company, Chilli, experiences a comparable development in FCF-F except for p4, where positive FCF-F is generated. Thus, both home interior retailers are for the first periods exposed to negative or at best neutral FCF-F, which in the case of IDdesign can have material impact on the crucial ability to repay debt.
Figure 10. FCF-F composition for IDdesign. This figure shows the percentage impact from free cash flow components on FCF-F for IDdesign throughout the observation period. The black dotted line marks the acquisition of IDdesign by Axcel. Source: Own contribution.

During the entire period of PE ownership, IDdesign experiences a negative impact from EBIT in the range -40% to -59%. The negative impact from investments is particularly high in the first year of Axcel ownership, but decreases during subsequent periods. The positive impact from adding back depreciations increases throughout the period of observation, reflecting high goodwill impairment costs. In the first two years of Axcel ownership, IDdesign generates 20% positive impacts from decreasing NWC, indicating that the company obtains rationalization gains early in the holding period.

Figure 38 in appendix 18 shows the equivalent of figure 10 for Chilli. During the first four periods, the company is exposed to a negative impact from increasing NWC. The impact is reversed during later periods. A comparable pattern is not observed for IDdesign.

Compared to IDdesign, which experiences a considerable impact from CapEx in the first year of Axcel ownership, Chilli invests continuously throughout the observation period. This could indicate that Axcel has a shorter investment horizon, demanding large CapEx and improvements of concept in the beginning of the holding period. This way, the PE fund attempts to reap the benefits from initiatives before a potential sale of the business in order to reach an optimal price.

Throughout the PE ownership, IDdesign generates negative EBIT. If omitting p5, Chilli experiences positive or slightly negative EBIT. This indicates stronger operating performance in Chilli.

In three out of five periods after PE acquisition, IDdesign generates lower FCF-F as a ratio of sales compared to its peer. FCF-F is neutral or negative in all periods. IDdesign’s lack of ability to generate positive FCF-F is mainly driven by negative impact from EBIT. IDdesign invests in the first period of PE ownership, while its peer invests throughout the observation period.

7.5. Cross case comparisons on free cash flow analysis

All case companies generate rather stable and positive FCF-F during the period prior to PE acquisition driven by operational income from EBIT. This could potentially increase their attractiveness, as FCF-F is crucial for PE funds. The subsequent table 6 summarizes the findings on FCF-F.
Table 6

Summary of findings on FCF-F and its composition

This table summarizes the main findings on elements investigated in the FCF-F analysis. FCF-F is indicated as a ratio of sales for the respective companies.

<table>
<thead>
<tr>
<th>Prior to PE acquisition</th>
<th>Matas</th>
<th>PWT</th>
<th>BabySam</th>
<th>IDdesign</th>
</tr>
</thead>
<tbody>
<tr>
<td>Positive FCF-F prior to PE acquisition?</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Which component influences the development in FCF-F positively prior to PE acquisition?</td>
<td>EBIT</td>
<td>EBIT</td>
<td>EBIT</td>
<td>EBIT</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>After PE acquisition</th>
<th>Case:</th>
<th>Peer:</th>
<th>Case:</th>
<th>Peer:</th>
<th>Case:</th>
<th>Peer:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of periods with positive FCF-F ?</td>
<td>5/6</td>
<td>2/6</td>
<td>5/5</td>
<td>4/5</td>
<td>3/6</td>
<td>1/6</td>
</tr>
<tr>
<td>Average FCF-F as a ratio of sales (Case and peer)</td>
<td>8.8%</td>
<td>-2.0%</td>
<td>6.0%</td>
<td>7.6%</td>
<td>-0.5%</td>
<td>-20.8%</td>
</tr>
<tr>
<td>Which main component influences the development in FCF-F positively?</td>
<td>EBIT</td>
<td>Depreciations</td>
<td>Depreciations</td>
<td>Depreciations</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Which main component influences the development in FCF-F negatively?</td>
<td>CapEx</td>
<td>Ambiguous</td>
<td>EBIT</td>
<td>EBIT</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Own contribution.

In the period after PE acquisition, two case companies, Matas and PWT, experience positive FCF-F in the majority of the observation period. While BabySam has an even number of periods with and without positive FCF-F, IDdesign stands out as the only case company having no periods of positive FCF-F. All case companies, except IDdesign have a larger number of periods with positive FCF-F compared to their peers.

PWT and IDdesign are the only case companies generating a lower average FCF-F compared to their peers. BabySam and IDdesign generate an average negative FCF-F. Since FCF-F constitutes a residual for equity and debt holders, this can potentially influence the crucial ability to service debt. This perspective is further investigated in section 8 on financial engineering.

As previously illustrated in the section on LBO strategy, operations (EBIT) fund the acquisition financing, imposed by the PE fund. At the same time, enterprise value is often grown through investments. Hence, one would expect to observe the main positive impact on FCF-F from EBIT and negative impact from CapEx. This is also what is observed in Matas. Contrary, BabySam and IDdesign experience the highest positive impact from adding back non-cash depreciations and main negative impact from EBIT. Correcting for the non-cash nature of depreciations, operating income is still negative in the majority of the periods. This scenario is expected to further challenge the ability of the PE owned companies to repay debt obtained at the acquisition. Operating profit margins are further investigated in section 10.3.

All cases – except Matas – realize gains from NWC improvements already during the first year of PE ownership. This could indicate that readily accessible improvement potentials exist for the majority of the case companies. This is further investigated based on core operations in section 10.4.
BabySam, IDdesign and Matas incur high CapEx during the first year of PE ownership, while the peer companies invest continuously throughout the observation period. One would expect this pattern, since the PE funds normally have shorter horizons for reaping benefits of investments compared to strategic owners. A detailed investigation of the composition of CapEx is performed in section 9.

8. Financial engineering analysis

This section provides an explorative analysis of company and capital structures to investigate how the PE funds, from a financial perspective, structure acquisitions of dispersedly-owned voluntary chains. This includes investigations of acquisition financing (equity versus debt), the application of alternative financing classes (subordinate loan capital), the recognition of external loans (security for lenders and placing of loans) and the reinvesting of proceeds by previous store owners. Two case companies are reconstructed during PE ownership. The reconstructions focus on refinancing the target company, including capital injections and debt cancellation. Due to the commitment by the PE funds to supply further equity capital if, for instance, covenants are breached, the total equity contribution in some cases increases considerably over the holding period. Thus, the lacking ability of the target company to support the financial leverage in reconstruction cases, forces the PE funds to increase their exposure towards the development of the individual investment. An investigation of the reconstruction background and process provides an insight on financial risks and initiatives taken by the PE funds during financial distress.

Appendix 19 includes an overview of the financing structure and leverage key metrics for each case company and its peer. The analysis relies on this an extensive investigation of annual report notes. The appendix includes key metrics on the development in financial gearing and the ability of the case company to support debt. The latter is captured in the interest coverage ratio that shows to which degree EBIT or EBITDA covers financial expenses. The application of interest coverage ratios is inspired by Wright et al. (2009), which argue that interest coverage ratios are more important than absolute gearing, since it is a stronger indicator of whether the case company can support debt on a continuous basis. The ratios rely on average, reformulated annual report data, including the negative impact from goodwill impairment in order illustrate the relationship between impairment and reconstructions.

In total, the section aims at investigating the following research questions:

- **How do PE funds finance the acquisition and development of newly established capital chains?**  
  *Investigates the composition and placement of debt and equity in the financing of acquisitions. Financial leverage and interest coverage ratios track the development of the financial structure and PE fund initiatives.*

- **Why and how are three case companies reconstructed?**  
  *Explores the reconstruction background and process.*

- **Did the financial structure of the voluntary chains increase the attractiveness of the companies towards PE funds?**  
  *Investigates whether the voluntary chains constitute low leverage companies with strong ability to service debt on which acquisition financing can be added.*
8.1. Matas

CVC announces its acquisition of Matas in February 2007. Since the chain operates as a dispersedly owned voluntary chain before the acquisition, the transformation to capital chain entails the implementation of a new, consolidated company structure. This also includes a new capital structure, reflecting that the company now operates as a PE owned capital chain.

The new parent company, M Holding A/S, is the departing point for a rather complex firm structure (figure 5 in appendix 4) relying on two overall sources of financial debt:

1. **Subordinate loan capital of DKK 1.4 bn.** provided by CVC to M Holding 2 A/S. The group pays annual interest of 12% on the subordinate loan, which is convertible to equity.

2. **Syndicated loan of DKK 2.7 bn.** with variable interest rate from credit institutions. Matas continuously engages in interest rate swaps, hedging against increasing interest rates. The syndicated loan is placed in M Holding 3 A/S which provides security for lenders in receivables from group companies, cash reserves, store operations, trademarks and property.

Table 37 in appendix 19 includes a period-by-period overview of the development in shareholders’ equity and financial leverage. CVC exploits the conversion right twice during the ownership period, effectively transferring the subordinate loan to equity. During the lifetime of the loan, Matas pays financial expenses of DKK 274 m. to the PE fund. In contrast to the period before CVC ownership, no dividends are paid after the acquisition.

Looking at equity, the total contribution from CVC, Materialisternes Invest and MLI Holding constitutes DKK 200 m., implying a debt/equity-ratio (D/E) of 22 in the end of p0. In p1, DKK 885 m. of subordinate loan capital is converted into equity, while the remaining is converted in p3. CVC owns 66.1% until p5, while residual shareholdings are possessed by previous store owners and company management. Thus, despite the conversion of the subordinate loan, minority shareholders are not diluted. Minority shareholders are not diluted due to:

- The subordinate loan is converted into equity, and the majority is booked on the share premium account.
- The debt conversions entail a limited increase in total share capital from establishment of a preference share class. The preference shares are owned by CVC, and have a clause, securing CVC a first-hand dividend right to 12% of total preference share capital if any dividends are paid out.

Concluding, CVC provides a subordinate loan at 12% interest, which is unsecured, and gradually converted to equity during the first four periods of PE ownership. The loan conversion is mainly recognized at the share premium reserve which provides more opportunities for application compared to recognition at the share capital account.

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10 Calculated from total group debt (credit institutions and subordinate loan capital) of DKK 4.106 m. and equity of DKK 186 m. Numbers are obtained from the M Holding A/S annual report 2006/07.

11 Derived from Danish company law ("Selskabsloven"), §180 (dividend payments) and §165 (issuance of bonus shares).
There may be several reasons for the PE fund to apply the above capital structure and debt conversion approach. Presumably, CVC has not had the opportunity to continue the business at the initial D/E-ratio of 22, since it would leave the external creditors very fragile to future losses. The first three periods of losses alone amount to more than the initial equity. Hence, it has presumably been a part of the initial capital structure planning to strengthen the equity on a continuous basis.

But why does CVC inject subordinate loan capital at first? Arguably, the PE fund has not been able to obtain further external financing than the DKK 2.7 bn. Credit institution debt is secured in receivables in group companies, cash reserves, store operations, trademarks and property. Property and cash reserves – constituting the most marketable assets – only amount to DKK 550 m. Thus, a majority of existing debt is secured in goodwill, company operations and group receivables. The relatively low amount of tangible assets limits the possibility for achieving further security for additional external debt. Furthermore, the subordinate loan provides an opportunity to suspend interest payments, but continue servicing external debt, if the fund has to face weak performance. From another perspective, depending on the perceived risk profile of the subordinate loan, supplying debt at 12% interest provides CVC with an opportunity to receive a return early in the holding period. The return is tax excepted for Matas, as it is not a dividend paid out from after-tax funds. At the same time, only the PE fund receives the continuous cash flow, as the minority interests do not supply any loans. The interest payments are paid to a Swedish subsidiary of CVC, which is ultimately owned by a company, registered in Luxembourg. CVC has an additional advantage relative to ordinary shareholders, as the PE fund has first priority to dividends from preference shares. All in all, the subordinate loan capital provides flexibility in the capital structure and early returns for the PE fund.

The DKK 2.7 bn. credit institution loan is increased until p3. From here, debt is repaid, and in the last period of observation constitutes almost DKK 2.3 bn. According to annual reports, the debt is equipped with covenants which are met in all years. During the observation period, the interest rate level drops continuously from 6.5-10% in p0 to 1.3-4.5% in p6, reflecting a general decrease in interest rates and the hedging of DKK 1-2 bn. of debt. In all periods, Matas possesses unused debt facilities from credit institutions, of which some can only be used for further acquisitions.

During the period of CVC ownership, the relative debt, captured in the D/E-ratio, decreases from 22 to 0.97. The conversion of subordinate loan capital in p1 alone decreases the ratio to 3.3. Throughout the period, DKK 520 m. of the DKK 2.7 b. credit institution loan is repaid, while the equity is increased with more than DKK 1.6 b. if only including capital increases from debt conversion. Thus, the decrease in overall leverage is driven by PE fund debt conversion, rather than repayment to external debt holders.

Tables 39-40 in appendix 19 include leverage and interest coverage ratios for Matas and peer. During the period before PE ownership, solvency is higher than 100%, indicating that Matas has net financial assets. The interest coverage ratios are, measured on both EBIT and EBITDA relative to net financial expenses before tax, very high in the range 32-41 in p2. In the last period as voluntary chain, the same ratios are high and negative, indicating that the company has high net financial income. Other things being equal, this could provide a good reason for CVC to acquire Matas, since the chain – measured on both leverage and the ability to support leverage – can obtain large amounts of debt for financing the acquisition.
After the acquisition of Matas, solvency drops to 15% and financial gearing, measured as net financial obligations to equity, increases to 5.6. During subsequent periods, solvency increases and in the last observation period, debt amounts to less than equity. As previously illustrated, this transformation is mainly driven by internal conversion of subordinate loan capital to equity, rather than repayment of external debt.

In the first observation period, all interest coverage ratios are 1 or less, indicating that Matas may not support its debt. In fact, the investment-adjusted interest coverage ratio is negative. Solely focusing on this perspective, Matas looks as a firm in financial distress. However, a large proportion of financial leverage is supplied by the PE fund. If adjusting for the subordinate loan capital – thereby assuming that Matas prioritizes to pay credit institutions first due to strong covenants – interest coverage ratios increases.

Hence, the private equity fund has the opportunity to avoid overall financial distress by suspending interest service on the subordinate loan capital.

Table 38 in appendix 19 includes an overview of peer debt development. In p.2-p.4, the peer is indirectly PE fund owned by FSN Capital through Validus. In this period, D/E-ratio is increased from 0 to 13 with debt from the group company. After the acquisition by Axstores, D/E-ratio drops, and debt is reorganized to external loans. Thus, the capital structure of Matas is relatively more complex. In the period, p.2-p.1, Kicks Norge has solvency ratios above 100% and negative financial gearing. In both p.1 and p.2, Kicks Norge possesses negative investment-adjusted interest coverage ratios, indicating that the company invests heavily and cannot support interest expenses if adjusting for investments. In subsequent periods, the solvency ratio drops, and in the last period it amounts to 14%. At the same time, financial gearing increases and interest coverage ratios decrease from servicing the higher amounts of debt. Thus, Kicks Norge experiences an increase in leverage similar to Matas, indirectly supplied by the PE fund.

### 8.2. PWT

Polaris acquires the PWT group in two stages beginning with the acquisition of Hansen & Pedersen I/S in December 2007 and later the acquisition of Tøjeksperten in June 2008. As previously described, Hansen & Pedersen includes wholesale activities through ownership of own brands in Texman and retail through the Wagner stores. Tøjeksperten consists of a purchasing arm and a voluntary distribution network.

The new company structure after acquisition of Hansen & Pedersen and Tøjeksperten includes multiple companies with different purposes. As seen in figure 8 in appendix 4, P-WT 2007 is the parent company of the entire group, holding a majority interest in PWT Holding A/S. Polaris Private Equity II K/S is the only owner with more than 5% of share capital and voting rights in P-WT 2007. Thus, the company represents the ownership position of a Polaris fund. The share capital of the company amounts to DKK 30.9 m. Additional DKK 258.6 m. is recognized at the share premium account. Almost no debt is observed in P-WT 2007 throughout the observation period. In contrast to the period before Polaris ownership, no dividends are paid after the acquisition.

PWT Holding has limited share capital of DKK 1.3 m., but also large share premium account reserves. Furthermore, the company holds DKK 270 m. of credit institution debt in the first year of Polaris.
ownership. The group in total has more than double this amount of debt, indicating that the total amount of loans is distributed around different companies in the group.

In the first observation period, it is evident from the balance sheet of PWT Holding that the company has a loan to group companies of DKK 166 m. This loan is provided to the wholly owned subsidiary, PWT A/S, which represents the activities of the newly consolidated Tøjeksperten. According to the notes of PWT A/S, the loan is subordinate, and provided as a deposit repayable at demand. Since the loan is described as subordinate, it is assumed that the loan is provided by the PE fund through PWT Holding equity reserves rather than through credit institution debt. In addition to the subordinate loan capital, PWT A/S has DKK 266 m. of credit institution loans. The shares in Hansen & Pedersen I/S, representing Texman and Wagner, and PWT A/S (Tøjeksperten) provide security for credit institution loans12.

Concluding, the total amount of group credit institution debt, dispersed across different companies, is secured in Hansen & Pedersen and Tøjeksperten (PWT A/S) shares. PWT A/S receives a subordinate loan from the PE fund through the holding company. This complex financing structure ensures that the capital heavy activities of Tøjeksperten, can receive both internal, unsecured financing and external, secured credit loans. Hansen & Pedersen generates high net income during the entire observation period, but has limited amounts of tangible assets13. Thus, the generation of high net income must be the main reason for credit institutions to obtain security in the ownership of Hansen & Pedersen I/S.

Table 41 in appendix 19 includes an overview of the development in debt across the entire observation period. The group has four overall types of debt – mortgage loans, credit institution debt, lease obligations and loans to associated companies. In some years, the mortgage loans are included in the balance sheet figure on credit institution debt. However, notes reveal that it amounts to maximum DKK 3 m. Hence, the majority of the DKK 600 m. credit institution debt is not related to financing of real estate, but rather financing of the acquisition by Polaris. The credit institution debt is gradually repaid, and in the last year amounts to app. DKK 400 m. Comparing the initial debt level of DKK 600 m. with the initial equity in P-WT 2007 of DKK 290 m., the PE fund acquires PWT with a little less than one third of equity and two thirds of credit institution loans.

In p3, the group is in negotiations with the existing debt provider regarding future credit facilities, since covenants in existing agreements have been violated. PWT expects a new debt facility agreement with the existing debt provider during p4. No further information is supplied on the background for the covenant breach. However, from the annual reports, it is evident that p3 is the only year in which credit institution debt is increased, suggesting that the company has had difficulties repaying debt according to a repayment schedule. An implied interest rate calculation14 reveals that the group pays 7.8% in p1 versus 8.1% in p5. The group achieves the lowest interest rate in p3 of 5.6%, suggesting that the renegotiated loan agreement in the spring of p4 implies increasing interest rates. This could indicate that despite a low

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12 PWT A/S owns the companies, SWAP VIII ApS and OKH ApS. Together with the shares in PWT A/S (Tøjeksperten), included in PWT Holding, SWAP VIII ApS and OKH ApS provide security for group debt to credit institutions through the ownership of Hansen & Pedersen I/S.
13 Hansen & Pedersen I/S annual reports 2008-09/2012/13.
14 Financial expenses are specified in annual report notes until p3 and account for 97-98% of total interest expenses during the first years of PE ownership. Therefore, the implied interest rates are calculated assuming that the total amount of interest expenses are related to credit institutions during the entire observation period and calculated as financial expenses divided with credit institution debt.
interest rate environment, credit institutions perceive a higher risk of default, demanding a higher interest rate in subsequent periods.

Throughout the observation period, the D/E-ratio decreases from 2.1 to 1.7 (see table 41 in appendix 19). Total debt and equity decreases with DKK 200 m. and DKK 37 m., respectively. Thereby, the overall decrease in financial leverage is driven by debt repayment. The development in the capital structure of the peer is positively influenced by strong operating performance from the Norwegian operations, creating substantial retained earnings. The D/E-ratio is in all years lower than 0.5, and the total amount of financial leverage is supplied by the parent company, the Varner Group.

Tables 43-44 in appendix 19 include interest coverage ratios and financial leverage measures for PWT and Dressmann. During the period before PE ownership, solvency ratios are slightly higher than 100% and financial gearing is zero. The chain has net financial expenses, suggesting that the consolidated company earns less from financial assets than paid on financial obligations. At the same time, both EBIT and EBITDA coverage ratios are high, indicating very limited risk of not being able to service the debt. In the first period of Polaris ownership, the solvency ratio drops to 32%, and all interest coverage ratios are close to zero. Interest coverage ratios measured on EBIT are negative due to PWT incurring an operating loss. Thus, all interest coverage ratios indicate low ability to service debt at the initial stage of consolidation. In the second period of ownership, interest coverage ratios are increased to between 1 and 3, but in subsequent periods decrease and in P₄ amount to -0.3 measured on EBIT. Thus, PWT cannot support its debt. This may be the covenant breach trigger. After the renegotiation of debt with existing credit institution lenders, interest coverage ratios are again increased and amount to between 0.3 (EBIT) and 2.1 (EBITDA) in P₅.

The solvency ratios of Dressmann are in the range 77% - 110% and financial gearing close to zero, confirming the low leverage impression of the company. During the period before PE acquisition of PWT, net interest coverage ratios are between 23 and 28. In the period after the acquisition, Dressmann has positive EBIT and EBITDA as well as net financial income, indicating that Dressmann can easily support its debt, even when adjusting for investment activity. This may be driven by Dressmann solely having debt to the parent company, possibly implying low group internal interest rates.

8.3. BabySam

In February 2008 (p₀), the two private equity funds, Polaris and AAC Capital, acquire the Danish baby article retailer, BabySam. HSH Nordbank provides the external debt financing for the acquisition, which is carried out through the firm, Samba Feeder A/S. The purpose of this company is to be the parent company of the entire BabySam Group. According to the first annual report, Samba Feeder A/S is 50/50 owned by P-BS 2008 ApS and Golden Eye A/S, representing Polaris and AAC Capital, respectively.

The primary asset in Samba Feeder A/S is the 75%-ownership of BabySam Holding A/S which includes the fully-owned subsidiary, BabySam A/S. During the beginning of p₀, all existing store companies and the purchasing arm of the previously voluntary chain are consolidated into BabySam A/S. Additionally, BabySam A/S holds the ownership in the joint venture, Nordic Baby Group AB. Thus, from the end of 2008, BabySam A/S represents the entire operations of the BabySam group. The indirect private equity
fund ownership through BabySam Holding A/S allows for previous store owners and company management to possess shares in the group, representing the residual 25% ownership of BabySam Holding A/S. In contrast to the period before Polaris ownership, no dividends are paid after the acquisition.

The first annual reports of Samba Feeder A/S, BabySam Holding and BabySam A/S provide some insight on the initial financing of the acquisition. In Samba Feeder A/S, the 75%-ownership of BabySam Holding A/S is recognized at an asset value of DKK 281 m. The company has a total share capital of DKK 1.6 m., but furthermore includes a share premium account of DKK 159 m. The parent company has long-term debt of DKK 128 m., which is supplied by the private equity funds\textsuperscript{15}. Thus, the two private equity funds supply a total of DKK 160 m. in equity and DKK 128 m. in long-term debt for financing the 75%-ownership of BabySam Holding A/S.

Total group debt amounts to DKK 456 m. of which credit institutions provide DKK 223 m. and DKK 232 m. is recognized as other long-term debt. Since DKK 128 m. is recognized in Samba Feeder A/S, the residual DKK 328 m. is included in companies closer to the operations of the group. BabySam Holding holds the residual DKK 104 m. of other long-term debt, which is supplied by previous store owners and company management, and DKK 202 m. of debt to credit institutions, indicating that the majority of the debt burden is placed in the holding company. The equity position of previous store owners and management is recognized separately as minority shareholdings of DKK 93 m. in the consolidated group report. In BabySam Holding, the minority shareholdings contribute both to share capital and share premium paid. Previous store owners and management provides a long-term loan of DKK 104 m. and equity recognized at DKK 93 m. in the consolidated report for financing a 25%-ownership. According to the first annual report of the group, external debt providers have security in land & buildings and other fixtures, totaling DKK 13 m. Thus, the external lenders have very limited security in tangible assets for their loans.

Table 45 in appendix 19 includes an overview of the development in leverage and equity during the observation period after the acquisition of BabySam by Polaris and AAC Capital. In general, the group experiences quite a volatile capital structure development. Both other long-term debt and debt to credit institutions are considerably decreased during the period. The same applies to the equity of the group in which no shareholders are endorsed with preference rights. Thus, the two PE funds do not have special dividend or voting rights compared to the minority interests in BabySam Holding A/S, represented by previous store owners and company management.

Initial group equity amounts to DKK 160 m. However, two consecutive losses of DKK -5 m. and DKK -26 in the first two periods of PE ownership require a capital increase and renewed financing agreement with HSH Nordbank after p\textsubscript{1}. The strengthening of the capital structure includes an equity capital increase of DKK 89 m., of which DKK 88 m. is supplied as a share premium. The equity increase is injected into Samba Feeder A/S, reflecting that the capital injection is solely financed by the two PE funds. The share premium contribution is applied for repaying external debt. The fact that debt is repaid from an equity capital injection reflects that operations cannot service the agreed debt repayment schedule.

\textsuperscript{15} Derived from the reconstruction plan, described in the annual report of 2011/12 (p.)
According to the annual report of p.2, credit facilities are again renegotiated during the year after the considerable capital injection. After fiscal year end, BabySam performs an extraordinary debt repayment of DKK 15 m. In p.3, the two PE funds further injects DKK 0.4 m. of share capital and DKK 75 m. in free reserves for covering a loss of DKK -79 m. In p.4, the group adopts a reconstruction plan affecting both the PE funds and the minority shareholders. Until the reconstruction plan, the PE funds have supplied additional equity capital of DKK 164 m., of which the majority is recognized as reserves for bringing down debt or covering net losses, increasing the total contribution to DKK 325 m. At the time of reconstruction, debt amounts to DKK 209 m.

The separation of financing activities from the operations enables a reconstruction in which debt is refinanced and the ownership of the group moved to a new company. According to the reconstruction plan in p.4 annual report, BabySam Holding A/S changes its name to “Selskabet af 12. marts 2013 A/S”. The company sells its 100% ownership of BabySam A/S to a new company which is funded with DKK 25 m. of equity. HSH Nordbank receives the proceeds – presumably, the beginning equity of DKK 25 m. in the new firm – from the sale and cancels all existing loans. At the time of reconstruction, the external loans amount to app. DKK 170 m. Thus, HSH Nordbank faces a considerable loss from the loan to BabySam. However, security for bank loans in p.1 amounts to DKK 22 m., indicating that a bankruptcy of BabySam would not provide a higher degree of recovery. In addition to the cancellation of bank debt, the PE funds and minority shareholders cancel their unsecured loans. In subsequent years, the BabySam group is nearly unlevered.

Tables 47-48 in appendix 19 include leverage and interest coverage ratios for BabySam and its peer, BH Nordic. During the period before PE ownership, the consolidated BabySam chain has solvency ratios of 74% and 70%. After the acquisition by the PE funds, solvency drops and financial gearing increases to 2.8. Later periods fluctuate due to the reconstruction. In the last period, the solvency ratio is higher than 100%, indicating the completion of the reconstruction program. In this period, external debt is very low and high cash reserves provide the background for net financial assets. The acquisition of BabySam by the PE funds marks a transition from two-digit interest coverage ratios to very low, and in some years, negative ability to service debt. In fact, measured on net interest expenses before tax and EBIT, the interest coverage ratio is negative during the entire PE ownership. We know from the above analysis that the PE funds and minority shareholders provide large amounts of debt to the BabySam group. However, annual report notes do not supply any information on financial expenses associated with the debt and therefore no information on the ability to suspend these.

Table 46 in appendix 19 shows that the peer increases solvency and reduces financial gearing, while BabySam is under PE ownership. However, BH Nordic generates negative interest coverage ratios throughout the observation period measured on net financial expenses before tax and EBIT. Thus, like BabySam, BH Nordic is not able to cover its net interest expenses with operational earnings. This could indicate that both companies from a macro perspective are affected by comparable environments.
8.4. IDdesign

In the fall of 2007, the Danish PE fund, Axcel, acquires the home interior retailer, IDdesign. The acquisition by Axcel marks the beginning of a tough and troubled transformation to a capital chain which culminates with the divestment of the chain in 2013 to the JYSK Group.

The below three companies provide the background for initial financing of the group:

- **IDinvest ApS**: Represents the 60% ownership of IDdesign Holding ApS by Axcel. The ownership is recognized at an initial value of DKK 166 m., almost solely financed with debt from credit institutions. During the second period of ownership, DKK 172 m. is provided as additional equity.
- **ID2007 Invest A/S**: Represents the 40% ownership of IDdesign Holding ApS by management and previous store owners.
- **IDdesign Holding ApS**: Constitutes the sole owner of IDdesign A/S. The ownership is recognized at an initial value of DKK 304 m. Except for a subordinate loan of DKK 17.5 m., provided by previous store owners, the company has almost no debt.
- **IDdesign A/S**: Responsible for operations and owns stores as well as the previous purchasing function. The ownership is recognized at an initial value of DKK 562 m. The company experiences a considerable share capital increase during the first year of PE ownership, but also has total credit institution debt of DKK 317 m. and loans to associated companies of DKK 36 m.

The above capital structure relies on a separation of operations in IDdesign A/S from group ownership in IDdesign Holding A/S. Since IDdesign A/S constitutes the operations of the group, and thus the main cash generating unit, the majority of external debt is placed in this company. According to annual report notes, the group provides security for external lenders in ownership of subsidiary companies. In contrast to the period before Axcel ownership, no dividends are paid after the acquisition.

In the second period of PE ownership, operations generate a considerable loss of more than DKK 150 m. At the same time, IDdesign acquires the rival, ILVA, requiring further funds for expansion. The PE fund injects DKK 172 m. into its company, and in total holding company equity is increased with almost DKK 280 m. of which the majority is recognized as free reserves for covering the loss from operations. During the same period, the subordinate loan from previous store owners and management is increased from DKK 18 m. to DKK 28 m. On a net basis, the accounting value of operations, recognized in the holding company, decreases to DKK 144 m. Since the PE fund supplies the majority of the capital injection, previous owners are diluted. Compared to an initial ownership of 40%, ownership is reduced to 6.3% after the second period due to the dilution.

In the end of p3, IDdesign engages in negotiations of new debt facilities. The negotiations entail a reconstruction of the capital structure including a share exchange and establishment of several new companies. In p4, the holding company recognizes a value of IDdesign A/S of DKK 144 m. The asset is almost solely financed from equity and a subordinate loan to previous store owners. In p5, the primary asset of the holding company – IDdesign A/S – generates a loss of DKK -239 m., and the ownership is written down to a value of DKK 1. Due to the substantial loss in the holding company, provided by a write-down of the ownership in IDdesign A/S, the PE fund injects DKK 100 m. of convertible debt for covering
the negative impact on equity. This maneuver leaves the holding company with an ownership of IDdesign A/S at a value of DKK 1 and a total balance sheet value of DKK 0.2 m of which the residual is cash reserves. “Datoselskabet af 6. juli 2011” acquires the ownership in IDdesign A/S from the previous holding company, and registers the value of the shareholding at DKK 1. The subordinate loan from previous owners is not “transferred” to the new holding company, and after the fiscal year p3, “Datoselskabet af 6. juli 2011” is liquidated. At the same time, the shares in the holding company are exchanged into a new company, representing the PE fund ownership. After the liquidation of “Datoselskabet af 6. juli 2011”, all holding activities are transferred to a new company, named IDdesign Holding 2011 A/S. In this company, the stake in IDdesign A/S – the operating company – is recognized at a value of DKK 80 m. The subordinate loan from minority interests is "left behind" in the previous holding company. This procedure has met criticism in several newspaper articles. While the lenders interpret the procedure as expropriation, Axcel defends its actions by referring to the store owners’ lack of willingness to invest during reconstruction (Børsen, 2011).

According to Børsen (2013a), the acquisition of IDdesign has been quite a troublesome investment for Axcel. The price paid by JYSK Group after p5 is undisclosed, but everything indicates that the disposal did not yield a return, which covers the capital contributions. Due to the development of the transformation – including considerable dilution of previous store owners, multiple capital injections, conversion of debt to equity and a full reconstruction – it is difficult to estimate the precise amount of capital contributed to IDdesign by the PE fund. However, if assuming that a consolidation of total share capital and reserve contributions to the operating company – IDdesign A/S – during the ownership period provides a reasonable estimate of total contributions, Axcel and previous store owners have contributed app. DKK 880 m.

Tables 51-52 in appendix 19 include interest coverage and financial leverage ratios of IDdesign and its peer. During the period before the acquisition by the PE fund, IDdesign has a positive solvency ratio higher than 50%, indicating that the equity more than overweighs the amount of debt. At the same time, IDdesign has net financial income, suggesting that the consolidated company has no difficulties in covering interest expenses. During the period after acquisition by Axcel, financial leverage is increased, and solvency ratios drop and amounts to 10% in the first year. The ratio is more than doubled in the second year, due to the capital increase. Throughout PE ownership, IDdesign is not able to cover interest expenses from operations due to negative operational income. Compared to IDdesign, the Swedish peer has lower financial leverage, and for the majority of the period, higher interest coverage ability.

8.5. Cross case comparison on financial engineering

In all cases, previous store owners possess a minority ownership in the new, capital chain through a joint holding company with the PE fund. This holding company is the joint owner of the capital chain operations which are often split across multiple operating units. In the majority of case companies, minority shareholders are not diluted from continuous equity contributions. The case of IDdesign constitutes an example of the opposite in which minority shareholders are substantially diluted.
During PE ownership, dividend payments are suspended and excess liquidity applied for debt repayment. This observation is in accordance with the leveraged buyout process introduced in section 3. In three out of four cases, the capital chains are supplied with subordinate loans from the PE funds and in some cases minority shareholders. This financing source provides the investors with an alternative to equity capital injections which on a later point in time can be converted to equity, but also a straw for drawing out funds from the case companies on a before-tax basis. The introduction of subordinate loan capital, potentially, also constitutes a tool for balancing between maximizing the benefit from tax-deductibility of interest payments and marginal distress costs, since lack of interest payments, presumably, do not entail a direct covenant breach on external debt.

In general, the case companies receive three overall types of financing – equity, subordinate loan capital and loans from credit institutions. All cases receive continuous equity injections from the initial owners of which the majority is recognized at the share premium account. Injecting funds through the share premium account provide opportunities for applying the funds for i.e. loss coverage and external debt repayment. External debt is provided by single lenders or consortiums of credit institutions. In most of the case companies, external debt is concentrated in the holding company or operational unit. In the case of PWT, external debt is equally split between the two. Tangible assets are low, and independent of loan placement, lenders are offered security in cash reserves, receivables and group company shares. It is doubtful whether these sources provide solid security. In the case of BabySam, the size of security and proceeds for the credit institution during reconstruction are coinciding and very limited compared to the total loan amounts.

Three out of four case companies are reconstructed during the period of PE ownership. It is difficult in advance to estimate the optimal balance between equity and debt financing. However, the analysis of financial leverage and interest coverage ability provides some insight on why the cases experience breach of debt covenants and/or reconstruction of the capital structure. During the period before PE ownership, solvency is high and for Matas and PWT in excess of 100%, indicating that the companies have net financial assets. The initial, dispersed structure of the chains is to a high degree expected to explain the low leverage. The ratio is increased during PE ownership, suggesting that the low initial leverage has constituted an attractive characteristic of the chains towards the PE funds. Before the acquisition by a PE fund, interest coverage ratios obtain positive values at which all companies are able to cover interest expenses. After the acquisition, all case companies, except for Matas, are in all periods not able to cover their interest expenses. Especially, IDdesign faces a tough debt service burden, since interest coverage ratios are negative in all periods during Axcel ownership. Hence, the lacking ability of operations to support the interest expenses from relatively high amounts of debt constitutes a main explanation for the reconstructions.

Section 3 shows how the process of decreasing net leverage with excess funds throughout the ownership period is a crucial part of leveraged buyout strategy. All case companies succeed in bringing down net leverage during the private equity fund ownership. However, the background for the decrease varies across the cases. In Matas, the decrease is driven by the conversion of subordinate loan capital to equity capital rather than debt repayment. In BabySam and IDdesign, changes in net leverage are observed
during reconstruction processes and thus in situations in which the PE funds are forced by external lenders to find a sustainable, future capital structure for the company.

In general, the peer companies have different capital structures compared to the case companies. The capital structure is simpler, measured on the types of debt, and two peers engage in groups which supply internal funds for the operations. Opposed to PWT and IDdesign, Dressmann and Chilli have high solvency and are able to cover interest expenses. On the other hand, Kicks Norge and BH Nordic, to some degree experience similar impact from leverage compared to Matas and BabySam, respectively.

9. Investment analysis

In the free cash flow analysis, investments accounted for a considerable impact on FCF-F during the period of PE ownership. This indicates that investment activities constitute an integral part of the PE strategy when acquiring the four voluntary chains.

This section investigates the investment activities of the case companies both before and after the acquisition by a PE fund. The investment metric includes capital expenditures related to tangible, intangible and goodwill investments. Since investments are calculated as changes in asset levels between two periods, adjusted for depreciations, the capital expenditures provide net values.

Capital expenditures are measured as a ratio of sales, and the individual components measured as constituents of total capital expenditures. Investments in goodwill are treated separately from intangible investments in order to provide an overview of capital expenditures strictly related to acquisitions. The development in investment components during the observation period is compared to strategic initiatives taken by the companies\textsuperscript{16}, including the means of store-network expansion\textsuperscript{17}.

The aim of the section is to investigate the following research questions:

1. **How do the voluntary chains invest before acquisition by a PE fund?**
   *Provides an insight on investment activity in the voluntary chains relative to peers.*

2. **What is the degree of investments in the case companies during PE ownership?**
   *Measures the development in investments from the period of transition to capital chain.*

3. **What do the investments consist of in the case companies during PE ownership?**
   *Focusing on the composition of capital expenditures and strategic initiatives.*

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\textsuperscript{16} Appendix 14 provides an overview of all initiatives identified from management commentaries.

\textsuperscript{17} Appendix 21 includes an overview of store expansion by the case companies and peers.
9.1. Matas

Before CVC ownership, Matas incurs lower capital expenditures (1-2%) compared to its peer (5-9%).

![Graph showing development in investments relative to sales for Matas and Kicks Norge (Peer).](image)

**Figure 11. Development in investments relative to sales for Matas and Kicks Norge (peer).** This figure shows the development of investments as a ratio of sales for Matas and its peer throughout the observation period. The dotted line represents the acquisition of Matas by CVC Capital Partners. *Source: Own contribution.*

In Matas, the store owners are responsible for local investments in own stores, but have to agree on larger company level investments outside the store domain. The investments of Kicks Norge are planned and decided by the central capital chain management. Hence, structural differences between the two companies are to some degree expected to explain the difference in investment activity during the period before CVC ownership of Matas. During the first three periods of PE ownership, investments in Matas increase to account for 4-16% of sales. Especially, in the first period, Matas invests heavily. In the last three periods, investments drop to pre-acquisition levels of 1-2% of sales.

In Kicks Norge, investments decrease from 10% in p1 to 3% in p5. In p6, investments increase, followed by a subsequent reduction. The sudden increase in investments is driven by changes in the store portfolio associated with the acquisition by Axstores AB in p4.

For both Matas and Kicks Norge tangible investments account for almost the total of capital expenditures in both companies during the period before PE ownership of Matas (figures 39-40 in appendix 20). The management commentaries of Matas in p2 and p1 show that the purchasing company invests in an overall modernization and expansion of the store network, including tangible investments in store PCs for customer guidance and return label printers. Intangible capital expenditures are associated with investments in online gift certificate systems.

In the first year of PE ownership, 90% of total investments are in goodwill related to acquisition of 24 individually owned Matas stores. The add-on of stores continues during p2 and p3 with the acquisition of 7 and 10 stores. In addition, Matas carries out tangible investments from the opening of 4 new stores and intangible investments in group IT. In later periods, the majority of investments are in tangible assets such as store openings, store security and a new central warehouse. Intangible investments are limited and related to local inventory management systems and the development of a loyalty program.

In the last observation period, goodwill investments increase to account for app. 30% of investments due to the acquisition of two Matas stores. The acquisition activity continues after year-end with the acquisition of the Esthetique chain. As the acquisition of the chain is carried out after year-end, any associated increases in goodwill are not included in the above figure. The nine Esthetique stores are
during subsequent years re-profiled to become Stylebox stores. The new concept introduces in-store styling of customers and adds to the expansion of the store network.

Until the acquisition of Kicks Norge by Axstores, the peer mainly invests in the rebuilding of existing stores to a more environmentally friendly appearance. At the acquisition by Axstores, the number of stores is increased from 76 to 83, and subsequently decreased to 76. This indicates that Axstores adjusts the store portfolio (see figure 54 in appendix 21).

9.2. PWT

In the period prior to PE acquisition, PWT has lower investment activity (0.2 - 2%) than its peer (1 - 4%).

![Figure 12](image)

*Figure 12. Development in investments relative to sales for PWT and Dressmann Norge (peer).* This figure shows the development of net investments as a ratio of sales for PWT and its peer throughout the observation period. The dotted line represents the acquisition of PWT by Polaris. *Source: Own contribution.*

Management commentaries from p-2 and p-1 reveal few investments in the purchasing arms (Eksperto and Hansen & Pedersen). Investments are mainly driven by store company initiatives. Hence, structural differences between the companies, potentially, explain the divergence in the beginning of the observation period.

After the acquisition of Tøjeksperten by Polaris, investments are marginally higher in periods, p2 and p3. In general, PWT invests less than Dressmann. The limited investments in PWT could indicate that the acquisition of Tøjeksperten constitutes the main investment in itself, and is an add-on to the Hansen & Pedersen business, owned by Polaris.

In the period before PE ownership, PWT mainly invests in tangible assets associated with store improvements, while all investments of Dressmann are tangible in the entire period (figure 41-42 in appendix 20). According to management commentaries, the company invests in better visualization of physical stores, pointing towards the same investment profile across the two companies during p2 and p1.

After the acquisition of Tøjeksperten, PWT invests in all three asset categories, but divests goodwill in p1 and p4. In the beginning of the transformation, PWT invests in consolidation of IT systems. PWT differentiates itself from Dressmann by having the wholesale division of Texman. The impact on investments from intangible assets in p1, is mainly related to Texman and the acquisition of the Bison brand. In later periods, electronic repurchasing on store level, supply chain management, automatic reordering in Texman and the development of a customer loyalty program generates the impact from intangible investments.
In p2, PWT opens and acquires 7 stores, reflected in goodwill and tangible investments. In p3, PWT acquires 17 Norwegian Wagner stores from a Norwegian partner, which goes into bankruptcy. The acquisition is assumed to be driving the tangible investments, accounting for nearly 80% of total investments, since PWT is expected to pay no goodwill on assets bought in bankruptcy. In p5, goodwill and tangible investments are driven by the establishment of 7 joint-venture stores in China.

Dressmann invests solely in tangible assets related to store openings. During p1-p4, the peer opens 19 new stores and invests in a new store layout. While Dressmann expands through store openings, PWT grows through store acquisitions and product portfolio investments (tables 55-56 in appendix 21). Thus, the structural development of PWT is quite different from the peer.

9.3. BabySam

During the period prior to acquisition by Polaris, BabySam experiences fluctuating capital expenditures.

![Figure 13. Development in investments relative to sales for BabySam and BH Nordic (peer).](image)

This figure shows the development of investments as a ratio of sales for Matas and its peer throughout the observation period. The dotted line represents the acquisition of BabySam by Polaris. *Source: Own contribution.*

The net divestment in p1 is driven by a decrease in land and buildings. The divestment represents the sale of store buildings from store companies to external parties or the previous store owners. As expected, the private equity fund only acquires the operations of the store companies, while store buildings are divested before the acquisition. The peer company, BH Nordic, carries out investments, equaling 1% of sales.

In p1, BabySam performs considerable investments. In subsequent years, investments are lowered and account for 0 to 3% of sales. In the same period, capital expenditures of BH Nordic fluctuate in the range 7 to 20% of sales.

In the first two periods after acquisition, the investments of BabySam are driven by all investment categories (figure 43 in appendix 20). In the first period, BabySam acquires another Danish retail chain, BabyVest, including 5 stores in Jutland and Funen, strengthening the position on the Danish market. The acquisition of BabyVest is followed by opening, relocation and modernization of stores. Simultaneously, BabySam invests in online ordering systems. The investments in intangible assets are continued in the second year of Polaris ownership with implementation of business intelligence systems, aiming at reducing manual routines.
During the period $p_3$ to $p_6$, BabySam invests in tangible assets focusing on activities in large cities. Store initiatives are supported by a web-shop investment. In $p_6$, the online perspective of BabySam is extended to include the possibility of customers placing orders from mobile phones. Furthermore, customers are now able to buy goods online and pick them up in local stores.

Capital expenditures of BH Nordic are mainly driven by investments in tangible assets and goodwill (figure 44 in appendix 20). During $p_1$-$p_2$, the company fully acquires a Swedish competitor, Rexinus, and a Norwegian creative toy manufacturer. BH Nordic re-profiles acquired stores to the Barnas Hus concept. In subsequent years, the Swedish activities suffer from unsatisfactory performance, and the investment is gradually divested. In $p_6$, BH Nordic aims at improving market share from opening of two, new stores.

Comparing the investment profiles of the two companies, BabySam invests in domestic operations through add-on acquisitions and tailoring of store portfolio, while BH Nordic mainly expands through the acquisition of a Swedish competitor (tables 57-58 in appendix 21).

### 9.4. IDdesign

In the period before PE ownership, the investments of IDdesign amount to 2% of sales, while the peer invests 1%.

![Figure 14. Development in investments relative to sales for IDdesign and Chili (peer)](image)

In the first period of Axcel ownership, investments increases to 8% of sales, followed by pre-acquisition levels of 0-1%. Thus, the majority of investments are carried out in the first full year of PE ownership, while peer investments fluctuate between 1% and 2% of sales.

In $p_4$, IDdesign primarily invests in tangible assets related to relocation of stores, extension of existing store capacity and opening of four new stores. In $p_1$, investments are carried out across all asset categories (figures 45 in appendix 20).

According to the management commentary of $p_1$, size is crucial in the home interior industry. Therefore, IDdesign acquires the ILVA chain and IdeMøbler Herning in the first period of ownership. In the same year, IDdesign invests in tangible assets from centralizing the warehouses of IDdesign and ILVA, and standardizes administrative procedures, assumed to increase intangible investments in IT-infrastructure. In later periods, IDdesign acquires IdeMøbler Odense and transforms two stores into ILVA stores. Given the aim of expansion, the limited investment activity during $p_2$-$p_5$ may be driven by the poor economic
performance by the company, demanding capital injections to be applied for loss coverage rather than investments.

The Swedish peer company solely grows through 17 organic store openings (table 60 in appendix 21). The physical store expansion is supported by investments in an online web-platform.

Thus, while IDdesign has the main aim of growing store network rapidly through acquisitions of individual IDDesign stores and ILVA, Chili steadily expands its store network and online presence without any add-on investments (table 59-60 in appendix 21).

9.5. Cross-case comparison on investment analysis
During the period prior to PE ownership, two out of four cases – Matas and PWT – have lower investments compared to peers. BabySam experiences both investments and divestments, while IDdesign has slightly higher investments compared to peer. In general, investment levels are lower in the voluntary chains than subsequent capital chains.

Table 7
Summary of findings in the Investment Analysis
This table summarizes the main findings on elements investigated in the investment analysis. Investment levels are indicated as a ratio of sales for the respective companies.

<table>
<thead>
<tr>
<th></th>
<th>Matas</th>
<th>PWT</th>
<th>BabySam</th>
<th>IDdesign</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment levels before PE acquisition (Peer)</td>
<td>1 to 2% (5 to 9%)</td>
<td>0 to 2% (1 to 4%)</td>
<td>-3 to 3% (1%)</td>
<td>2% (1%)</td>
</tr>
<tr>
<td>Investment levels during PE ownership, low/high (Peer)</td>
<td>1 to 16% (3 to 10%)</td>
<td>0 to 3% (2 to 5%)</td>
<td>0 to 7% (-7 to 20%)</td>
<td>0 to 8% (1 to 2%)</td>
</tr>
<tr>
<td>Period with largest investment under PE ownership</td>
<td>p1</td>
<td>p1</td>
<td>p1</td>
<td>p1</td>
</tr>
</tbody>
</table>

Source: Own contribution.

The composition of investments in the period before is dominated by local store initiatives and is reflected in tangible capital expenditures. The same is the case for the peer companies.

During PE ownership, case company investments fluctuate and are particularly high in p1 for three out of four cases. This indicates that the PE funds have a deliberate investment plan which is introduced shortly after acquisition. In contrast to the period before, the investment composition consists of all investment categories. Goodwill accounts for a considerable proportion of total investments within the first periods. This indicates an acquisition-based strategy to rapidly grow the newly established capital chains. For Matas, this is reflected in the acquisition of 41 additional Matas stores. In the case of BabySam, it is reflected in the acquisition of 5 BabyVest stores. Lastly, it is reflected in IDdesign, with the acquisition of five ILVA stores. Common for all three investments is an aim to extend the store network and increase
market coverage. In the case of PWT, the acquisition of Tøjeksperten in itself might constitute the store network expansion combined with the later acquisition of 17 Wagner stores that goes bankrupt and additional investments in intangible brand assets. Overall, this suggests that all case companies apply the same expansion strategies.

10. **Operational engineering analysis**

Section 4.8 introduced the decomposition of operational engineering as suggested by the DuPont-framework. This section follows the decomposition by introductorily analysing the overall PE return from ROCE, and subsequently investigating the impact from profit margins and asset turnovers through RNOA. In addition, the impact from financial leverage on operations is shortly investigated. When calculating asset turnovers, total goodwill amounts before any impairment are included to reflect the turnover of the initially acquired firm. In subsequent analyses the focus is narrowed to an emphasis on the RNOA-components: profit margins and net working capital. The profit margin analysis focuses on core profit margins, on which the PE funds are expected to have the highest influence. The net working capital analysis applies cash conversion cycle estimations for investigating core net working capital components – e.g. inventories, trade receivables and trade payables. The total analysis is combined with qualitative investigations of management commentaries for exploring the initiatives taken by the PE funds to drive the development of profit margins and net working capital.

ROCE provides an impression of the returns generated to the PE funds. Ultimately, besides the ability to generate free cash flows, most funds focus on the selling price of a company relative to the purchase price. This may be best captured in the IRR-approach in which the return from selling a company relative to the purchase price is the actual object of investigation. As two out of four case companies are unrealized and the selling price of the residual two is unknown, we are not able to apply this approach. However, the DuPont-framework and ROCE provides us with an impression of period-by-period continuous returns across the holding period, and it provides us with the opportunity for investigating operating and financial return levers systematically. Thus, in our investigations, the DuPont-framework and ROCE provide reasonable tools for analysis.

10.1. **Return on common equity analysis**

Table 8 provides an overview of case and peer company ROCE during the observation period. Appendix 22 includes graphical overviews of the development in ROCE, and the associated composition impacts from operations and financial activities. ROCE is considerably higher in the period before PE acquisition. During the period before, the store companies have relatively small equities, but rather large net incomes. Operating a store in local conditions, which are often well-known by the store owner, does not require the same solvency as operating a levered capital chain. Combining this with the premise that a considerable part of the store owners’ salary is paid out through dividends, drives high ROCE during the period before. Besides the impact from salaries, high financial expenses, stemming from acquisition financing, affect the income statement during the period after acquisition. In total, comparisons of return to shareholders across the two periods should be inferred with caution due to the structural differences.
Table 8 and the analysis aim at investigating the following questions:

- **Are the case companies able to generate shareholder returns during the period of PE ownership relative to peers?**
  *Provides an overview of the ability to generate continuous returns.*

- **Is the development in shareholder returns driven by the impact from operations and/or financial leverage?**
  *Illustrates the ability of the case companies to leverage operational performance.*

### Table 8

**ROCE for case companies and their peers**

This table shows ROCE for case companies and their peers in each observation period. ROCE constitutes the total return to equity holders including impact from other comprehensive income. Thus, the measure can be sensitive towards the inclusion of special financial income which is non-recurring. Such is marked by (*) in the below figure. The numbers are reformulated in accordance to the Penman framework (2013) and corrected for goodwill impairment as described in the introduction to this section. Besides these adjustments, no further have been imposed.

<table>
<thead>
<tr>
<th>Period</th>
<th>p.2</th>
<th>p.1</th>
<th>p.2</th>
<th>p.3</th>
<th>p.4</th>
<th>p.5</th>
<th>p.6</th>
</tr>
</thead>
<tbody>
<tr>
<td>Matas</td>
<td>36.2%</td>
<td>43.4%</td>
<td>-19.3%</td>
<td>-7.8%</td>
<td>3.6%</td>
<td>10.2%</td>
<td>11.2%</td>
</tr>
<tr>
<td>Kicks Norge (Peer)</td>
<td>32.3%</td>
<td>21.5%</td>
<td>12.7%</td>
<td>0.5%</td>
<td>-9.4%</td>
<td>-79.0%</td>
<td>55.1%</td>
</tr>
<tr>
<td>PWT</td>
<td>32.2%</td>
<td>32.7%</td>
<td>7.9%</td>
<td>9.9%</td>
<td>2.5%</td>
<td>0.5%</td>
<td>2.2%</td>
</tr>
<tr>
<td>Dressmann Norge (Peer)</td>
<td>62.4%</td>
<td>55.0%</td>
<td>52.8%</td>
<td>54.3%</td>
<td>37.9%</td>
<td>49.2%</td>
<td>54.1%</td>
</tr>
<tr>
<td>BabySam</td>
<td>39.4%</td>
<td>42.8%</td>
<td>-3.1%</td>
<td>-3.8%</td>
<td>-3.4%*</td>
<td>-7.5%</td>
<td>1.6%*</td>
</tr>
<tr>
<td>BH Nordic (Peer)</td>
<td>43.6%</td>
<td>41.4%</td>
<td>-4.2%</td>
<td>-4.4%</td>
<td>-69.8%</td>
<td>-151.8%</td>
<td>-80.9%</td>
</tr>
<tr>
<td>IDdesign</td>
<td>59.1%</td>
<td>-122.2%</td>
<td>-90.1%</td>
<td>-33.2%</td>
<td>43.6%**</td>
<td>-43.1%</td>
<td></td>
</tr>
<tr>
<td>Chilli (Peer)</td>
<td>33.7%</td>
<td>-10.7%</td>
<td>51.5%</td>
<td>15.0%</td>
<td>-0.9%</td>
<td>-58.6%</td>
<td></td>
</tr>
</tbody>
</table>

*BabySam receives income from financial special items related to a restructuring. If adjusting for this, BabySam generates of -12.4% in p.2 and -3.6% in p.4. **The positive ROCE is generated solely from special financial income related to dilution of minority shareholders during reconstruction. Adjusting for this impact, IDdesign generates ROCE of -50.0%. Source: Own contribution.*

During the majority of periods under PE ownership, Matas and PWT generate positive returns, while BabySam and IDdesign experience negative ROCE. This could indicate that the sample consists of a well performing and a less well performing group. However, when compared to peers, the picture is less unambiguous. In the case of Matas, the performance of the peer company fluctuates, but in four out of six years, Kicks Norge outperforms Matas. Dressmann generates considerably higher returns compared to PWT, pointing towards a relatively better performance of the peer. Adjusting for non-recurring financial items, BabySam and IDdesign provide negative ROCE in all years during PE ownership. However, BabySam outperforms its peer, while IDdesign is outperformed by Chilli. Thus, there is no definite conclusion applicable to the overall performance of the cases. Taken in isolation, Matas and PWT provide positive returns to shareholders throughout the majority of the observation period, while BabySam and IDdesign generate negative returns. This is in line with the previous free cash flow and financial engineering analyses, illustrating that BabySam and IDdesign are suffering from low ability to service debt.
Matas and PWT experience positive contributions from operations during the period of PE fund ownership (figures 48+51 in appendix 22). IDdesign generates negative returns from operations during all years, while operations only in p1 and p2 add positively to ROCE of BabySam (figures 57+54 in appendix 22). Adjusting for non-recurring financial items, BabySam and IDdesign, experience negative influence on ROCE from leverage (figures 64+66 in appendix 23). In all periods after the acquisition by Axcel, IDdesign leverages up negative operating returns, implying an overall worsening of ROCE from the imposing of financial leverage. The same unfortunate combination is observed for BabySam in later periods. Matas increases the positive impact from leverage during PE ownership, while PWT, in most years, experiences a negative influence from financial activities (figures 60+62 in appendix 23). Thus, in general, financial gearing has not been able to add positively to continuous PE returns. Except for Dressmann, the peer companies experience the same overall negative impact from leverage. The lacking ability to earn a return from debt has a particular tough impact on the PE owned companies, since they have relatively high debt levels.

10.2. Profit margins and asset turnovers
This section aims at providing an overall impression of operating performance of case companies during PE ownership. Operating performance is affected by profit margin (PM) and asset turnover (ATO). Therefore, the section investigates the below research questions:

- **Do the case companies generate returns from operations (RNOA) during PE ownership?**
  *Investigating the operational performance of case companies focusing on RNOA.*

- **What drives the ability of the case companies to generate returns from operations (RNOA)?**
  *Investigating profit margin (PM) and asset turnover (ATO) development. The impact from asset turnover (ATO) is decomposed into influence from revenues and net operating assets.*

**Matas**
During the period of PE ownership, Matas increases RNOA from 4.6% to 7.8%. Figure 15 provides an impression of Matas experiencing a two-string improvement in operating returns from both ATO and PM. Figure 67 in appendix 24 provides a comparable overview for the peer.
Figure 15. Decomposed RNOA development during PE ownership for Matas

During the first four years of PE ownership, RNOA is improved solely from PM increases, while ATO improvements drive higher RNOA during the last two years. The positive impact from ATO is driven by increasing revenues and decreasing net operating assets (table 65 in appendix 25).

Compared to its peer, Matas experiences a less volatile development in RNOA, driven by both PM and ATO improvements. During the observation period, Matas reaches the same RNOA level comparable to Kicks Norge.

**PWT**

During the observation period, PWT increases RNOA from less than 1% to 4%. As evident from figure 16, PWT experiences wide fluctuations in both ATO and PM entailing a volatile RNOA development. Figure 68 in appendix 24 provides a comparable overview for the peer.
Figure 16. Decomposed RNOA development during PE ownership for PWT

PWT generates considerably lower returns from operations compared to its peer. While PWT increases RNOA from a relatively low level, Dressmann slightly decreases RNOA from a high level. In the case of PWT, the increase in RNOA is created from an improvement of PM, while the decrease in the case of Dressmann stems from lower ATO. The limited ATO decrease of PWT is driven by decreasing revenues and increasing net operating assets. The decrease in ATO of Dressmann stems from higher increases in net operating assets compared to revenues (Table 66 in appendix 25).

**BabySam**

After the PE acquisition, BabySam experiences a decrease in RNOA from 2.3% to -0.9% as evident from figure 17 below. During the last four years of observation, RNOA amounts to negative values indicating that BabySam creates negative returns from operating activities in the majority of the observation period under PE ownership. Figure 69 in appendix 24 provides a RNOA overview for the peer.
During the first two years of Polaris ownership, BabySam decreases RNOA from 2.3% to -5.2%, mainly from a 10 percentage point decrease in the PM. Thus, BabySam is shortly after the transformation to a capital chain severely affected by a worsening of the revenue-cost relationship.

Both BabySam and BH Nordic experience a decrease in RNOA between $p_2$ and $p_3$. In both cases, the worsening is due to a decreasing PM. In contrary to BH Nordic, BabySam is able to increase RNOA during subsequent periods by increasing the PM. In the last year of observation, both companies generate negative RNOA, albeit at different levels. The lower ATO of BabySam stems from a combination of decreasing revenues and increasing net operating assets (table 67 in appendix 25).

**IDdesign**

During PE ownership, IDdesign generates negative RNOA in the range -8% to -23% as evident from figure 18 below. In the second year of Axcel ownership, RNOA is decreased from -11% to -20%, driven by a decrease in PM and an increase in ATO. The increase in ATO stems from the company increasing revenues at higher speed than net operating assets (figure 68 in appendix 25). This would normally be a positive achievement, but combined with decreasing PM, it constitutes a very unfortunate combination. In this way, IDdesign increases the negative impact from a worsening of PM by increasing the speed at which assets are converted to revenues. This entails that IDdesign loses more from increasing revenues. Figure 70 in appendix 24 provides a RNOA overview for the peer.
Contrary to IDdesign, Chilli obtains positive operating returns in three out of five periods. However, both the initial and final returns observed are negative. In the last period of observation, RNOA is decreased to a final value of -18%. As for IDdesign, the decrease is created by a worsening of PM which is levered by an increase in ATO. Revenues growing at higher speed than net operating assets drive the increase in ATO (table 68 in appendix 25).

Figure 18. Decomposed RNOA development during PE ownership for IDdesign
Cross-case comparison of RNOA

PE funds operate with relatively short investment horizons and have a median holding period of 6 years. Therefore, the object of main interest is the absolute improvement of operational performance during the holding period. From this narrow perspective, the conclusion on RNOA performance is twofold. In absolute terms, Matas and PWT improve RNOA during the observation period, while BabySam and IDdesign experience decreasing operational performance.

Table 9

Cross case comparisons on RNOA

<table>
<thead>
<tr>
<th></th>
<th>Matas</th>
<th>PWT</th>
<th>BabySam</th>
<th>IDdesign</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beginning RNOA (Peer)</td>
<td>4.6% (16.3%)</td>
<td>0.8% (55.9%)</td>
<td>2.3% (-0.4%)</td>
<td>-10.6% (-1.2%)</td>
</tr>
<tr>
<td>End RNOA (Peer)</td>
<td>7.8% (7.1%)</td>
<td>4.0% (49.9%)</td>
<td>-0.9% (-78.7%)</td>
<td>-22.6% (-18.3%)</td>
</tr>
<tr>
<td>RNOA development (Peer)</td>
<td>Increasing (Decreasing)</td>
<td>Increasing (Decreasing)</td>
<td>Decreasing (Decreasing)</td>
<td>Decreasing (Decreasing)</td>
</tr>
<tr>
<td>RNOA development driver</td>
<td>Profit margin (+)</td>
<td>Profit margin (+)</td>
<td>Profit margin (-)</td>
<td>Profit margin (-)</td>
</tr>
<tr>
<td>Asset turnover (+)</td>
<td>Asset turnover (-)</td>
<td>Asset turnover (-)</td>
<td>Asset turnover (-)</td>
<td>Asset turnover (-)</td>
</tr>
<tr>
<td>Asset turnover drivers</td>
<td>Revenue increase</td>
<td>Revenue decrease</td>
<td>Revenue decrease</td>
<td>Revenue increase</td>
</tr>
<tr>
<td>NOA decrease</td>
<td>NOA increase</td>
<td>NOA increase</td>
<td>NOA increase</td>
<td>NOA decrease*</td>
</tr>
</tbody>
</table>

*For IDdesign, this combination is very unfortunate since it lever negative profit margins. Source: Own contribution.

Focusing on the drivers of RNOA, profit margins of Matas and PWT increase. As the only company, Matas is able to achieve improvements from increasing asset turnover driven by strengthened revenues on fewer net operating assets. BabySam and IDdesign experience negative impact on RNOA from both profit margins and asset turnover.

Taking into account the performance of the respective peers, the conclusion is less obvious. Matas increases RNOA from a lower level than its peer to a comparable level. PWT increases RNOA from a remarkably lower level, but still operates on a lower level compared to peer in the last period. BabySam and IDdesign, as well as their peers, generate decreasing RNOA. However, the RNOA of BabySam decreases to a higher level than its peer, implying relatively better performance. The operational performance of IDdesign worsens to a lower level than peer.
10.3. Profit margin drivers

PE funds attempt to improve profit margins to increase enterprise value during ownership. Their focus is on the development of profit margins rather than their initial levels, since the development drives changes in enterprise value. Therefore, this analysis emphasizes the development of core profit margin drivers under influence by the PE fund and the initiatives taken to improve them. Focusing on the core profit margin also improves comparability of performance to peers, since it is not affected by differences in tax rules and/or depreciation standards.

The core profit margin drivers are: revenue, COGS, staff costs and other operating costs.

The aim is to investigate the following research questions:

1. **Do case companies improve absolute profit margins during PE ownership?**
   *This provides an idea of the absolute performance for each case company.*

2. **Do case companies improve profit margins relative to their peers during PE ownership?**
   *This provides insights on the relative profit margin development corrected for peer performance.*

3. **What initiatives do the PE funds employ to improve profit margins?**
   *This provides insights into the underlying causes of acquisition, and what PE funds perceive as value enhancing initiatives to grow enterprise value in the previous voluntary chains.*

4. **What are the similarities or differences across cases in the development of profit margin performance and the underlying initiatives imposed to improve item?**
   *This increases the overall understanding of profit margin performance and the initiatives imposed during PE fund ownership to increase enterprise value in previous Danish voluntary chains.*

The analysis is based on reformulated financial statements that track revenues and operational profit margin drivers. The impact of drivers, from the first 12-month period of PE ownership to the latest available 12-month period, is the point of investigation. The main drivers’ impact on profit margin is reported as either positive (green) or negative effect (red). The emphasis is on profit margins before minority interests, since these provide a better reflection of operational performance adjusted for ownership structures. Subsequently, the initiatives taken to improve profit margins are investigated and is concluded on in a cross case comparison.

The identification of macro effects, revenue drivers and other profit margin drivers is based on coding of management commentaries. These are referred to in each section. Information on the net openings and acquisitions of stores is found in appendix 21, while profitability drivers for peers are found in appendix 26.
10.3.1. Matas

Matas has managed to increase revenues by 11.8% from DKK 2.86 bn. in p₁ to DKK 3.2 bn. in p₆. In the same period, Kicks Norge increases revenues by 17.7%. The higher increase of Kicks Norge is partly expected to be driven by a lower initial level of revenues (table 73 in appendix 27).

Table 10

Matas’ profitability drivers and impact as a ratio of revenue

This table shows period-on-period development and composition of operational profit margins before any financial influence. All numbers are corrected for non-recurring special items. The impact from p₁ to p₆ indicates the development under PE ownership and its influence on profit margins. The impact relative to peer during the same period illustrates the development when controlling for macro and industry effects.

<table>
<thead>
<tr>
<th>Period</th>
<th>p₂</th>
<th>p₁</th>
<th>p²</th>
<th>p₁</th>
<th>p³</th>
<th>p₄</th>
<th>p₅</th>
<th>p₆</th>
<th>Impact from p₁ to p₆</th>
<th>Impact relative to peer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue (million DKK)</td>
<td>2.616</td>
<td>2.875</td>
<td>2.861</td>
<td>3.011</td>
<td>2.948</td>
<td>2.992</td>
<td>3.097</td>
<td>3.200</td>
<td>11.8%</td>
<td>-5.9%**</td>
</tr>
<tr>
<td>- COGS</td>
<td>-53.3%</td>
<td>-53.8%</td>
<td>-56.7%</td>
<td>-56.7%</td>
<td>-55.0%</td>
<td>-55.0%</td>
<td>-54.4%</td>
<td>-54.0%</td>
<td>-2.7%</td>
<td>-2.9%</td>
</tr>
<tr>
<td>Gross Margin</td>
<td>46.7%</td>
<td>46.2%</td>
<td>41.9%</td>
<td>43.3%</td>
<td>45.0%</td>
<td>45.0%</td>
<td>45.6%</td>
<td>46.0%</td>
<td>2.7%</td>
<td>2.9%</td>
</tr>
<tr>
<td>- Staff costs</td>
<td>-16.0%</td>
<td>-16.1%</td>
<td>-18.8%</td>
<td>-19.7%</td>
<td>-19.4%</td>
<td>-18.6%</td>
<td>-18.0%</td>
<td>-18.1%</td>
<td>-0.7%</td>
<td>-11.2%</td>
</tr>
<tr>
<td>- Other operating costs*</td>
<td>-19.1%</td>
<td>-17.5%</td>
<td>-9.4%</td>
<td>-8.9%</td>
<td>-9.2%</td>
<td>-8.7%</td>
<td>-8.9%</td>
<td>-9.5%</td>
<td>0.1%</td>
<td>12.2%</td>
</tr>
<tr>
<td>- Depreciations and amortizations</td>
<td>-2.0%</td>
<td>-1.9%</td>
<td>-4.4%</td>
<td>-4.3%</td>
<td>-4.6%</td>
<td>-4.2%</td>
<td>-4.0%</td>
<td>-4.1%</td>
<td>-0.3%</td>
<td>-1.8%</td>
</tr>
<tr>
<td>Sales PM before Tax</td>
<td>9.6%</td>
<td>10.7%</td>
<td>7.7%</td>
<td>10.4%</td>
<td>11.8%</td>
<td>13.5%</td>
<td>14.7%</td>
<td>14.3%</td>
<td>3.6%</td>
<td>5.6%</td>
</tr>
<tr>
<td>- Operating tax</td>
<td>-2.7%</td>
<td>-2.9%</td>
<td>-3.0%</td>
<td>-3.9%</td>
<td>-4.1%</td>
<td>-4.0%</td>
<td>-4.3%</td>
<td>-4.2%</td>
<td>-1.1%</td>
<td>1.7%</td>
</tr>
<tr>
<td>+ Dirty surplus items</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
</tr>
<tr>
<td>- Operating special items</td>
<td>0.0%</td>
<td>0.5%</td>
<td>-1.4%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>-0.01%</td>
<td>0.05%</td>
<td>0.0%</td>
<td>1.4%</td>
<td>1.4%</td>
</tr>
<tr>
<td>- Tax expense on operating special items</td>
<td>0.0%</td>
<td>-0.1%</td>
<td>0.3%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>-0.3%</td>
<td>-0.3%</td>
</tr>
<tr>
<td>PM after Tax. before Minority Interests</td>
<td>6.9%</td>
<td>8.2%</td>
<td>6.7%</td>
<td>6.5%</td>
<td>7.8%</td>
<td>9.5%</td>
<td>10.4%</td>
<td>10.2%</td>
<td>3.5%</td>
<td>4.9%</td>
</tr>
<tr>
<td>- Minority shareholders share of profit margins</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
</tr>
<tr>
<td>PM after Tax. after Minority Interests</td>
<td>6.9%</td>
<td>8.2%</td>
<td>6.6%</td>
<td>6.5%</td>
<td>7.8%</td>
<td>9.5%</td>
<td>10.4%</td>
<td>10.2%</td>
<td>3.5%</td>
<td>4.9%</td>
</tr>
</tbody>
</table>

*= Positive impact  
= Negative impact

* For comparison reasons external costs have been relocated to other operating costs  **Impact corrected for exchange rate effects. Source: Own contribution.

In the period under PE ownership, Matas increases profitability by 3.5%-points from 6.7% to 10.2%. The increase in absolute profitability is primarily explained by a decrease in COGS of -2.7%-points, decreasing staff-costs of -0.7%-points, but is negatively influenced by a slight increase in other operating expenses of 0.1%-points. Kicks Norge decreases profitability from 3.5% in p₁ to 2.0% p₆. Hence, relative to its peer, Matas improves profitability with 4.9%-points. This is driven by a relatively better performance on COGS and other operating costs, while Kicks decreases staff costs considerably more than Matas due to a re-profiling and restructuring to a new concept. Focusing solely on the drivers under primary influence by
the PE fund\textsuperscript{18}, the \textbf{absolute improvement is 3.3\%-points}, while \textbf{the relative improvement is 3.9\%-points} as a ratio of revenue.

According to the management commentaries of Matas, revenues are generally negatively affected from the external market conditions during CVC ownership. Matas reports that they face increased competition from supermarkets, and that consumers are more reluctant due to the economic crises (table 74 in appendix 27). This is in great contrast to the period before PE ownership that was characterized by low interest rates, low unemployment, tax stops, and increased consumer spending as well as willingness to spend on self-indulgence (Matas, 2005/2006). Danish retail sales of cosmetics and personal care products grows prior to PE acquisition, but experiences a decrease in the periods $p_0$-$p_3$ for hereafter to gradually improve. In contrast, the Norwegian market steadily grows (figure 21 in appendix 7). Despite this environment, Matas increases overall revenues during the PE ownership period.

**Initiatives employed to grow revenues in the group**

Matas employs group initiatives on four key areas to grow revenues during PE ownership (table 75 in appendix 27):

1) **Rebuilding, relocation and expansion of store-network**: Initially, Matas focuses on acquisitions of existing Matas stores, and less on organic growth. In-store facilities are rebuilt to become more appealing, and stores are relocated to more attractive locations.

2) **Product assortment development – focus on private label**: Matas continuously introduces a series of new private label product lines targeted to specific customer segments.

3) **Focus on employee training**: An increased focus on employee training is initiated to increase sales and service in the stores based on uniform concepts and best practice.

4) **Online sales and/or loyalty program**: To increase customer loyalty and retention, Matas introduces the loyalty program, Club Matas, and invests to improve its online web-shop in $p_4$. These investments continue in $p_5$ and $p_6$, and the loyalty program grows substantially period-on-period.

Additional initiatives are taken with respect to IT infrastructure investments in sales excellence in $p_5$. During difficult market conditions ($p_1$-$p_3$), revenue growth stems from the middle-price segment, while in $p_6$, growth comes from more high-end products in improved market conditions. This is interpreted as Matas being adaptable towards changing markets through its product offerings in the middle-price segment. Additionally, online sales increase. In $p_6$, it accounts for approximately 1\% of total revenues.

Kicks Norge takes similar initiatives. It focuses on rebranding and change of physical appearance of stores combined with an increasing assortment to grow revenues. Furthermore, it introduces the loyalty concept Kicks Club. The main difference is that Kicks grows its store network organically. This is in contrast to Matas’ acquisition-based approach. This difference may be explained in differences in investment horizons and can be interpreted as an increasing sense of urgency for the PE fund to grow the store network.

\textsuperscript{18}These are: COGS, external costs/other operating costs and staff costs
Initiatives employed to further improve profit margins

The PE fund not only employs initiatives directly linked to improve revenues. It also attempts to employ other initiatives, not directly linked to revenues in order to improve profit margins (table 76 in appendix 27).

In the period of PE ownership, Matas continuously invests in IT infrastructure. This could indicate, that there is a rationalization potential, operating the entire chain on an integrated platform. On a store level, the inventory system, implemented in p_2, leverages data from stores in order to improve future purchasing and forecasting of sales. From p_4 and onwards, there is an indication that the leveraging of data enables Matas to adjust assortments to each individual store based on its size and consumer preferences. This indicates that Matas exploits consumer insights to increase the profitability in individual stores.

During PE fund ownership, Matas continuously improves purchasing agreements (p_1+p_3) as well as enters into partnership agreements with important suppliers. This indicates that the PE fund perceives potential for pressuring suppliers for better terms, but at the same time, extends collaboration to improve future purchasing agreements and product offerings. This could also explain the decreasing COGS, which is the major driver of profitability improvements during PE ownership.

Matas also invests in in-store security. This could indicate that theft is an issue that previously decreased profitability in stores. Additionally, Matas invests in streamlining and structural changes related to general cost reductions. This could potentially explain the reduction in staff costs, and indicates that standardization of procedures and implementation of best practices decrease the relative impact from staff costs on profitability.

The cost reduction focus in Kicks Norge revolves around rent costs and practices related to product supply with an emphasis on automated product ordering. However, Kicks Norge does not achieve the same cost reduction improvements as Matas. This can explain the relative difference in the development of COGS between the two firms.
### 10.3.2. PWT

PWT decreases revenues in the period of PE ownership by -4.5% from DKK 872 m. in p\textsubscript{1} to DKK 832, in p\textsubscript{5}. In the same period, Dressmann increases revenues by 19.8% (table 77 in appendix 28).

#### Table 11

**PWT's profitability drivers and impact as a ratio of revenue**

This table shows period-on-period development and composition of operational profit margins before any financial influence. All numbers are corrected for non-recurring special items. The impact from p\textsubscript{1} to p\textsubscript{5} indicates the development under PE ownership and its influence on profit margins. The impact relative to peer during the same period illustrates the development when controlling for macro and industry effects.

<table>
<thead>
<tr>
<th>Period</th>
<th>p\textsubscript{2}</th>
<th>p\textsubscript{1}</th>
<th>p\textsubscript{2}</th>
<th>p\textsubscript{1}</th>
<th>p\textsubscript{3}</th>
<th>p\textsubscript{4}</th>
<th>p\textsubscript{5}</th>
<th>Impact from p\textsubscript{1} to p\textsubscript{5}</th>
<th>Impact relative to peer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue (million DKK)</td>
<td>857</td>
<td>933</td>
<td>872</td>
<td>817</td>
<td>831</td>
<td>820</td>
<td>832</td>
<td>-4.5%</td>
<td>-24.3%</td>
</tr>
<tr>
<td>- COGS</td>
<td>-56.2%</td>
<td>-55.9%</td>
<td>-52.5%</td>
<td>-46.7%</td>
<td>-46.3%</td>
<td>-46.0%</td>
<td>-45.4%</td>
<td>-71.1%</td>
<td>0.5%</td>
</tr>
<tr>
<td>- External costs**</td>
<td>-21.8%</td>
<td>-21.5%</td>
<td>-19.7%</td>
<td>-21.6%</td>
<td>-23.1%</td>
<td>-22.5%</td>
<td>-21.9%</td>
<td>2.3%</td>
<td>1.0%</td>
</tr>
<tr>
<td>Gross Margin</td>
<td>22.0%</td>
<td>22.6%</td>
<td>27.9%</td>
<td>31.7%</td>
<td>30.7%</td>
<td>31.5%</td>
<td>32.7%</td>
<td>4.8%</td>
<td>-1.0%</td>
</tr>
<tr>
<td>- Staff costs</td>
<td>-13.5%</td>
<td>-13.7%</td>
<td>-24.3%</td>
<td>-22.5%</td>
<td>-23.3%</td>
<td>-24.1%</td>
<td>-23.9%</td>
<td>-0.4%</td>
<td>-1.6%</td>
</tr>
<tr>
<td>- Depreciations and amortizations</td>
<td>-1.1%</td>
<td>-1.3%</td>
<td>-1.9%</td>
<td>-2.0%</td>
<td>-2.6%</td>
<td>-2.8%</td>
<td>-2.2%</td>
<td>0.4%</td>
<td>0.8%</td>
</tr>
<tr>
<td>= Sales PM before Tax</td>
<td>7.4%</td>
<td>7.7%</td>
<td>1.7%</td>
<td>7.2%</td>
<td>4.8%</td>
<td>4.6%</td>
<td>6.6%</td>
<td>4.9%</td>
<td>0.5%</td>
</tr>
<tr>
<td>- Operating tax</td>
<td>-0.9%</td>
<td>-1.2%</td>
<td>0.1%</td>
<td>-1.2%</td>
<td>-0.4%</td>
<td>-0.8%</td>
<td>-1.3%</td>
<td>1.4%</td>
<td>0.4%</td>
</tr>
<tr>
<td>= Sales PM after Tax</td>
<td>6.5%</td>
<td>6.5%</td>
<td>1.8%</td>
<td>6.0%</td>
<td>4.4%</td>
<td>3.9%</td>
<td>5.3%</td>
<td>3.5%</td>
<td>1.6%</td>
</tr>
<tr>
<td>- Dirty surplus items from equity statement</td>
<td>0.0%</td>
<td>0.0%</td>
<td>-1.1%</td>
<td>2.3%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>-1.1%</td>
<td>-1.1%</td>
</tr>
<tr>
<td>= Sales PM after dirty surplus items</td>
<td>6.5%</td>
<td>6.5%</td>
<td>0.7%</td>
<td>8.3%</td>
<td>4.4%</td>
<td>3.9%</td>
<td>5.3%</td>
<td>4.6%</td>
<td>1.6%</td>
</tr>
<tr>
<td>+ Operating special items</td>
<td>0.1%</td>
<td>-0.1%</td>
<td>-1.5%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>-0.6%</td>
<td>-0.5%</td>
<td>-1.0%</td>
<td>-1.0%</td>
</tr>
<tr>
<td>- Tax expense ratio on operating special items</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.4%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.2%</td>
<td>0.1%</td>
<td>0.3%</td>
<td>0.1%</td>
</tr>
<tr>
<td>= PM after Tax. before Minori Interests</td>
<td>6.6%</td>
<td>6.4%</td>
<td>-0.4%</td>
<td>8.3%</td>
<td>4.4%</td>
<td>3.4%</td>
<td>5.0%</td>
<td>5.3%</td>
<td>2.4%</td>
</tr>
<tr>
<td>- Minority shareholders share of profit margins</td>
<td>0.0%</td>
<td>0.0%</td>
<td>1.2%</td>
<td>-1.1%</td>
<td>-0.7%</td>
<td>-0.2%</td>
<td>-0.7%</td>
<td>-1.8%</td>
<td>-1.8%</td>
</tr>
<tr>
<td>= PM after Tax. after Minority Interests</td>
<td>6.6%</td>
<td>6.4%</td>
<td>0.8%</td>
<td>7.2%</td>
<td>3.7%</td>
<td>3.3%</td>
<td>4.3%</td>
<td>3.5%</td>
<td>0.5%</td>
</tr>
</tbody>
</table>

**Other operating costs have been moved to external costs for comparison reasons to peer. Source: Own contribution.**

In the period under PE ownership, PWT increases profitability by 5.3%-points from -0.4% to 5.0%. The increase in absolute profitability is primarily explained by a decrease in COGS of -7.1%-points, decreasing staff costs of -0.4%-points and dirty surplus items, but is negatively influenced by a slight increase in external costs of 2.3%-points and operating special items. Dressmann increases profitability from 12.3% in p\textsubscript{1} to 15.2% p\textsubscript{5}. Hence, relative to its peer, PWT improves profitability with 2.4%-points, but from a
remarkably lower level\textsuperscript{19}. This is driven by staff costs, dirty surplus items and operating special items, while Dressmann performs relatively better on external costs and COGS. Focusing solely on the elements under the primary influence by the PE fund\textsuperscript{20}, the \textbf{absolute improvement is 5.2\%-points} while the \textbf{relative improvement is limited to 0.1\%-points} as a ratio of revenue.

According to PWT, revenues are negatively affected by a difficult external environment (table 78 in appendix 28). This affects the clothing industry, impacting its two retail chains Wagner and Tøjeksperten, as well as wholesales and exports from Texman. In general, Danish retail sales of clothing are lower in the period after PE acquisition compared to the period before (table 22 in appendix 7). The opposite is the case for the Norwegian market. This could explain parts of the absolute revenue decrease in PWT and the comparable increase in revenues for Dressmann.

\textbf{Initiatives employed to grow revenues in the group}

PWT employs group initiatives on three key areas in an attempt to grow revenues during PE ownership (table 79 in appendix 28).

1) **Rebuilding, relocation and expansion of store-network:** Subsequent to the acquisition of Tøjeksperten, PWT expands its store network by acquiring 17 Wagner stores in Norway in p\textsubscript{3}, and the opening of own-brand stores in China in p\textsubscript{5}. Furthermore, several stores are closed and relocated to better locations.

2) **Product assortment development - focus on own brands:** Throughout the observation period, PWT concentrates on building and acquiring own brands (e.g. Bison in p\textsubscript{1}). Clothing from own brands is sold through exports and via the two retail chains. Tøjeksperten increases the number of own brands throughout the period.

3) **Focus on exports** Texman focuses on export of own brands to independent retailers. The number of export countries increases during the period from 11 to 20. In p\textsubscript{4}, PWT shifts from using agents to having its own sales force.

4) **Online sales and/or loyalty program:** PWT increases investments in the loyalty program in p\textsubscript{4} and p\textsubscript{5}. It also invests in a point-shop where customers can spend points obtained through the loyalty program on gifts online.

Furthermore, PWT increases control and follow-up on store performance and campaigns. It also invests in an electronic repurchasing system to improve service in stores, by securing the availability of basic products in all given sizes. This increases the probability for additional sales of other products.

The Tøjeksperten concept is focused on quality clothing to fashion-concerned men in all ages with own and foreign brands. Wagner focuses on “value-for-money”, primarily, by selling own brands. During PE ownership, revenues of the acquired Tøjeksperten chain decreases until p\textsubscript{3} where it stabilizes. In contrast, Texman and Wagner experience better revenue performance (table 79 in appendix 28). Thus,

\textsuperscript{19} Dressmann’s profitability has been corrected for a series of poor impact from international operations reported as financial income from investments in financial assets to isolate the Norwegian operations. This could indicate that the differences in revenue development is due to differences between the Norwegian and the Danish market for clothing (See attached CD for more information).

\textsuperscript{20} These are: COGS, external costs/other operating costs and staff costs
Tøjeksperten drives the negative revenue development in the beginning of the PE ownership period. Assuming that the higher-priced concept of Tøjeksperten is more exposed to macro-economic volatility, PWT has increased its overall exposure with the extension of the store network.

When comparing to PWTs initiatives taken prior to acquisition, it is evident that the strategy was very simple in the purchasing divisions, since it solely reports a focus on marketing efforts to improve market share. Comparing to Dressmann, it focuses on commercializing products to adult men at the lowest prices by developing its stores visually and expanding the store network organically in Norway. The differences in pricing could explain why PWT with the acquisition of Tøjeksperten has a negative revenue development compared to its peer.

**Initiatives employed to further improve profitability**

In the first two periods (p1-p2), PWT consolidates and centralizes back-offices, physical headquarters, IT systems, warehousing and purchasing functions across the chains (table 80 in appendix 28). The consolidation could explain the relative improvement in staff costs compared to its peer, since some positions after the acquisition overlap. Additionally, PWT liquidates unprofitable stores.

In p4, PWT reports on positive results from streamlining the purchasing process. This is assumed to bring down costs, due to improvements in purchasing agreements. However, the results could also be attributed to the market development, since Dressmann and PWT experience comparable decreases in COGS. Throughout the period, PWT reports a general focus on streamlining, professionalization and optimization of group processes.

Dressmann Norge reports rather limited on its cost reduction initiatives. It imposes a cost saving program to meet economic downturn and additionally focuses on optimizing the store spacing areas. Hence, it is difficult conclude whether the initiatives imposed by PWT are similar to that of the industry.
10.3.3. BabySam

BabySam decreases revenues in the period of PE ownership by -25.5%, from DKK 491 m. in p₁ to DKK 366 million, in p₆. In the same period, BH Nordic increases revenues by 4% (table 81 in appendix 29).

Table 12

BabySam's profitability drivers and impact as a ratio of revenue

This table shows period-on-period development and composition of operational profit margins before any financial influence. All numbers are corrected for non-recurring special items. The impact from p₁ to p₆ indicates the development under PE ownership and its influence on profit margins. The impact relative to peer during the same period illustrates the development when controlling for macro and industry effects.

<table>
<thead>
<tr>
<th>Period</th>
<th>p-2</th>
<th>p₁</th>
<th>p₂</th>
<th>p₃</th>
<th>p₄</th>
<th>p₅</th>
<th>p₆</th>
<th>Impact from p₁ to p₆</th>
<th>Impact relative to peer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue (million DKK)</td>
<td>432</td>
<td>484</td>
<td>491</td>
<td>475</td>
<td>451</td>
<td>386</td>
<td>379</td>
<td>366</td>
<td>-25.5%</td>
</tr>
<tr>
<td>- COGS</td>
<td>-46.3%</td>
<td>-46.3%</td>
<td>-57.3%</td>
<td>-58.3%</td>
<td>-59.9%</td>
<td>-56.1%</td>
<td>-58.6%</td>
<td>-56.5%</td>
<td>-0.9%</td>
</tr>
<tr>
<td>- External costs**</td>
<td>-24.4%</td>
<td>-25.0%</td>
<td>-17.5%</td>
<td>-16.5%</td>
<td>-20.8%</td>
<td>-19.5%</td>
<td>-20.8%</td>
<td>-19.3%</td>
<td>1.8%</td>
</tr>
<tr>
<td>Gross Margin</td>
<td>29.3%</td>
<td>28.7%</td>
<td>25.2%</td>
<td>25.2%</td>
<td>19.3%</td>
<td>24.4%</td>
<td>20.7%</td>
<td>24.2%</td>
<td>-1.0%</td>
</tr>
<tr>
<td>- Staff costs</td>
<td>-14.3%</td>
<td>-13.3%</td>
<td>-20.7%</td>
<td>-21.3%</td>
<td>-22.7%</td>
<td>-25.7%</td>
<td>-23.9%</td>
<td>-24.2%</td>
<td>3.5%</td>
</tr>
<tr>
<td>- Depreciations and amortizations</td>
<td>-1.7%</td>
<td>-1.4%</td>
<td>-1.6%</td>
<td>-2.2%</td>
<td>-2.8%</td>
<td>-2.1%</td>
<td>-2.0%</td>
<td>-1.5%</td>
<td>-0.1%</td>
</tr>
<tr>
<td>Sales PM before Tax</td>
<td>13.4%</td>
<td>14.0%</td>
<td>2.8%</td>
<td>1.7%</td>
<td>-6.2%</td>
<td>-3.4%</td>
<td>-5.2%</td>
<td>-1.5%</td>
<td>-4.3%</td>
</tr>
<tr>
<td>- Operating tax</td>
<td>-3.6%</td>
<td>-3.4%</td>
<td>-0.5%</td>
<td>-0.5%</td>
<td>-1.9%</td>
<td>-2.1%</td>
<td>2.1%</td>
<td>-0.2%</td>
<td>0.3%</td>
</tr>
<tr>
<td>Sales PM after Tax</td>
<td>9.8%</td>
<td>10.6%</td>
<td>2.3%</td>
<td>1.2%</td>
<td>-8.2%</td>
<td>-5.5%</td>
<td>-3.1%</td>
<td>-1.7%</td>
<td>-4.0%</td>
</tr>
<tr>
<td>- Dirty surplus items</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
</tr>
<tr>
<td>Sales PM after dirty surplus items</td>
<td>9.8%</td>
<td>10.6%</td>
<td>2.3%</td>
<td>1.2%</td>
<td>-8.2%</td>
<td>-5.5%</td>
<td>-3.1%</td>
<td>-1.7%</td>
<td>-4.0%</td>
</tr>
<tr>
<td>+ Operating special items</td>
<td>0.1%</td>
<td>0.1%</td>
<td>0.0%</td>
<td>-0.6%</td>
<td>-0.8%</td>
<td>-3.7%</td>
<td>-1.9%</td>
<td>-0.5%</td>
<td>0.5%</td>
</tr>
<tr>
<td>- Tax expense ratio on operating special items</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.1%</td>
<td>0.2%</td>
<td>0.9%</td>
<td>0.5%</td>
<td>0.1%</td>
<td>-0.1%</td>
</tr>
<tr>
<td>PM after Tax before Minority Interests</td>
<td>9.9%</td>
<td>10.7%</td>
<td>2.4%</td>
<td>0.7%</td>
<td>-8.8%</td>
<td>-8.3%</td>
<td>-4.5%</td>
<td>-2.0%</td>
<td>-4.4%</td>
</tr>
<tr>
<td>- Minority shareholders share of profit margins</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.3%</td>
<td>0.6%</td>
<td>2.1%</td>
<td>3.3%</td>
<td>0.0%</td>
<td>0.6%</td>
<td>-0.3%</td>
</tr>
<tr>
<td>PM after Tax after Minority Interests</td>
<td>9.9%</td>
<td>10.7%</td>
<td>2.7%</td>
<td>1.3%</td>
<td>-6.7%</td>
<td>-5.0%</td>
<td>-4.5%</td>
<td>-1.5%</td>
<td>-4.1%</td>
</tr>
</tbody>
</table>

= Positive impact on PM
= Negative impact on PM

**Notice: For comparison reasons costs have been relocated from other operating costs to external costs. Source: Own contribution.

In the period of PE ownership, BabySam decreases profit margins by -4.4%-points from 2.4% to -2.0%. The decrease in absolute profit margins is primarily explained by increasing external and staff costs, while decreasing COGS affects positively. BH Nordic decreases profit margins from -0.10% in p₁ to -28.5% in p₆. Even though both companies experience decreasing profit margins, BabySam’s profit margin decreases less than its peer. The relative “improvement” is driven by better performance on external and staff costs, while COGS relatively worsens. Focusing solely on the elements under the primary influence by
the PE fund\textsuperscript{21}, the absolute worsening is -4.4\%-points, while relative to its peer, BabySam “improves” profit margins by 18.3\%-points. The overall decrease in profit margins across the two companies could indicate that the industry in general is affected negatively by the macro environment.

According to BabySam, revenues are negatively affected by a very challenging external environment (table 82 in appendix 29). BabySam reports that they face increased competition from online sales, second-hand markets and a decreasing birth rate due to the financial crisis. The Danish retail sales of baby equipment and children’s clothing decreases dramatically in the period after acquisition by Polaris compared to the period before. The same development is evident its peer’s primary market, Norway (table 23 in appendix 7). This could explain the revenue decrease and is expected to impact profitability negatively.

**Initiatives employed to grow revenues in the group**

BabySam employs group initiatives on four key areas in an attempt to grow revenues during PE ownership (table 83 in appendix 29).

1) **Rebuilding, relocation and expansion of store-network:** Throughout the period, BabySam modernizes, expands and relocates stores. It focuses on larger stores located in larger cities while closing smaller stores. Additionally, BabySam increases its store-network, by acquiring BabyVest’s five stores in p\textsubscript{1}.

2) **Product assortment development – focus on homogenization:** Introduction of a new and improved product assortment in collaboration with key suppliers and an increased focus on clothing.

3) **Focus on employee training:** A primary focus is on education of employees to offer a high service level. This is especially present within high expenditure product areas such as prams, baby carriages and car security seats.

4) **Online sales and/or loyalty program:** Due to increased competition from online retailers, BabySam increases efforts to grow sales online by investing in its web and mobile-platforms.

In addition, BabySam increases marketing effort by intensifying distribution of product catalogues in p\textsubscript{1}. The product catalogues are object for further initiatives during later periods. Here, content is increased and developed in collaboration with key suppliers. Throughout the period, increased online sales, improved product assortment with a focus on clothes and relocation of stores contribute positively to revenue development (table 83 in appendix 29).

BabySam’s peer performs a series of acquisitions to increase revenues and consolidate the industry in Norway and Sweden. The expansion grows revenues substantially, but the profit margins do not follow and the company divests Swedish activities in p\textsubscript{3} and later reconstructs in p\textsubscript{4}. The mean of growth through acquisition is similar for the two companies. Due to difficult market conditions, this growth strategy has proved challenging.

\textsuperscript{21} These are: COGS, external costs/other operating costs and staff costs
Initiatives employed to further improve profit margins

In p₁, BabySam invests in a new IT system. Additionally, it focuses on standardization and consolidation of marketing and business processes/manuals. Furthermore, it negotiates new supplier agreements to improve purchasing prices (table 84 in appendix 29). This indicates that the primary levers of profitability are within optimization and standardization of business processes, a strong focus to improve assortments and lower prices with suppliers.

The implementation of the IT system is done to leverage data from stores with the purpose of benchmarking and more effectively take managerial decisions and improve future supplier agreements. BabySam focuses on improving gross margin by continuously adapting its assortment in close collaboration with important suppliers. On a store level, BabySam introduces a uniform shop design, and relocates stores to larger sites in bigger cities. This is underlined by establishment of four flagship stores in the largest Danish cities in p₁. It indicates that the structure of the store network prior to acquisition does not reflect the strategy, the PE fund has for the store network.

BabySam’s peer primarily focuses on a uniform product platform and supplier agreements to consolidate and streamline the product assortment in the series of stores they acquire. These initiatives are in line with those of BabySam.
10.3.4.  IDdesign

IDdesign increases revenues by 23% from DKK 1.35 bn in p1 to DKK 1.66 bn. in p5. In the same period, Chilli increases revenues by 132%. The higher increase of Chili is expected to be driven by a remarkably lower initial level of revenues (table 85 in appendix 30).

Table 13

IDDesign's profitability drivers and impact as a ratio of revenue

This table shows period-on-period development and composition of operational profit margins before any financial influence. All numbers are corrected for non-recurring special items. The impact from p1 to p5 indicates the development under PE ownership and its influence on profit margins. The impact relative to peer during the same period illustrates the development when controlling for macro and industry effects.

<table>
<thead>
<tr>
<th>Period</th>
<th>p-1</th>
<th>p1</th>
<th>p2</th>
<th>p3</th>
<th>p4</th>
<th>p5</th>
<th>Impact from p1 to p5</th>
<th>Impact relative to peer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue (million DKK)</td>
<td>1.217</td>
<td>1.352</td>
<td>1.649</td>
<td>1.660</td>
<td>1.647</td>
<td>1.657</td>
<td>23%</td>
<td>-1.10%</td>
</tr>
<tr>
<td>- COGS</td>
<td>-74.8%</td>
<td>-68.9%</td>
<td>-59.8%</td>
<td>-59.9%</td>
<td>-59.8%</td>
<td>-58.5%</td>
<td>10.3%</td>
<td>7.4%</td>
</tr>
<tr>
<td>- External costs**</td>
<td>-9.8%</td>
<td>-18.7%</td>
<td>-25.3%</td>
<td>-22.8%</td>
<td>-23.5%</td>
<td>-24.8%</td>
<td>-6.1%</td>
<td>-1.9%</td>
</tr>
<tr>
<td>Gross Margin</td>
<td>15.4%</td>
<td>12.4%</td>
<td>14.9%</td>
<td>17.2%</td>
<td>16.7%</td>
<td>16.6%</td>
<td>4.2%</td>
<td>5.4%</td>
</tr>
<tr>
<td>- Staff costs</td>
<td>-9.9%</td>
<td>-20.3%</td>
<td>-21.6%</td>
<td>-21.8%</td>
<td>-19.6%</td>
<td>-19.1%</td>
<td>1.2%</td>
<td>2.8%</td>
</tr>
<tr>
<td>- Depreciations and amortizations</td>
<td>-0.8%</td>
<td>-1.8%</td>
<td>-2.6%</td>
<td>-2.0%</td>
<td>-1.6%</td>
<td>-1.2%</td>
<td>0.6%</td>
<td>1.2%</td>
</tr>
<tr>
<td>Sales PM before Tax</td>
<td>4.7%</td>
<td>-9.8%</td>
<td>-9.3%</td>
<td>-6.6%</td>
<td>-4.5%</td>
<td>-3.7%</td>
<td>6.1%</td>
<td>9.4%</td>
</tr>
<tr>
<td>- Operating tax</td>
<td>-0.9%</td>
<td>2.8%</td>
<td>0.7%</td>
<td>2.8%</td>
<td>-3.9%</td>
<td>-5.2%</td>
<td>-8.0%</td>
<td>-7.7%</td>
</tr>
<tr>
<td>Sales PM after Tax</td>
<td>3.8%</td>
<td>-7.0%</td>
<td>-8.6%</td>
<td>-3.9%</td>
<td>-8.4%</td>
<td>-8.9%</td>
<td>-1.9%</td>
<td>1.7%</td>
</tr>
<tr>
<td>- Dirty surplus items</td>
<td>0.0%</td>
<td>-0.6%</td>
<td>-0.3%</td>
<td>0.1%</td>
<td>0.0%</td>
<td>0.2%</td>
<td>0.7%</td>
<td>0.7%</td>
</tr>
<tr>
<td>Sales PM after dirty surplus</td>
<td>3.8%</td>
<td>-7.5%</td>
<td>-8.9%</td>
<td>-3.7%</td>
<td>-8.4%</td>
<td>-8.7%</td>
<td>-1.2%</td>
<td>2.4%</td>
</tr>
<tr>
<td>+ Operating special items</td>
<td>1.4%</td>
<td>-0.1%</td>
<td>-0.1%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.1%</td>
<td>0.1%</td>
</tr>
<tr>
<td>- Tax on operating special items</td>
<td>-0.4%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
</tr>
<tr>
<td>PM after Tax, before Minority Interests</td>
<td>4.9%</td>
<td>-7.6%</td>
<td>-9.0%</td>
<td>-3.7%</td>
<td>-8.4%</td>
<td>-8.7%</td>
<td>-1.1%</td>
<td>2.5%</td>
</tr>
<tr>
<td>- Minority shareholders share</td>
<td>0.0%</td>
<td>2.4%</td>
<td>0.6%</td>
<td>0.3%</td>
<td>-0.2%</td>
<td>0.2%</td>
<td>-2.2%</td>
<td>-3.0%</td>
</tr>
<tr>
<td>PM after Tax, after Minority Interests</td>
<td>4.9%</td>
<td>-5.2%</td>
<td>-8.4%</td>
<td>-3.4%</td>
<td>-8.6%</td>
<td>-8.5%</td>
<td>-3.3%</td>
<td>-0.6%</td>
</tr>
</tbody>
</table>

= Positive impact on PM
= Negative impact on PM

**Notice: For comparison reasons other operating costs have been relocated to external costs**

During PE ownership, IDdesign decreases profitability by -1.1%-points from -7.6% to -8.7%. The decrease in absolute profitability is primarily explained by a considerable tax payment of deferred tax in p5, while COGS, staff costs, dirty surplus items and operation special items contribute positively, external costs affects negatively. Chilli decreases profitability from -0.30% in p1 to -3.9% in p5.

Even though both companies experience decreasing profitability, IDdesign's profitability decreases less than its peer, but from, and to a lower level. Focusing solely on elements under influence by the PE fund22, profit margins improve absolutely by 5.4%-points, while relatively IDdesign “improves” profit.

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22 These are: COGS, external costs/other operating costs and staff costs
margins by 8.3 %-points. The relative “improvement” is driven by better performance on COGS and staff costs, dirty surplus items and operating special items, while external costs relatively worsens.

According to IDdesign, revenues are negatively affected by a very difficult external environment (table 86 in appendix 30). The macro environment, after the financial crisis, is characterized as unfavorable, affecting the sales of durable goods negatively. This is in contrast to the period prior to PE acquisition, where the market is characterized by increasing real estate values, impacting the consumption of durable goods positively (Inbohome, 2004/2005). Danish retail sales of furniture decreases in the period after acquisition by Axxel compared to the period before. In the same period, the Swedish market for furniture is very volatile (table 24 in appendix 7).

**Initiatives employed to grow revenues in the group**

IDdesign employs group initiatives on four key areas in an attempt to grow revenues during PE ownership (table 87 in appendix 30).

1) **Rebuilding, relocation and expansion of store-network**: IDdesign acquires the ILVA chain and additional IDEmøbler stores in p₂ and p₃. It rebrands ILVA to a more premium-oriented concept, offering quality and distinct products at affordable prices. This includes an intensified marketing effort focusing on door-to-door distribution of an improved advertising circular. Furthermore, depending on the sales and customer profile in current locations, stores are modernized, relocated or change format.

2) **Product assortment development – focus on increased coordination**: IDdesign initiates, with the acquisition of ILVA, an increased coordination of the product portfolio in the two chains.

3) **Focus on employee training**: IDdesign increasingly focuses on developing a strong sales and performance culture in its stores. This is done through training programs and by an attempt to attract more competent workforce.

IDdesign’s acquisition based strategy indicates that the PE fund attempts to grow quickly, and is in contrast to Chili, that solely uses organic growth to expand its store network (table 59-60 in appendix 21). The acquisition of ILVA contributes positively to absolute revenue development in p₂. However, sales in ILVA decrease more than the industry in general in the first periods of ownership, while it stabilizes in later periods (table 87 in appendix 30). Assuming that the higher-priced concept of ILVA is more exposed to macro-economic volatility, IDdesign increases its overall macro exposure with the acquisition. This can partly explain the less fortunate revenue development of ILVA.

**Initiatives employed to further improve profitability**

Within the first two periods, IDdesign focuses on rationalization of staff in ILVA and IDEmøbler (table 88 in appendix 30). It further, consolidates, standardizes and streamlines a series of back-office and administrative functions. Centralization of warehouse storage is also initiated. It is a clear priority to obtain quantitative discounts and improve conditions with suppliers by coordinating the product assortments of the two chains. In p₄, after the standardization of processes, the physical headquarters
merge. In the same period, IDdesign reduces the number of suppliers to a few European providers. This is done to improve quality, assortment prices and delivery service.

Overall, there is a clear indication of a strategy to improve profit margins that revolves around two central areas: First, infrastructure merger, to realize synergies from the merger of the two companies and the previous independent stores. Second, quantity discounts and improved terms and conditions with suppliers by combining the purchasing power of ILVA and IDdesign. These are considered the primary levers of profit margin improvements, not directly linked to increased revenues, and it further indicates that size is considered a prerequisite to succeed in the industry.

The peer of IDdesign focuses on high margin products and direct delivery to stores from selected European suppliers that bypasses the central warehouse facility. This saves logistics costs.
10.3.5. Cross case comparisons on profit margin drivers

Table 14 below illustrates the development in profit margin drivers, which are under primary influence by the PE funds.

### Table 14

**Absolute and relative development of profit margins drivers under primary influence by the PE fund from p1 to the last observation period**

This table shows the absolute and relative development of the drivers under main influence by the PE fund. These are: COGS, external costs and staff costs. The development is illustrated as percentage point changes measured as a ratio of revenue in each period for the respective cases and their peers. The numbers are color coded. Green marks a positive influence on profit margins, while red marks a negative influence on profit margins.

<table>
<thead>
<tr>
<th></th>
<th>Matas</th>
<th>PWT</th>
<th>BabySam</th>
<th>IDdesign</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Absolute terms</td>
<td>Relative to peer</td>
<td>Absolute terms</td>
<td>Relative to peer</td>
</tr>
<tr>
<td>COGS development</td>
<td>-2.7%</td>
<td>-2.9%</td>
<td>-7.1%</td>
<td>0.5%</td>
</tr>
<tr>
<td>External costs/other</td>
<td>0.1%</td>
<td>-12.2%</td>
<td>2.3%</td>
<td>1.0%</td>
</tr>
<tr>
<td>operating costs</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>development</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Staff costs</td>
<td>-0.7%</td>
<td>11.2%</td>
<td>-0.4%</td>
<td>-1.6%</td>
</tr>
<tr>
<td>development</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total impact on</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>profit margins from</strong></td>
<td><strong>3.3%</strong></td>
<td><strong>3.9%</strong></td>
<td><strong>5.2%</strong></td>
<td><strong>0.1%</strong></td>
</tr>
<tr>
<td>main drivers under</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>influence of the PE</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>fund</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dirty surplus items</td>
<td>-1.1%</td>
<td>-1.1%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>development</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operating special</td>
<td>-1.4%</td>
<td>-1.4%</td>
<td>-1.0%</td>
<td>-1.0%</td>
</tr>
<tr>
<td>items development</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total impact on</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>profit margins incl.</strong></td>
<td><strong>4.7%</strong></td>
<td><strong>5.3%</strong></td>
<td><strong>7.3%</strong></td>
<td><strong>2.2%</strong></td>
</tr>
<tr>
<td>dirty surplus and</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>operating special</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>items</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

= Positive impact on PM  
= Negative impact on PM

Three out of four cases experience an absolute positive development in profit margins throughout the period, from drivers, which can be influenced by the PE funds. BabySam is the only case that experiences an overall negative impact, primarily through negative contributions from external/other operating costs and staff costs. Across cases, the main positive profit margin driver is COGS. This implies that the case companies pay relatively less for the goods they sell in the last period of observation compared to the first period of ownership. External costs/other operating costs impact profit margins negatively throughout the period for all case companies. This implies that a series of expenses, not directly linked to staff costs or COGS, increase as a ratio of revenue. Staff costs decrease relative to sales, and have a positive implication on profit margins for all case companies except BabySam.
All cases experience greater profit margin improvements compared to peers. The improvements come from various sources and there is no overall driver pattern across cases. Two out of four cases improve COGS relative to their peers, while two cases experience improvements in external/other operating costs and staff costs. PWT shifts from having the best development to the worst, while BabySam shifts from having the worst development to the best. Overall, the best relative improvements are found in BabySam and IDdesign. Paradoxically, both companies have poor absolute performance, but a relatively more negative development in peer profit margins provides a positive impression of their relative development.

Overall, the case companies experience absolute and/or relative profit margin improvements from drivers, influenced by the PE fund. The following investigates which initiatives are taken to achieve the improvements.

Table 15

Initiatives employed to improve profit margins across cases.

This table shows the initiatives imposed to improve profit margins in the four cases. They are divided into two categories: Revenue growth initiatives and other initiatives to improve profit margins. The two categories are not mutually exclusive, but do provide an overall categorization of the initiatives taken.

<table>
<thead>
<tr>
<th>Revenue growth initiatives</th>
<th>Matas</th>
<th>PWT</th>
<th>BabySam</th>
<th>IDdesign</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rebuilding, relocation and expansion of store-network</td>
<td>Rebuilding, relocation and expansion of store-network</td>
<td>Rebuilding, relocation and expansion of store-network</td>
<td>Rebuilding, relocation and expansion of store-network</td>
<td></td>
</tr>
<tr>
<td>Product assortment development – focus on private label</td>
<td>Product assortment development - focus on own brands</td>
<td>Product assortment development – focus on homogenization</td>
<td>Product assortment development – focus on increased coordination</td>
<td></td>
</tr>
<tr>
<td>Focus on employee training</td>
<td>Focus on exports</td>
<td>Focus on employee training</td>
<td>Focus on employee training</td>
<td></td>
</tr>
<tr>
<td>Online sales and/or loyalty program.</td>
<td>Online sales and/or loyalty program:</td>
<td>Online sales and/or loyalty program</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Other profit margin initiatives</th>
<th>Matas</th>
<th>PWT</th>
<th>BabySam</th>
<th>IDdesign</th>
</tr>
</thead>
<tbody>
<tr>
<td>Infrastructure merger</td>
<td>Infrastructure merger</td>
<td>Infrastructure merger</td>
<td>Infrastructure merger</td>
<td>Infrastructure merger</td>
</tr>
<tr>
<td>Improved terms and conditions with suppliers</td>
<td>Improved terms and conditions with suppliers</td>
<td>Improved terms and conditions with suppliers</td>
<td>Improved terms and conditions with suppliers</td>
<td></td>
</tr>
<tr>
<td>Leverage of IT</td>
<td>Leverage of IT</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>In-store security</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Own contribution.

The initiatives employed across cases are fairly similar. The new ownership structure allows for faster changes in the store portfolio. This is evident, as all case companies rebuilt, relocate and expand their store network. The store networks are primarily expanded through acquisitions, and the stores are modernized, rebuilt and relocated to improved locations. This indicates that the PE funds exploit the possibilities of the new ownership structure to increase revenues from adjusting the store portfolios.
All case companies attempt to grow revenues from developing their respective product assortments. Matas introduces more private label products for increasing the exposure towards the middle-price segment. PWT acquires additional brands and develops existing brands for the purpose of exports and increasing sales through the acquired Tøjeksperten and Wagner store networks. Thus, both companies focus on leveraging the impact from own brands. On the other hand, BabySam and IDdesign coordinate and homogenize product assortments across stores for the purpose of decreasing the number of suppliers and achieve improved terms. However, improved supplier terms are also an object for concern for Matas and PWT. Hence, the PE funds attempt to improve supplier terms to a degree, which was not incorporated prior to PE ownership, by pressuring suppliers.

All companies, except for PWT, emphasize the importance of employee training. This could indicate that the PE funds see a further potential in providing sales excellence improvements and employee training coordinated across the chain store portfolios. In addition, three out of four companies increase revenues and customer retention from introducing web-shops and loyalty programs. Introducing such initiatives are considered less conflicting when operating as a capital chain as opposed to a voluntary chain, since independent store sales are not cannibalized on the disadvantage of individual store owners.

The PE funds attempt to further improve profit margins from other initiatives, primarily related to infrastructure mergers, involving standardization of business procedures and consolidation of operating divisions as well as physical locations. In addition, Matas and BabySam increasingly focus on implementing IT systems with the purpose leveraging customer preference and demand data. This improves product offerings towards customers, but is also applied in collaboration with key suppliers for optimizing product assortments and inventory management.
10.4. Net working capital

Net working capital provides an important source for improving free cash flows. This section explores the development of tied up capital in a more narrow perspective than the FCF-F analysis, focusing solely on core operational elements under influence by the PE fund. The cash conversion cycle (CCC) is applied for quantifying the amount of time working capital is tied up in the operating cycle. CCC-formulas are found in appendix 31. The lower the amount of time cash is tied up in the business, the better.

For each case company, CCC is investigated focusing on the development during PE ownership compared to peers. Tables 89-92 in appendix 32 provide sorted lists of all identified initiatives taken by the PE fund to improve underlying drivers of CCC. Concluding, a cross case comparison illustrates similarities and differences for the cases investigated.

10.4.1. Matas

Matas decreases its yearly average CCC from 56 days in p₁ to 25 days in p₆, and to a lower level than before PE acquisition. Kicks Norge has, from a lower level than Matas, experienced an increase in its CCC during the same period.

Table 16

<table>
<thead>
<tr>
<th>Period</th>
<th>p₂</th>
<th>p₁</th>
<th>p₂</th>
<th>p₃</th>
<th>p₄</th>
<th>p₅</th>
<th>p₆</th>
<th>Impact from p₁ to p₆</th>
<th>Impact relative to peer</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Matas</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash Conversion Cycle (CCC)</td>
<td>54</td>
<td>57</td>
<td>56</td>
<td>60</td>
<td>61</td>
<td>53</td>
<td>39</td>
<td>25</td>
<td>-31</td>
</tr>
<tr>
<td>Days Inventory Outstanding (DIO)</td>
<td>123</td>
<td>122</td>
<td>126</td>
<td>134</td>
<td>143</td>
<td>138</td>
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<td>Days Sales Outstanding (DSO)</td>
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<td>9</td>
<td>9</td>
<td>9</td>
<td>9</td>
<td>10</td>
<td>10</td>
<td>-1</td>
</tr>
<tr>
<td>Days Payable Outstanding (DPO)</td>
<td>77</td>
<td>74</td>
<td>81</td>
<td>84</td>
<td>91</td>
<td>93</td>
<td>96</td>
<td>106</td>
<td>25</td>
</tr>
<tr>
<td><strong>Kicks Norge (Peer)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Cash Conversion Cycle (CCC)</td>
<td>58</td>
<td>43</td>
<td>38</td>
<td>59</td>
<td>76</td>
<td>63</td>
<td>71</td>
<td>98</td>
<td>60</td>
</tr>
<tr>
<td>Days Inventory Outstanding (DIO)</td>
<td>129</td>
<td>120</td>
<td>114</td>
<td>123</td>
<td>127</td>
<td>121</td>
<td>148</td>
<td>166</td>
<td>52</td>
</tr>
<tr>
<td>Days Sales Outstanding (DSO)</td>
<td>5</td>
<td>4</td>
<td>6</td>
<td>9</td>
<td>10</td>
<td>7</td>
<td>5</td>
<td>5</td>
<td>-1</td>
</tr>
<tr>
<td>Days Payable Outstanding (DPO)</td>
<td>76</td>
<td>81</td>
<td>82</td>
<td>73</td>
<td>61</td>
<td>65</td>
<td>82</td>
<td>73</td>
<td>-9</td>
</tr>
</tbody>
</table>

= Positive impact
= Negative impact

Source: Own contribution

For Matas, DPO drives the absolute improvement in CCC. This implies a considerable extension of the credit period to suppliers. In relative terms, the improvement stems from both DIO and DPO.

DPO is improved from a series of initiatives. In p₁, Matas establishes a central purchasing function and improves purchasing agreements. In p₂, it initiates partnership agreements with key suppliers, and based
on an adjustment of the assortment of goods offered, the payment terms are improved even further in \( p_3 \), \( p_4 \) and \( p_5 \).

To improve DIO, Matas upgrades its IT systems in \( p_2 \) to include statistically based order suggestions and improved forecasting. Additionally, it rebuilds the central warehouse including a new layout in \( p_2 \). Furthermore, Matas adapts its assortment to focus on products with higher conversion rates and cleans out inventories for products with low conversion rates. In \( p_2 \) – \( p_4 \), Matas emphasizes improving inventory management on a store level, through focusing on best practice. In \( p_3 \) and \( p_4 \), Matas reports issues with its new inventory management system as well as challenges with the reduction of inventories in stores. This is reflected in table 16, where DIO increases from \( p_1 \) – \( p_3 \), and subsequently decreases again.

The above could indicate that one of the primary value enhancing possibilities CVC identified before the acquisition, was the possibility to improve CCC through improvements in credit terms to suppliers and inventory management.

10.4.2. PWT

PWT has increased its yearly average CCC from 97 days in \( p_1 \) to 119 days in \( p_5 \). During the same period Dressmann Norge also increases its CCC, but from a higher level.

**Table 17**

**Cash Conversion Cycle decomposition and impact for PWT and Dressmann Norge**

This table shows the development of yearly average CCC for PWT and its peer Dressmann Norge. The impact from \( p_1 \) to \( p_5 \) indicates the development under PE ownership and its influence on CCC. The impact relative to peer during the same period illustrates the development when controlling for macro and industry effects. The impact is color coded. Green indicates a positive impact on CCC, while red indicates a negative impact on CCC. *Drivers are considered inappropriate for conclusive comparisons, due to two reasons: 1) PWT has a whole ale division (Texman) implying longer credit periods, due to the B2B nature of certain sales. Dressmann solely sells B2C, implying over the counter payments. 2) Dressmann is a subsidiary of the Varner group, implying low DPO, since the parent company constitutes the supplier of products. In contrast PWT is supplied by external producers. Therefore, DIO is the only appropriate figure for comparisons.

<table>
<thead>
<tr>
<th>Period</th>
<th>( p_2 )</th>
<th>( p_1 )</th>
<th>( p_1 )</th>
<th>( p_2 )</th>
<th>( p_3 )</th>
<th>( p_4 )</th>
<th>( p_5 )</th>
<th>Impact from ( p_1 ) to ( p_5 )</th>
<th>Impact relative to peer</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>PWT</strong></td>
<td>Cash Conversion Cycle (CCC)</td>
<td>67</td>
<td>63</td>
<td>97</td>
<td>135</td>
<td>146</td>
<td>131</td>
<td>119</td>
<td>22</td>
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<td>Days Inventory Outstanding (DIO)</td>
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<td>146</td>
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<td>194</td>
<td>181</td>
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<td>-36</td>
</tr>
<tr>
<td>Days Sales Outstanding (DSO)</td>
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<td>37</td>
<td>40</td>
<td>35</td>
<td>28</td>
<td>23</td>
<td>24</td>
<td>-16</td>
<td>-15*</td>
</tr>
<tr>
<td>Days Payable Outstanding (DPO)</td>
<td>50</td>
<td>47</td>
<td>88</td>
<td>79</td>
<td>76</td>
<td>73</td>
<td>76</td>
<td>-13</td>
<td>4*</td>
</tr>
<tr>
<td><strong>Dressmann Norge (Peer)</strong></td>
<td>Cash Conversion Cycle (CCC)</td>
<td>195</td>
<td>171</td>
<td>172</td>
<td>192</td>
<td>223</td>
<td>226</td>
<td>249</td>
<td>77</td>
</tr>
<tr>
<td>Days Inventory Outstanding (DIO)</td>
<td>204</td>
<td>179</td>
<td>200</td>
<td>224</td>
<td>258</td>
<td>247</td>
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<td>Days Sales Outstanding (DSO)</td>
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<td>0</td>
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</tr>
<tr>
<td>Days Payable Outstanding (DPO)</td>
<td>11</td>
<td>10</td>
<td>29</td>
<td>33</td>
<td>35</td>
<td>21</td>
<td>12</td>
<td>-17</td>
<td></td>
</tr>
</tbody>
</table>

= Positive impact

= Negative impact

*Source: Own contribution.*
For PWT, DIO and DPO drive the absolute worsening in CCC, while DSO counteracts. This indicates an extension of inventory days for products, a shortening of the credit period to suppliers, but shorter credit period to customers. In relative terms, on the only appropriate metric for comparison, DIO, PWT performs better than its peer. In total, this indicates that PWT has not succeeded to improve CCC. However, the same is the case for its peer.

In an attempt to improve CCC, PWT introduces a series of initiatives. In p2, inventories are consolidated for the entire group. From p3 and onwards, PWT works to implement electronic repurchasing systems for their stores as well as budgeting systems to improve the purchasing function. The same initiative is implemented in the stores trading with Texman in p5. Combined with the consolidation of warehouses this could possibly be the explanation for the continuous decrease in DIO that is experienced after the peak in p3.

The above could indicate the one of the primary value enhancing possibilities, Polaris identified before the acquisition of Tøjeksperten in terms of NWC, was the synergies of consolidating warehouses to improve inventory days outstanding for Tøjeksperten’s products. This is done with capabilities, already present in Texman and Wagner. Since one of the primary focus areas in PWT is the export of brands in Texman’s portfolio, this might explain why the acquisition of Tøjeksperten does not seem sufficient to improve payment terms with suppliers.

### 10.4.3. Baby Sam

BabySam decreases CCC from 135 days in p1 to 63 days in p6, to a lower level than before PE acquisition. In contrast, BH Nordic increases CCC in the same period, from a lower level than BabySam.

### Table 18

**Cash Conversion Cycle decomposition and impact for BabySam and BH Nordic**

This table shows the development of yearly average CCC for BabySam and its peer BH Nordic. The impact from p1 to p6 indicates the development under PE ownership and its influence on CCC. The impact relative to peer during the same period illustrates the development when controlling for macro and industry effects. The impact is color coded. Green indicates a positive impact on CCC, while red indicates a negative impact on CCC.

<table>
<thead>
<tr>
<th>Period</th>
<th>p-2</th>
<th>p-1</th>
<th>p1</th>
<th>p2</th>
<th>p3</th>
<th>p4</th>
<th>p5</th>
<th>p6</th>
<th>Impact from p1 to p6</th>
<th>Impact relative to peer</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Baby Sam</strong></td>
<td></td>
<td></td>
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<td></td>
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<td>Days Payable Outstanding (DPO)</td>
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<td>51</td>
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<tr>
<td>BH Nordic (Peer)</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>18</td>
<td>16</td>
</tr>
<tr>
<td>Days Inventory Outstanding (DIO)</td>
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<td></td>
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<td></td>
<td></td>
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<td></td>
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<td>22</td>
<td>21</td>
</tr>
<tr>
<td>Days Sales Outstanding (DSO)</td>
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<td></td>
<td></td>
<td>5</td>
<td>3</td>
</tr>
<tr>
<td>Days Payable Outstanding (DPO)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>36</td>
<td>51</td>
</tr>
<tr>
<td>Days Inventory Outstanding (DIO)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>41</td>
<td>56</td>
</tr>
<tr>
<td>Days Sales Outstanding (DSO)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>18</td>
<td>16</td>
</tr>
<tr>
<td>Days Payable Outstanding (DPO)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>22</td>
<td>21</td>
</tr>
</tbody>
</table>
For BabySam, all drivers of CCC improve in both absolute and relative terms. The main driver is a considerable improvement in DIO, implying a shortening of inventory days. Credit terms to both customers and suppliers are also improved.

To improve CCC, BabySam takes a series of initiatives. In p₁, BabySam implements a new IT platform to leverage data on the current supplier relations and agreements. The goal of the new IT system is to improve logistics and inventory management. In p₂, BabySam focuses on reducing inventories through homogenization of the assortment in close collaboration with its suppliers. Furthermore, BabySam implements automatic order generation and receipt of orders, business intelligence and EDI for benchmarking. The impact from the new IT system is achieved in p₃. Here, the results of comprehensive analysis of the product assortment combined with clearance sales have decreased inventories remarkably. The effort to reduce inventories continues through p₄ - p₆ where BabySam concludes that the majority of improvements are achieved, and that further reductions are expected to happen at a slower pace in the future.

The above could indicate the one of the primary value enhancing possibilities Polaris and AAC identified before the acquisition, was the possibility to improve inventory management through leverage of IT, an improved product assortment and stronger supplier relationships.

10.4.4. IDdesign

IDdesign decreases yearly average CCC from 72 days in p₁ to 28 days in p₆ and to a lower level than before PE acquisition. Chili also experiences a decrease in CCC, though from a remarkably higher level than ID design.

Table 19
Cash Conversion Cycle decomposition and impact for IDdesign and Chilli

This table shows the development of yearly average CCC for IDdesign and its peer Chilli. The impact from p₁ to p₅ indicates the development under PE ownership and its influence on CCC. The impact relative to peer during the same period illustrates the development when controlling for macro and industry effects. The impact is color coded. Green indicates a positive impact on CCC, while red indicates a negative impact on CCC.

<table>
<thead>
<tr>
<th>Period</th>
<th>p₁</th>
<th>p₂</th>
<th>p₃</th>
<th>p₄</th>
<th>p₅</th>
<th>Impact from p₁ to p₅</th>
<th>Impact relative to peer</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>IDdesign</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash Conversion Cycle</td>
<td>47</td>
<td>72</td>
<td>47</td>
<td>37</td>
<td>36</td>
<td>28</td>
<td>-44</td>
</tr>
<tr>
<td>(CCC)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>36</td>
</tr>
<tr>
<td>Days Inventory Outstanding (DIO)</td>
<td>54</td>
<td>109</td>
<td>119</td>
<td>120</td>
<td>117</td>
<td>104</td>
<td>-5</td>
</tr>
<tr>
<td>Days Sales Outstanding (DSO)</td>
<td>10</td>
<td>17</td>
<td>11</td>
<td>11</td>
<td>12</td>
<td>12</td>
<td>-5</td>
</tr>
<tr>
<td>Days Payable Outstanding (DPO)</td>
<td>16</td>
<td>54</td>
<td>83</td>
<td>94</td>
<td>93</td>
<td>88</td>
<td>-24</td>
</tr>
<tr>
<td><strong>Chilli (Peer)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash Conversion Cycle</td>
<td>142</td>
<td>204</td>
<td>151</td>
<td>212</td>
<td>197</td>
<td>124</td>
<td>-80</td>
</tr>
<tr>
<td>(CCC)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Days Inventory Outstanding (DIO)</td>
<td>179</td>
<td>234</td>
<td>182</td>
<td>284</td>
<td>299</td>
<td>212</td>
<td>-22</td>
</tr>
<tr>
<td>Days Sales Outstanding (DSO)</td>
<td>2</td>
<td>5</td>
<td>8</td>
<td>8</td>
<td>5</td>
<td>5</td>
<td>0</td>
</tr>
<tr>
<td>Days Payable Outstanding (DPO)</td>
<td>39</td>
<td>35</td>
<td>39</td>
<td>80</td>
<td>107</td>
<td>93</td>
<td>58</td>
</tr>
</tbody>
</table>

= Positive impact  
= Negative impact  
Source: own contribution.
For IDdesign, all elements of CCC improve in absolute terms. The main driver is a considerable improvement in DPO, implying an extension of the credit period to suppliers. In relative terms, IDdesign achieves an improvement in DSO from decreasing customers’ credit period. Chilli has higher improvements in DIO and DPO compared to IDdesign, but the improvements stem from relative poor performance in p₁, indicating that considerable room for improvement initially existed.

To improve CCC, IDdesign takes a series of initiatives. In p₁, it centralizes warehouse activities for the chain stores (IDEmøbler and ILVA) and improves terms and conditions with suppliers. In p₂, management initializes rationalization and coordination of the product assortment across the two chains. Contracts with common suppliers are consolidated and put under one. The coordination of assortment and increased purchasing power are considered main explanations for the improved credit terms with suppliers.

Adjustments in product assortments, common storage facilities and realization of unmarketable goods to give space for new products with improved conversion rates, constitute the foundation for a slightly improved DIO. However, improvements in inventory management take three periods to achieve. This could imply that it takes time to realize synergies from coordination of assortment and consolidated logistics.

The above could indicate the one of the primary value enhancing possibilities Axcel identified before the acquisition, was the possibility to improve credit terms with suppliers through coordination and adjustments of product assortment combined with increased purchasing power from the ILVA add-on acquisition.

**10.4.5. Cross case comparisons on net working capital**

The following section investigates the drivers of CCC across cases. In addition, it concludes on the primary initiatives imposed by the PE funds.

### Table 20

**Absolute and relative drivers of CCC from p₁ to last observation period**

This table summarizes the findings from investigations of CCC in the four case companies. It shows the absolute and relative development in CCC from the first period of PE ownership to the last observation period under PE ownership. The impact is color coded. Green indicates a positive impact on CCC, while red indicates a negative impact on CCC.

<table>
<thead>
<tr>
<th></th>
<th>Matas</th>
<th>PWT</th>
<th>BabySam</th>
<th>IDdesign</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cash Conversion Cycle (CCC)</strong></td>
<td>Absolute terms</td>
<td>Relative to peer</td>
<td>Absolute terms</td>
<td>Relative to peer</td>
</tr>
<tr>
<td></td>
<td>-31</td>
<td>-91</td>
<td>22</td>
<td>-55</td>
</tr>
<tr>
<td><strong>Days Inventory Outstanding (DIO)</strong></td>
<td>-5</td>
<td>-57</td>
<td>25</td>
<td>-36</td>
</tr>
<tr>
<td><strong>Days Sales Outstanding (DSO)</strong></td>
<td>-1</td>
<td>0</td>
<td>-16</td>
<td>-15*</td>
</tr>
<tr>
<td><strong>Days Payable Outstanding (DPO)</strong></td>
<td>25</td>
<td>-36</td>
<td>-13</td>
<td>4*</td>
</tr>
</tbody>
</table>

*Drivers are considered inappropriate for conclusive comparisons due to differences in operating and ownership structure*

Source: Own contribution

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Three out of four case companies experience absolute improvements in CCC throughout the period of PE ownership. This is value enhancing for the PE funds since it frees capital tied up in the operational cycle, which can be used elsewhere in the business or paid out to debt or equity holders. PWT is the only firm that experiences an absolute worsening of CCC. The main drivers of improvements vary across cases. For Matas and IDdesign, the main driver is increasing DPO. For PWT and BabySam improvements are driven by DSO and DIO, respectively.

When investigating CCC relative to peers, it is evident that three out of four cases experience improvements. The absolute worsening in PWT is converted to a relative improvement. Given its peer Dressmann Norge is representative for the industry, this could indicate that PWT’s CCC is affected negatively by industry trends in general, but does relatively well improving DPO. The relative improvements in IDdesign are converted to a relative worsening. This is partly due to remarkable performance improvements by its peer, which improves DIO and DPO from a worse level than IDdesign to a level that is more comparable. Taking into consideration that its peer comes from a considerably higher CCC level, implying that considerable improvement opportunities were possible, the relative performance of IDdesign can be considered less negative.

### Table 21

**Main drivers of CCC improvements and initiatives taken across cases**

This table summarizes the main drivers improving CCC and the underlying activities taken to improve CCC in general across cases during PE ownership.

<table>
<thead>
<tr>
<th>Main driver of improved CCC</th>
<th>Matas</th>
<th>PWT</th>
<th>BabySam</th>
<th>IDdesign</th>
</tr>
</thead>
<tbody>
<tr>
<td>Longer supplier credit</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Shorter credit to customers</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Shorter inventory periods</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Longer supplier credit</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Main initiatives taken to improve CCC during PE ownership</th>
<th>Matas</th>
<th>PWT</th>
<th>BabySam</th>
<th>IDdesign</th>
</tr>
</thead>
<tbody>
<tr>
<td>Centralizing purchasing division</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Consolidation of warehouses</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Assortment adjustments</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Source:** Own contribution.

The main drivers for improved CCC in Matas and IDdesign are longer supplier credits. For Matas, this is achieved through stronger supplier relations, assortment adjustments and improved supplier agreements, based on leverage of data from its new IT system. For IDdesign the improvement stems from centralization of purchasing divisions, product assortment adjustments in ILVA and IDEmøbler as well as

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23 The main element of interest in PWT due to the incomparability of DSO and DPO due to the operating and ownership differences between PWT and Dressmann.
consolidation of purchasing agreements. This increases purchasing power, which drives the improvement in DPO.

In BabySam, the primary driver of improvements stem from shorter inventory periods. This is a result of stronger supplier relationships and a renewed focus on products with higher conversion rates made possible by leveraging data from the new IT system.

In PWT, the only improvement in CCC stems from lower credit periods to its customers. Even though it improves IT systems, consolidates warehouses and centralizes the purchasing divisions, it does not experience absolute improvements in DIO or DPO. Tøjeksperten is acquired and “added” to Hansen & Pedersen. This implies that improvements in DIO and DPO can be offset by the development in Texman and Wagner. However, relative to its peer, PWT experiences improvements in DIO implying that the initiatives contribute to a more positive development than seen on the general market.

In summary, the above analysis indicates that the PE funds in general experience absolute and relative improvements in CCC throughout the observation period. The drivers and initiatives imposed are different from case to case. However, Matas and IDdesign achieve improvements from improved supplier agreements, while BabySam and PWT improve inventory management and customer credit periods, respectively.
11. Corporate governance engineering analysis

The following section investigates corporate governance engineering initiatives, imposed by the PE fund subsequent to acquiring the voluntary chains. The section aims to provide insights into two main elements of corporate governance engineering – active ownership and economic incentive alignment on company management level.

The following questions are investigated to provide insights on active ownership:

- **How many official board meetings are held each year?**
  
  *A large number of official board meetings indicates increased level of active ownership.*

- **What is the size and the degree of PE representation in the board of directors?**
  
  *The smaller the size of the board and the larger the representation by the PE fund, the higher the agility and ability to impose active ownership.*

- **What changes are made in the board, and what is the profile of any independent members?**
  
  *Provides an understanding of active ownership imposed through changes, and indicates the competencies, which the PE fund actively seeks to add.*

- **What changes are made in management, and what is the profile of the new management?**
  
  *Provides an understanding of active ownership imposed through changes, and indicates the competencies, which the PE fund actively seeks to add.*

The following questions are investigated to improve the understanding of how PE funds impose economic incentive alignment on the previous voluntary chains:

- **Does the management team have an equity position and/or a warrant program in the company?**
  
  *A warrant program or equity position by management is expected to reduce the principle agent problem by aligning economic interests of owners and management.*

- **Are there any bonus programs for management in the case companies?**
  
  *This is expected to motivate management to achieve milestones, set by the board.*

- **To what degree are previous owners in the independent store-companies included in top level management/board and/or as shareholders?**
  
  *Provides an indication of how the PE funds include previous store owners and incorporate industry know-how into the new capital chain.*

The two above elements are, when data is available, compared to their respective peers in order to control for industry effects. Lastly, the four cases are concluded on in a cross case comparison.
11.1. Matas

Active ownership

Matas has, throughout the observation period, 9-12 official board meetings incl. an annual two-day strategy seminar with participation of management. Initially, it is company policy to have at least 12 meetings, which is also the number of meetings held in p₁ (table 93 in appendix 33). In the remaining period of investigation, company policy changes to have at least 9 official board meetings. In the first two periods, Matas holds 11 annual board meetings. In the subsequent periods, the number of meetings decreases to 9-10 per year. In addition to the official board meetings, the board receives a written report each month on the development and financial situation in Matas. This could indicate that the PE fund follows its investment closely, and that the influence and coordination with management is more needed in the initial part of the transformation, than in the subsequent periods.

The following investigates the size and changes made in the board during PE ownership.

Table 22

<table>
<thead>
<tr>
<th></th>
<th>p₂</th>
<th>p₁</th>
<th>p₁</th>
<th>p₂</th>
<th>p₃</th>
<th>p₄</th>
<th>p₅</th>
<th>p₆</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Matas</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Board size</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>% from PE fund</td>
<td>60%</td>
<td>60%</td>
<td>60%</td>
<td>60%</td>
<td>60%</td>
<td>60%</td>
<td>60%</td>
<td>60%</td>
</tr>
<tr>
<td>Current members out</td>
<td>-4</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>New members in</td>
<td></td>
<td>+4</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Kicks Norge</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Board size</td>
<td>6</td>
<td>6</td>
<td>6</td>
<td>6</td>
<td>6</td>
<td>6</td>
<td>6</td>
<td>3</td>
</tr>
<tr>
<td>Current members out</td>
<td>-1</td>
<td>-2</td>
<td>-6</td>
<td>-6</td>
<td>-6</td>
<td>-6</td>
<td>-5</td>
<td></td>
</tr>
<tr>
<td>New members in</td>
<td>+1</td>
<td></td>
<td>6</td>
<td></td>
<td>6</td>
<td></td>
<td>2</td>
<td></td>
</tr>
</tbody>
</table>

Source: Own contribution based on Annual Reports 2005-2013 for MHolding 3 and Kicks Norge. For detailed information on the composition of the boards, please see table 94 – 95 in appendix 33.

From table 22, it is evident that the size of Matas' board is unchanged when comparing the period before and after PE ownership. Comparing the size to its peer, the result is more ambiguous. Before the period of PE ownership, Matas’ board is slightly smaller. In the period after PE acquisition, the board in Matas is smaller in the majority of the periods. In terms of changes in the board, Matas introduces four new members in the period after acquisition, and subsequently does not perform any changes. This is in contrast to its peer that performs a series of changes. Despite the replacement of the board in p₄, as a result of the merger between Esthitique and Kicks Norge, there exists no official explanation on the changes imposed.

In the period before PE ownership, the board of Matas consists solely of Matas store owners (table 94 in appendix 33). In the period after acquisition, the board consists of representatives from the two majority owners: CVC Capital and Materialisternes Invest A/S (table 95 in appendix 33). There are no independent members, and the former chairman in the period before PE ownership, Lars Frederiksen, is also present after the acquisition by CVC as a representative for Materialisternes Invest A/S.
Matas imposes one change to the management team subsequent to PE ownership (table 96 in appendix 33). Anders T. Skole-Sørensen is hired as new CFO. He comes from a position as Treasurer in DT Group A/S that was taken over by CVC in 2003 (table 106 in appendix 34). The peer company changes CEO in p4 from Thor Hauge to Carina Sønsteby as a result of the merger between Esthitique and Kicks Norge. This is an indication that the PE fund imposes changes to the management team and actively seeks to add a CFO with experience from a company under comparable PE ownership structure that understands the PE funds financial agenda.

**Economic incentive alignment**

From table 23, it is evident that the previous Matas owners have a significant equity position between 28.9 – 30.3% after PE acquisition.

**Table 23**

**Equity positions, bonuses and warrant programs for management and previous owners in Matas and Kicks Norge during the PE ownership of Matas**

This table shows the equity positions by previous owners and management in Matas and Kicks Norge throughout the period of PE ownership of Matas. Additionally, it provides information on any bonus and warrant programs.

<table>
<thead>
<tr>
<th></th>
<th>p1</th>
<th>p2</th>
<th>p3</th>
<th>p4</th>
<th>p5</th>
<th>p6</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Matas</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Previous owners</td>
<td>28.9%</td>
<td>28.9%</td>
<td>28.9%</td>
<td>28.9%</td>
<td>28.9%</td>
<td>30.3%</td>
</tr>
<tr>
<td>Management</td>
<td>5%</td>
<td>5%</td>
<td>5%</td>
<td>5%</td>
<td>5%</td>
<td>0.3%</td>
</tr>
<tr>
<td>Bonus program</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes*</td>
</tr>
<tr>
<td>Warrant program</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td><strong>Kicks Norge</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Management</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Bonus program*</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Warrant program</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
</tbody>
</table>

*Source: Own contribution, based on Matas and Kicks Annual Reports 2007-2012 *IPO Bonus program N/A indicates that there is no information provided in the annual report.*

To align interest between management and owners, the management of Matas has a 5% equity position throughout the majority of the period and a bonus program. In p6, the majority of management’s equity position is repurchased and replaced with an IPO bonus program. The IPO bonus payment is contingent on NASDAQ OMX Copenhagen admission and releases a payment to the management and key-employees (MHandling, 2012-2013). This is a clear indication of a goal oriented incentive program imposed by the PE fund incentivizing management to achieve a successful exit on behalf of the fund. In contrast, the management of Kicks Norge does not have an equity stake, nor a warrant program to obtain ownership. Neither is there information of a bonus payment to management. This implies differences in economic incentive alignment for the two companies, where the PE fund imposes economic incentives for the management in Matas to a larger degree than its peer.
11.2. PWT

Active ownership

It is evident from table 127 in appendix 35 that PWT has 5-6 official board meetings throughout the observation period. In the first period, PWT has 6 board meetings. In the remaining observation period, the board holds 5 board meetings. In addition, the chairman of the board and the management team meet every second month, and have extraordinary meetings when the need arises. This could indicate that the PE fund is slightly more actively involved in the initial part of the transformation.

Table 24

| Board sizes and changes during the observation period for PWT and Dressmann Norge |
|------------|------------|----------|----------|----------|----------|----------|----------|
|            | P2         | P1       | P0**     | P1       | P2       | P3       | P4       | P5       |
| PWT Board size | 8*        | 8*       | 8        | 7        | 7        | 6        | 6        | 6        |
| % from PE fund | 25%       | 29%      | 29%      | 33%      | 33%      | 33%      | 33%      |          |
| Current members out | -6       | -1       | -3       |          |          |          |          |          |
| New members in | +6        |          |          |          |          |          |          |          |
| Dressmann Norge Board size | 7        | 7        | 8        | 7        | 7        | 7        | 7        | 7        |
| Current members out | -1       | -3       | -1       | -3       |          |          |          |          |
| New members in | 2         | 2        |          |          |          |          |          |          |

Source: Own contribution based on Annual Reports 2005-2013 for PWT Holding and Dressmann Norge. *Includes the board for both Eksperto a.m.b.a and Hansen & Pedersen in the latest period prior to acquisition. **P0 is not included in the operational section, since it is not a 12-month report. For detailed information on the composition of the boards, please see table 128 – 131 in appendix 35.

From table 24, it is evident that the size of PWT’s board is gradually decreasing during PE ownership. When comparing the size of the board in PWT to its peer, the result is more ambiguous. Before the acquisition, PWT’s board is slightly larger than its peer. In the period after PE acquisition, the board in PWT is of similar size in the first three periods and slightly smaller in the last three periods. In terms of changes in the board, PWT introduces six new members after acquisition, and subsequently performs few changes in p1 and p3. Its peer also imposes a few changes in the board during p0 and p1 and is hereafter unchanged.

Prior to acquisition, PWT’s board primarily consists of store owners (table 128 in appendix 35). In the case of Eksperto A.m.b.a, there is only one independent member, Villy Rasmussen. He is an experienced retailer and former CEO of FDB and Dagrofa, and has a background as board member in more than 35 large Danish companies (table 107 in appendix 34).

In the period after PE acquisition, the board consists of representatives from the four majority owners; Polaris, TE Geninvest (previous owners of Tøjeksperten stores), OKH Holding ApS and Wagner Holding

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24 Board represented by Eksperto A.m.b.a and Hansen & Pedersen I/S
25 FDB (Fællesforeningen for Danmarks Brugsforeninger) was a large Danish association of retailers within the grocery segment that merged with the retail grocery cooperative COOP in 2013 including retail chains such as Kvickly, Brugsen, Irma and Fakta.
26 A large Danish retailer within groceries.
Aalborg II Aps (previous owners of Hansen & Pedersen I/S) (table 129 in appendix 35). It is noteworthy that PWT has many independent board members with different backgrounds (4/8).

The background of independent members, Jesper Brøckner Nielsen, is within the telecom industry, where he was CEO of Telia Denmark and responsible for buying Orange, Debitel and 20 Telekæden stores. Jan Bøgh has a long career as a purchasing director in JYSK. Claus Stagaard Juul is a professional board member including board membership of IC Companies where he also served as executive sales director. Finally, Carsten Bo Pedersen has a financial background as CEO of ITH Industri Invest (table 108-111 in appendix 34). There are two interesting aspects of the independent members. First, three out of four have experience within the retail industry. Second, the independent board members supply different capabilities, which support the transformation of PWT into a capital chain. Jesper Brøckner Nielsen has experience of acquiring and integrating a previous voluntary chain into an organization. Jan Bøgh has experience within optimization of purchasing processes. Claus Stagaard Juul has experience within sales and export of clothing, while Carsten Bo Pedersen is experienced within the area of finance and investments.

In p₁, the professional board member Claus Stagaard Juul resigns from the board. In p₃, the other previous owner of Hansen & Pedersen I/S, and CEO of PWT, Ole Koch Hansen, replaces Sven Wagner Pedersen. In addition, Henrik Theilbøhn, who has profound experience within the fashion and clothing industry, is recruited to the board (table 112 in appendix 34). Jesper Brøckner Nielsen and Carsten Bo Pedersen resign in p₃. This could indicate that their main contribution was experience during the process of acquiring and consolidating Tøjeksperten into the PWT group. The above reveals active ownership imposed by the PE fund to professionalize the board and actively tailor it to the functional needs of the organization.

When investigating the changes of management imposed during PE ownership, it is noteworthy, that neither PWT nor Dressmann Norge impose any changes to management²⁷ throughout the observation period (table 136 in appendix 35).

**Economic incentive alignment**

From table 25, it is evident that the previous owners of Hansen & Pedersen I/S and Tøjeksperten stores have an equity position in PWT after PE acquisition. The equity stake for previous owners throughout the observation period is 34% when including CEO’s equity position as a previous owner.

---

²⁷ Management is referred to as the management team in PWT and the CEO in Dressmann Norge.
Table 25

**Equity positions, bonuses and warrant programs for management and previous owners in PWT and Dressmann Norge during the PE ownership of PWT**

This table shows the equity positions by previous owners and management in PWT and Dressmann Norge throughout the period of PE ownership of PWT. Additionally, it provides information on any bonus and warrant programs.

<table>
<thead>
<tr>
<th>PWT</th>
<th>p1</th>
<th>p2</th>
<th>p3</th>
<th>p4</th>
<th>p5</th>
<th>p6</th>
</tr>
</thead>
<tbody>
<tr>
<td>Previous owners and board</td>
<td>37%</td>
<td>37%</td>
<td>32%</td>
<td>32%</td>
<td>32%</td>
<td>32%</td>
</tr>
<tr>
<td>Management *</td>
<td>3%</td>
<td>3%</td>
<td>2%</td>
<td>2%</td>
<td>2%</td>
<td>2%</td>
</tr>
<tr>
<td>Bonus program</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Warrant program</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Dressmann Norge</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Management***</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Bonus program</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Warrant program</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
</tbody>
</table>

Source: Own contribution, based on PWT Holding and Dressmann Norge's Annual Reports 2007-2012 *Ole Koch Hansen is the CEO of PWT and also previous owner of Hansen & Pedersen I/S owns 16% of share. He is considered previous owner here ***CEO, Petter Varner, is co-owner of Varner Group that owns Dressmann

In terms of aligning interest between management and owners, the management of PWT has an initial 3% equity position (CEO and previous owner Ole Koch Hansen has 16%, and the remaining management team 3%). The 3% ownership for the remaining management is a result of a warrant program imposed at the time of acquisition by the PE fund. The PE fund increases its equity position from p₃.

In contrast, the CEO of Dressmann Norge, Petter Varner, has a strong incentive alignment, since he is a co-owner of the Varner Group that owns Dressmann Norge. There is no information, that the remaining management team has equity positions or warrant programs – for which reasons it is concluded that there is no economic incentive alignment in terms of equity upside for the remaining management team.

The above reveals a different degree of economic incentive alignment in the case of PWT compared to its peer. If not taking into consideration that the CEO of Dressmann Norge is the co-owner, the PE fund employs economic incentives for the management to a larger degree than its peer.

11.3. **Baby Sam**

**Active ownership**

It is evident from table 138 in appendix 36 that BabySam has 5-8 official board meetings excluding teleconferences throughout the observation period. In the first three periods BabySam has 8 annual meetings. In subsequent periods, the number of meetings decreases and is supported by a number of teleconferences and special topic meetings. This could indicate that the PE fund follows its investment closely, and that the influence as well as coordination with management is prioritized in the initial part of the transformation.
Table 26

| Board sizes and changes during the observation period for BabySam and BH Nordic |
|---------------------------------|------|------|------|------|------|------|
| BabySam                         | p2   | p1   | p1   | p2   | p3   | p4   |
| Board size                      | 5    | 5    | 5    | 5    | 4    | 4    |
| % from PE fund                  | 50%  | 40%  | 40%  | 40%  | 50%  | 50%  |
| Current members out             | -4   | -1   | -1   | 8    | 6    | 6    |
| New members in                  | +4   | +6   | +3   | +1   |      |      |
| BH Nordic                       |      |      |      |      |      |      |
| Board size                      | 6    | 6    | 7    | 7    | 6    | 6    |
| Current members out             | -2   | -3   | +3   | +1   |      |      |
| New members in                  | +2   | +6   | +3   | +1   |      |      |

Source: Own contribution based on Annual Reports 2007-2014 for BabySam Holding and BH Nordic

As seen from table 26, the size of BabySam’s board is decreasing in the period of PE ownership. Compared to its peer, BabySam’s board is smaller throughout the entire observation period. In terms of changes in the board, BabySam introduces four new members after acquisition, and subsequently performs minor changes in p3 and p5. Its peer imposes a series of changes in the board in the periods; p-1, p1, p2, and p5.

Investigating the composition of BabySam’s board prior to acquisition, the majority of the members are owners of BabySam stores (table 139 in appendix 36). The only independent member is Hans Christian Jensen, who is an experienced board member, primarily within the telecom and construction industry (table 113 in appendix 43).

After PE acquisition, the board consists of representatives from the three majority owners, AAC Capital, Polaris and Vender Co. Holding Aps (previous owners of BabySam stores) (table 140-142 in appendix 36). The number of independent board members is increased after acquisition (2/5). Independent member, Sanna Mari Suvanto-Harsae has experience from management positions in two multinational consumer goods companies (Reckitt Benckiser and Procter & Gamble) as well as a director position in the Nordic voluntary optician chain, Synoptik. Lars Frederiksen is a former board member in Matas and has experience transforming the voluntary chain into a capital chain (table 114-115 in appendix 34). There are two interesting aspects of the independent members. First, they have experience from the retail and consumer goods industry. Second, they have functional experience from voluntary chains. In the case of Lars Frederiksen’s from the transformation of Matas into a capital chain. In p4, David Holm-Ovrén from ACC Capital is succeeded by another representative from ACC Capital, Karl Tommy Wikström. From p4 and onwards, Lars Frederiksen is no longer a part of the board.

The above could indicate that the PE fund prioritizes to hire independent board members with industry and functional experience. Especially, it is noticeable how Lars Frederiksen is hired to presumably contribute with his experience from the similar capital chain transformation of Matas.

The PE funds impose a series of changes to the management of BabySam. In p1 it introduces a new CEO and CFO (table 143 in appendix 36). Claus Jensen (CEO) has experience within the retail industry, both

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BabySam A.m.b.a

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28 Board of the purchasing company BabySam A.m.b.a
from capital and voluntary chains. He is the former CEO of Fakta A/S as well as chain director in the voluntary chains, Inspiration Retail and Din Tøjmand (table 116 in appendix 34). The new CFO, Finn Petersen, is the former CFO of Matas A/S, and thereby has experience in the transformation of a voluntary chain and knows a PE funds financial agenda (table 117 in appendix 34). In p1, a new purchasing director, Allan Agerskov Andersen is employed. He has experience within purchasing from Duni AB and COOP (table 118 in appendix 34). In p2, Jeanette Aaen succeeds Claus Jensen as CEO. She is a former store director in the department store, Magasin, as well as sales director for Menu A/S (table 119 in appendix 34).

The above indicates that the PE funds perform active ownership by hiring a new management team with functional experience from retail, voluntary chains and the transformation into a capital chain. Especially, the hiring of former CFO of Matas, Finn Petersen, indicates that a CFO with experience of a PE funds financial agenda is important for the PE fund. Furthermore, the hiring of a purchasing director could indicate that the PE funds perceive the purchasing area as an area for potential future value enhancements.

Economic incentive alignment

From table 27, it is evident that the previous owners of BabySam stores have ownership after PE acquisition. This could be an attempt to retain an economic incentive alignment, since a number of the previous owners are still managers in their previous wholly-owned stores.

### Table 27

**Equity positions, bonuses and warrant programs for management and previous owners in BabySam and BH Nordic during the PE ownership of BabySam**

This table shows the equity positions by previous owners and management in BabySam and BH Nordic throughout the period of PE ownership of BabySam. Additionally, it provides information on any bonus and warrant programs.

<table>
<thead>
<tr>
<th></th>
<th>BabySam</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>p1</td>
<td>p2</td>
<td>p3</td>
<td>p4</td>
<td>p5</td>
<td>p6</td>
</tr>
<tr>
<td>Previous owners</td>
<td>20%</td>
<td>20%</td>
<td>27%</td>
<td>27%</td>
<td>27%</td>
<td>27%</td>
</tr>
<tr>
<td>Management</td>
<td>5.4%</td>
<td>5.4%</td>
<td>7%</td>
<td>7%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Bonus program</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Warrant program</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>BH Nordic</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Management</td>
<td>0%</td>
<td>1.3%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Bonus program*</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Warrant program</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
</tbody>
</table>

Source: Own contribution based on BabySam Holding and BH Nordic’s Annual Reports 2007-2013 *Bonus program for peer is assumed, since there is a bonus payment in p2.

The management of BabySam has between 5.4 - 7% equity stake until p4 due to the reconstruction. This is a clear indication of initial economic incentive alignment between the management and the PE funds. In contrast, the equity positions of the management in BH Nordic are much smaller, and only present in one
year\textsuperscript{29}. Furthermore, BabySam introduces a warrant program to management and key employees. A warrant program is not present in the peer company. Additionally, both Babysam and its peer, have a bonus program to award management. The above indicates a stronger economic incentive alignment for the management in BabySam compared to its peer.

11.4. IDdesign

It is evident from table 153 in appendix 37 that IDdesign has at least 5 official board meetings annually incl. an annual strategy seminar throughout the observation period. The official meetings are supported by extraordinary meetings in p\textsubscript{2} and p\textsubscript{3}.

Table 28

<table>
<thead>
<tr>
<th></th>
<th>p\textsubscript{1}</th>
<th>p\textsubscript{2}</th>
<th>p\textsubscript{3}</th>
<th>p\textsubscript{4}</th>
<th>p\textsubscript{5}</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>IDdesign</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Board size</td>
<td>6</td>
<td>6</td>
<td>4</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>% from PE fund</td>
<td>17%</td>
<td>25%</td>
<td>25%</td>
<td>25%</td>
<td>25%</td>
</tr>
<tr>
<td>Current members out</td>
<td>-4</td>
<td>-2</td>
<td>-1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>New members in</td>
<td>+4</td>
<td></td>
<td></td>
<td></td>
<td>+1</td>
</tr>
<tr>
<td><strong>Chilli AB</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Board size</td>
<td>3</td>
<td>3</td>
<td>3</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Current members out</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>New members in</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Own contribution based on Annual Reports 2007-2014 for IDdesign Holding A/S and Chilli AB

Table 28 shows that the size of IDdesign’s board is decreasing in the period after PE acquisition, but is larger compared to peer throughout the entire period. This could be explained by the fact, that Chilli is remarkably smaller measured on revenues, and has a considerable identity between management and ownership. IDdesign introduces four new members in the period after acquisition, and subsequently performs adjustments in p\textsubscript{1}, p\textsubscript{4} and p\textsubscript{5}. Its peer does not impose any changes to the board during the observation period.

During the period before PE ownership, the majority of the board members\textsuperscript{30} are owners of IDEmøbler stores (table 154 in appendix 37). In addition, the board contains two independent members. Jens Christian Lorenzen is an experienced board member with previous positons in more than 100 companies and associations, including Imerco, Magasin, Danske Bank and Otto Mønsted (table 120 in appendix 34). The second independent member is Søren Bach. He is a former CEO of Expert Danmark, a Danish voluntary chain with retail brands such as: Punkt1, Expert, Lysmesteren and ELplus (table 121 in appendix 34). The degree of independent board members could indicate a professionalization already prior to PE acquisition.

After the acquisition by Axcel, the board consists of representatives from the two majority owners, Axcel and IDinvest 2007 A/S (previous owners of IDEmøbler stores) as well as a high degree of independent

\textsuperscript{29} The one year presence is due to a subsequent change of management in p\textsubscript{2}.

\textsuperscript{30} In Inbohome A.m.b.a.
members (3/6) (table 155 in appendix 37). Willy Kim Støckler and Jens Christian Lorenzen are present in the board both before and after acquisition. This could indicate that the PE fund values consistency. In terms of independent members, Trygve Holtskog is as a former CEO of the voluntary chain Expert Nordic (table 122 in appendix 34). Sven-Olof Kulldorff has a background within supply chain and purchasing, as previous responsible for the supply chain of the ICA-group\(^{31}\), and all purchase activities in the IKEA-group\(^{32}\) (table 123 in appendix 34). The independent members supply both industry and functional experience.

In terms of board adjustments, the two representatives from IDinvest 2007 A/S resign in p\(_4\). This is due to dilution from a capital increase by Axcel. In p\(_4\), Søren Peschardt Olesen is appointed new chairman of the board. He is a former CEO of Expert Norge, where he was responsible for transforming it into a capital chain (table 124 in appendix 34). Lastly, Christian Lorenzen resigns in p\(_5\).

The above indicates that the PE fund imposes active ownership and that it sees great value in utilizing industry and functional experience from the independent board members. The profile of the board members could indicate a focus towards optimization of the purchasing division as well as an expansion of the store network. The experience of Søren Peschardt Olesen further enhances the indication that the PE fund intends to grow and expand the capital chain.

The board in IDdesign hires a new CEO, Mikael Thinghuus, in p\(_1\). He is the former CEO of ECCO\(^{33}\) A/S, where he managed to increase earnings remarkably (table 125 in appendix 34). This indicates a strong focus on growth by the PE fund. In p\(_3\), Mikael Thinghuus resigns, and is replaced by Michael Christiansen, who is the former CEO of the Danish retailers Fakta\(^{34}\) and Silvan\(^{35}\) (table 159 in appendix 37). The initial employment of Mikael Thinghuus as the new CEO is a clear sign of active ownership imposed by the PE fund to find a management profile to execute the growth strategy. In contrast, its peer does not perform any changes to management. This can be explained by the fact, that it is a family-owned business and that the CEO is also co-owner of the company.

**Economic incentive alignment**

The previous owners of IDEmøbler stores initially have an equity position in IDdesign before their ownership share is diluted by a capital increase from the PE fund.

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\(^{31}\) ICA Gruppen AB is a leading retail company in Sweden with operations in the Baltics and a focus on food and health.

\(^{32}\) IKEA is a world-wide retailing company that designs and sells ready-to-assemble furniture.

\(^{33}\) Large Danish shoe producer and retailer.

\(^{34}\) Danish grocery retailer.

\(^{35}\) Danish lumber yard chain.
Table 29

Equity positions, bonuses and warrant programs for management and previous owners in IDdesign and Chilli during the PE ownership of IDdesign

This table shows the equity positions by previous owners and management in IDdesign and Chilli throughout the period of PE ownership of IDdesign. Additionally, it provides information on any bonus and warrant programs.

<table>
<thead>
<tr>
<th></th>
<th>p0</th>
<th>p1</th>
<th>p2</th>
<th>p3</th>
<th>p4</th>
<th>p5</th>
</tr>
</thead>
<tbody>
<tr>
<td>IDdesign</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Previous owners</td>
<td>40%</td>
<td>0.4%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Management</td>
<td>5.9%</td>
<td>5.9%</td>
<td>3.7%</td>
<td>6.3%</td>
<td>2.2%</td>
<td></td>
</tr>
<tr>
<td>Bonus program</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>N/A</td>
</tr>
<tr>
<td>Warrant program</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>N/A</td>
</tr>
<tr>
<td>Chilli AB</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Management*</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Bonus program</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Warrant program</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>N/A</td>
</tr>
</tbody>
</table>

Source: Own contribution, IDdesign Holding and Chili's Annual Reports 2007-2012 *CEO Jack Moell, is co-owner of the company.

The management of IDdesign has between 2.2% and 6.3% equity position throughout the observation period. Furthermore, IDdesign has a bonus program and a warrant program that encompasses 2-3 board members and the management team. This is a clear indication of economic incentive alignment between the PE fund and the management.

The CEO of Chilli AB, Jack Moell, has a strong incentive alignment, since he is a co-owner of the company. There is no information, that the remaining management team has equity positions or warrant programs – for which reasons it is concluded that there is no economic incentive alignment in terms of equity upside for the remaining management team.

This implies differences in economic incentive alignment for the two companies, where the PE fund employs economic incentives for the management in IDdesign to a larger degree than its peer Chilli AB, if not taking into consideration that the CEO is the co-owner.

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36 This is the case for all years, except p5 where Jysk takes over IDdesign after year-end and there is no information on any bonus or warrant programs anymore.
11.5. Cross case comparisons on corporate governance

The number of board meetings decrease in the period under PE ownership. This suggests that the PE funds are more actively involved in the initial part of the transformation than in subsequent periods.

Table 30

Cross case comparison from findings on corporate governance engineering

<table>
<thead>
<tr>
<th>Active ownership</th>
<th>Matas</th>
<th>PWT</th>
<th>BabySam</th>
<th>IDdesign</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initial and subsequent meeting frequency</td>
<td>12 → 9 (Decreasing from p1)</td>
<td>6 → 5 (Decreasing from p1)</td>
<td>8 → 5 (Decreasing from p3)</td>
<td>At least 5</td>
</tr>
<tr>
<td>Board size: Before-First period – Last period.</td>
<td>5-5-5</td>
<td>8-8-6</td>
<td>5-5-4</td>
<td>6-6-4</td>
</tr>
<tr>
<td>Board members from voluntary chain present in capital chain in the first period.</td>
<td>1/5</td>
<td>2/8</td>
<td>1/5</td>
<td>2/6</td>
</tr>
<tr>
<td>PE representation in the board first to last period</td>
<td>60%</td>
<td>25→33%</td>
<td>40→50%</td>
<td>17→25%</td>
</tr>
<tr>
<td>Independent representation in the board – first period.</td>
<td>0/5</td>
<td>3/8</td>
<td>2/5</td>
<td>3/6</td>
</tr>
<tr>
<td>Experience of independent board members after acquisition.</td>
<td>No independent members</td>
<td>Transformation Retail industry Purchasing Financial</td>
<td>Transformation Retail industry Voluntary chains</td>
<td>Transformation Retail industry Purchasing</td>
</tr>
<tr>
<td>Management changes within the first period.</td>
<td>New CFO</td>
<td>None</td>
<td>New CEO and CFO</td>
<td>New CEO</td>
</tr>
<tr>
<td>New management experience</td>
<td>PE ownership</td>
<td>-</td>
<td>Retail industry Transformation PE ownership</td>
<td>Retail industry</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Economic incentive alignment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Previous store owners’ equity stake from first to last period.</td>
</tr>
<tr>
<td>Management ownership from first to last period.</td>
</tr>
<tr>
<td>*IPO bonus</td>
</tr>
<tr>
<td>Bonus program</td>
</tr>
<tr>
<td>Warrant program</td>
</tr>
</tbody>
</table>

Source: Own contribution.

In terms of active ownership, the board size decreases in the period of PE ownership, while the PE representation increases in all cases, except for Matas. This is an indication of the board increasing its
decision-making ability during PE ownership. In all cases, the majority of the board members are replaced in the period after PE acquisition. In all cases, except for Matas independent members are hired to the board. This suggests, the PE funds impose active ownership by replacing the majority of the board and actively seek to add competencies from independent members. The profile of the independent members suggests that the PE funds seek industry and functional experience. The functional experience constitutes the transformational process from voluntary chains to capital chains as well as experience within the purchasing area. Furthermore, the majority of the PE funds replace part of the management team after acquisition. The experience for the new management members is within the retail industry, the transformational process from voluntary chain and PE ownership structure. We interpret this as the PE funds exercising active ownership by setting its own team and adding competencies to the board within the transformational process and purchasing area. This could further suggest that the purchasing area is interpreted as an area for potential value enhancement. Additionally, the replacement of part of the management team suggests that the PE funds interpret the current management team as not having the necessary capabilities to execute the PE strategy. For Matas and BabySam the new CFOs have experience from the PE ownership structure, suggesting that it is interpreted as important for the PE fund, that a CFO is aware of the PE funds financial agenda.

In terms of economic incentive alignment, all case companies offer initial management equity positions in the range 3%-5.9%, while previous store owners are offered between 20% and 40%. The economic incentive alignment for management is greater for the PE owned case companies than their respective peers in terms of imposed warrant and bonus programs as well as equity positions, when controlling for identity between management and owners. The equity position offered to previous store owners can be interpreted as economic incentive alignment between the PE fund owners and the store managers, as many of the previous owners are presumed to continue as store managers subsequent to acquisition.
12. Conclusion and discussion

Rosenbaum (2011) states six characteristics of attractive leveraged buyout candidates (section 3). From the perspective of the PE fund, the four case companies possess some of these characteristics during the period prior to acquisition. The case companies generate positive free cash flows, driven by operational income (EBIT). Furthermore, leverage is low, and interest coverage ratios are high. This indicates that the case companies have high debt capacity and can generate free cash flows for repaying and servicing the debt, imposed by the PE funds. Since both are important aspects for application of a leveraged buyout model, this partly explains why the PE funds consider the voluntary chains attractive investment objects.

In the majority of the observation period under PE ownership, two out of four cases – Matas and PWT – generate positive free cash flows amounting to an average of 8.8% and 6% of sales, respectively. On average, BabySam and IDdesign generate negative free cash flows as a ratio of sales, driven by poor EBIT performance. However, also the peers of BabySam and IDdesign experience negative free cash flows. This could indicate that these PE acquisitions took place during challenging industry conditions. This is confirmed when looking at Danish retail sales within baby clothing and furniture. The lacking ability to generate free cash flows negatively affects the ability to service and repay external debt.

In general, Matas and PWT generate positive continuous returns to shareholders (ROCE) under PE ownership, while the opposite is the case for BabySam and IDdesign when adjusting for special financial income. In contrast to BabySam and IDdesign, Matas and PWT experience positive influence from operational returns (RNOA). All cases, except for Matas generate negative returns from financing activities. All in all, return on common equity analysis reveals a similar conclusion as the free cash flow analysis.

Focusing on operational performance, we investigate profit margins and net working capital. The analysis of profit margin development reveals that all case companies, irrespective of initial levels, experience higher improvements in core profit margins compared to peers. Three out of four case companies experience relative improvements in net working capital, by lowering the cash conversion cycle. However, from a PE fund perspective, absolute performance is more important for increasing the enterprise value. In absolute terms, all case companies, except for BabySam, improve core profit margins. In terms of net working capital, all case companies except for PWT improve net working capital by lowering the cash conversion cycle. All in all, this indicates that the PE funds are able to impose operational improvements to the newly established capital chains. In retrospect, this could indicate that the PE funds see efficiency enhancement opportunities not previously realized in the voluntary chains. This is in accordance with Rosenbaum, 2011 characteristics of an attractive leveraged buyout candidate. Due to the nature of the explorative case study methodology it is difficult to directly compare findings with previous studies. However, Strömberg (2009) suggests that across various methodologies, measurements and time periods, PE funds do in general improve operating performance in their acquired targets. In line with this, our findings suggest that PE funds enhance operational performance in the acquired voluntary chains.

The acquisitions of voluntary chains involve considerable amounts of goodwill, financed with external debt by the PE funds. Goodwill reflects the ability of the company to produce future free cash flows. However, when this potential is not realised, goodwill is impaired, entailing a negative impact on
comprehensive income. Combined with the highly levered capital structure, goodwill impairments result in the reconstructions of BabySam and IDdesign.

Despite the goodwill impairments and the associated risk of reconstruction, the PE funds are able to impose operational improvements to the case companies. This suggests that acquisitions of voluntary chains could constitute interesting investment opportunities for PE funds. However, this requires further insight into the structuring of the transformation from voluntary to capital chain, based on financial, operational, investing and corporate governance engineering initiatives.

Section 8 on financial engineering shows how previous store owners are minority shareholders in the new capital chains through joint holding companies with the PE funds. From a financial perspective, we interpret this as an attempt to distribute risk between the fund and the previous owners. In contrast to the period before PE ownership, no dividends are paid, and excess cash is applied for debt repayment and servicing. This is expected and in accordance with the leveraged buyout model. In all cases, except for PWT, subordinate loan capital is provided from either the PE funds or previous owners. Especially, in the case of Matas, the PE fund provides a substantial amount of convertible, subordinate loan capital. This source of financing provides flexibility for the case company, and an alternative, early return generator for the PE fund.

External financing is concentrated in the holding company or split across the holding and operational companies. This is not fully in accordance with the debt pushdown observations by Spliid (2014), suggesting that lenders demand the placement of debt in operational companies, offering the highest degree of security. Except for BabySam, all case companies provide security in group company shares and/or receivables/cash reserves, suggesting a similar form of security, despite the placement of debt. The ability to provide security in less tangible assets may be a product of the easy access to external financing during pre-financial crisis years.

In all case companies, initial equity contributions are limited and continuously increased throughout the holding period, bringing down net financial leverage. Due to the performance differences, the background for supplying additional equity varies across the case companies. However, in general, it indicates a PE fund preference for external financing which is combined with equity contributions. For instance, if performance is weak and the PE funds forced to do so by external lenders. The preference for debt relative to equity is in accordance with the leveraged buyout model, presented in section 3.

The combination of continuous equity contributions, often for covering losses from goodwill impairment, and low interest coverage ability, indicates that the PE funds have difficulties finding the optimum balance between benefitting from external financing and financial distress costs. As suggested by Rosenbaum (2011), this constitutes a main risk of the highly levered leveraged buyout model, and is in accordance with the trade-off theory, described in section 3.

Section 9 on investments shows how capital expenditures are lower during the period before PE ownership compared to the period after. The composition of investments in the period before is dominated by local store initiatives. During PE ownership, case company investments fluctuate, but are particularly high in the first period for three out of four cases. This indicates that the PE funds have a
deliberate investment plan which is introduced shortly after acquisition. Goodwill accounts for a considerable proportion of total investments within the first periods. This indicates an acquisition-based strategy to rapidly grow the capital chains from add-on acquisitions. The early investments may be driven by the rather short investment horizons of the PE funds. Interpreting the acquisition of Tøjeksperten as the add-on investment to the existing PWT Group, all four case companies invest in expansions of the store networks. In contrast to most of the peers, the expansions are driven by M&A activity. This could suggest a buy-an-build strategy, in which companies are targeted to consolidate a particular sector and generate value from synergies (Hoffmann, 2008). According to Rosenbaum (2011), targets, possessing low investment requirements constitute attractive leveraged buyout candidates. However, same source suggests that high growth potential can justify additional investment requirements. It is noteworthy how investments in most cases as a ratio of sales decrease after the first year of PE ownership. This is in line with Kaplan (1989) which finds capital expenditures declining during the time of PE ownership.

Section 10 on operational engineering shows how revenues of all case companies are challenged by industry conditions during the financial crisis. However, the degree of influence is expected to depend on product assortment initiatives taken after the acquisition by the PE fund. While Matas increases its focus on the middle-price segment, from introduction of private label articles, and PWT introduces own value-for-money brands in the Tøjeksperten stores, BabySam and IDdesign are negatively affected from having highly cyclical, durable goods constituting the main part of their product portfolios.

The case companies employ fairly similar initiatives for improving the core profit margins. Focusing on initiatives for improving revenues, common for all case companies is a focus on rebuilding, relocation and expansion of the store network. Matas, PWT and BabySam introduce online sales and loyalty programs for higher customer retention. Matas, BabySam and IDdesign invest in employee training for leveraging employee capabilities. All case companies improve profit margins from renegotiating terms and conditions with suppliers as well as merging infrastructure functions. This suggests that the funds find readily accessible rationalization potentials. Given the new ownership structure, this indicates that the PE funds have improved possibilities for adjusting the store portfolio, introducing company-wide training programs, standardizing business processes and leveraging the increased purchasing power and adjusted product portfolio for improving terms and conditions with suppliers.

The case companies receive net working capital improvements from various sources. Matas and IDdesign improve credit terms with suppliers, while PWT and BabySam shorten the credit period to customers and decreases inventory days, respectively. The initiatives employed vary across cases, but revolves around centralization of purchasing divisions, assortment adjustments and leverage of IT.

Section 11 on corporate governance engineering investigates active ownership and economic incentive alignment in the newly-established capital chains. In terms of active ownership, our study suggests that the majority of chains under PE ownership have more official board meetings in the initial period of the transformation than in subsequent periods. Except for Matas, the size of the board decreases and the degree of PE representation increases. This is interpreted as the PE funds actively seeking to enhance influence through increased representation and improved decision making ability by introducing smaller boards. This is in line with the theory of active ownership and increased control through a concentrated
and participating board, which can act quicker in case of ineffective management and put pressure on the agent, as suggested by Jensen & Meckling, (1976) Lowenstein, (1986) and Smith, (1990).

The board composition of the newly acquired capital chains change remarkably after acquisition. All cases, except for Matas, have independent board member representation. The profiles of the independent board members, suggest that the PE funds actively seek to add industry and functional experience to the boards. Industry experience constitutes of explicit retail industry and/or voluntary chain involvement. All cases except for Matas, hire independent members with experience in distinct functional areas. The first area is the transformation process from voluntary chain into capital chain present in PWT, BabySam and IDdesign. Second, is the experience from the purchasing area present in PWT and IDdesign. This suggests that the PE funds execute active ownership, by adding competences and experience, they do not possess themselves, and that it is mostly present within the area of transformation and purchasing. This could further indicate that the PE funds experience the transformation as complex, and that they have identified purchasing as an unexploited area of optimization. These findings are in line with Sing (1990), which suggests that PE funds apply radical changes in corporate governance structure of the acquired firm, introducing a more focused board.

In terms of management changes, all cases except for PWT, hire a new CEO and/or CFO at the time of acquisition. The new CFOs in Matas and BabySam have experience from PE-owned companies, and in BabySam’s case transformation from a voluntary chain to a capital chain. Further, it suggests that the PE funds in two out of four cases employ a new CFO that, presumably, understands the PE funds’ financial agenda. This is in accordance with findings by Cornelli & Karakas, (2008), which suggests that the PE funds are likely to recruit a professional management team.

Management teams in all case companies have equity positions after PE acquisition. Initially, the equity stake for management is between 3%-5.9%. However, in all cases, the equity positions of the management teams are lower compared to previous empirical findings on management ownership in PE acquisitions. Acharya & Kehoe (2008) and Kaplan & Strömberg (2008) find that the management team obtains 15-16% equity upside. Nonetheless, comparing the cases to their peers, the economic incentive alignment for management is stronger for the case companies, when controlling for identity between management and ownership. This is evident through larger equity positions for management and increased presence of warrant and bonus programs in the case companies. This suggests a stronger economic incentive alignment between management in the case companies to minimize the principle agent problems compared to their peers.

Previous store owners also have equity positions after PE acquisitions. The initial equity stake is between 20%-40%. As the previous store owners, to some degree, are expected to continue management positions in the acquired stores, this is considered an attempt by the PE fund to decrease the principle-agent problem and align economic interests of the fund and the store managers. This could potentially explain why the equity positions from management is lower compared to previous empirical findings, as the equity positions to a larger extend are offered to store managers who were previously independent in order to minimize the principle agent problem.
13. Out of sample perspective: Indeks Retail

Indeks Retail A/S is the chain office of the voluntary chains, Bog & Idé, Bøger & Papir, BOGhandleren and Legekæden (IndeksRetail, 2013). The chain office provides concept development, human resource capabilities, marketing, product assortment, web, IT, finance and logistics to the four voluntary chains (ibid).

The voluntary group is the result of multiple mergers and acquisitions in the Danish book and toys retailing industry. In 2005, the two voluntary bookseller concepts, Bog & Idé and Bøger & Papir, merged, and in 2006, the BOGhandleren chain was established in collaboration with independent booksellers (IndeksRetail, 2015). In 2007, Indeks Retail became the largest book retailer in Denmark with the acquisition of G.E.C. Gads Boghandel. Today, previous stores of Gad are owned by the chain office and operate under the Bog & Idé concept. In 2013, Indeks Retail increased its exposure towards retailing of toys with the acquisition of Legekæden amba. Indeks Retail operates the chain services, while store activities in Legekæden are continued through independent stores. The acquisition enables the chain to focus bookselling in the Bog & Idé stores and retail of toys in the Legekæden stores, to a higher degree combine books and toys in Bøger & Papir stores and provide a reasonable web offering (IndeksRetail, 2013).

In total, Indeks Retail represents more than 220 retail stores in Denmark, Faroe Islands, Greenland and Finland with retail revenues of app. DKK 1.85 bn. and more than 1,000 employees. The toy operations of Legekæden constitute app. 14% of total revenues and 20% of total employees (ibid).

An investigation of recent annual reports reveals that except for the stake in Nordic Toys AB, Sweden, all subsidiaries of the group are consolidated into the annual group report of Indeks Retail A/S. Besides the retailing activities of 11 Bog & Idé stores through Indeks Retail Invest A/S and one Legekæden store in Svendborg, the chain office carries out no store activity. Thus, independent retailers perform the far majority of retail activities. The supporting functions of the voluntary chain are gathered in the Indeks Retail A/S and Legekæden amba companies. Other group companies are of limited size and focus on providing store financing and e-media solutions for e-books, offered through the group web shop. Thus, a potential PE acquisition of the total voluntary chain would mainly include the independent stores and the chain office function.

Assuming that a PE fund perceives Indeks Retail as an attractive investment opportunity, the following puts forward suggestions for structuring the transformation from voluntary to capital chain. The suggestions revolve around investment activities, operational engineering, financial engineering as well as corporate governance engineering initiatives as identified in previous sections.

Today, the Indeks Retail group offers two overall product assortments – books and toys. In 2007, after the acquisition of the Gad chain, Bogmarkedet estimated the total market share of the book business to 65% (Bogmarkedet.dk, 2007). No market share data of toy activities are obtainable. At the acquisition of the chain office in 2013, Legekæden included 53 stores (IndeksRetail, 2013). A main competitor is Top-Toy, having 108 BR and Toys”R”Us stores in Denmark (Top-Toy, 2015). Large, Danish retailers, such as Coop and Dansk Supermarked are considered important competitors on both books and toys (Finans.dk, 2015).
All case companies of our investigations employ an acquisition-based strategy to rapidly grow the capital chains from add-on acquisitions. Assuming competition authority approval and depending on PE fund strategy, there seems to be room for further store network expansions and store portfolio improvements. Depending on the risk profile of the PE fund, an option-based approach – comparable to CVC’s continuous store acquisition strategy in the acquisition of Matas – could be employed. The considerable size of the transformation, including more than 220 stores, two overall product concepts, total retail revenues of DKK 1.85 bn. and a recent acquisition of the Legekæden chain office, may point towards the application of an option-based store network expansion approach.

During recent years, the book industry has experienced an increasing number of customers switching to electronic books, read on computers and tablets (Finans.dk, 2015). At the same time, physical booksellers have experienced increased competition from online suppliers of both physical and e-books (ibid). If Indeks Retail is not able to participate in the transformation, it may leave the PE fund with an extensive physical store network but decreasing activity. Today, Indeks Retail has online web shops for their respective chains, and as previously illustrated, owns a company, providing e-media solutions. The PE fund may utilize the more centralised decision power of the capital chain to invest heavily in online solutions. A potential add-on target could be the online provider of both e-books and physical books, Saxo.com. Such buy-to-build strategies are in general seen across the sample of case companies.

Figure 25-26 in appendix 7 suggests a general industry decline within book retailing during recent years, while the retailing of toys and games has experienced a relatively stable development. The combination of rapid, industry-wide changes and declining industry revenues constitute a main risk in a leveraged buyout of the chain. As previously seen, declining revenues can drive goodwill impairments and associated reconstructions, resulting in poor overall performance. This could also indicate that a given PE fund should continue and prioritize the recently established focus on toys in Legekæden.

Including management and previous store owners in the ownership structure of the newly-established capital chain services multiple purposes from both a financial and corporate governance perspective. The chairman of Indeks Retail A/S, Michael Meyer, has in relation to the acquisition of Gads Boghandel, declared:

“The acquisition is a large step towards the industry consolidation, carried out by Indeks Retail A/S. We do it ourselves and with no assistance from a private equity fund or other without experience or love for the industry” (Business.dk, 2012)

The quote reveals that the Indeks Retail management has expressed aversion against being acquired by a PE fund. From a corporate governance perspective, including previous store owners and management aligns the interests with the PE fund and could potentially mitigate the aversion against a PE fund acquisition. From a financial perspective, a high proportion of equity owned by previous store owners and management provide the PE fund with an alternative acquisition financing source, decreasing capital requirements of the PE fund. The co-investors would reinvest funds from the acquisition through a joint holding company, which owns the total operations of the purchasing arm and stores. Another structural initiative, providing flexibility for the PE fund and case company, could be the application of subordinate
loan capital. If including conversion clauses, the PE fund has the future opportunity of converting the debt into equity, depending on i.e. the performance of the newly-established capital chain.

Previous analysis revealed how the case companies introduce various product assortment initiatives, subject to different macro influence. Our analysis suggests two overall strategies applicable for Indeks Retail. Inspired by Matas and PWT, Indeks Retail could focus on private label solutions, i.e. publishing activities under own brands or private label toys. The cases of BabySam and IDdesign suggest closer coordination of book and toy retailing activities. This can, potentially, increase purchasing power and lower COGS.

The case companies of previous analyses employ fairly similar initiatives to improve core profit margins. Depending on the overall strategy of the PE fund, this suggests that the fund should introduce store portfolio improvements, company-wide training programs, increase customer retention from loyalty programs, invest in online sales, leverage group IT and improve supplier terms and conditions. As suggested by Rosenbaum, 2011, efficiency improvements constitute a great source for increasing enterprise value of the target.

From a corporate governance perspective, previous analyses show two areas of initiatives – active ownership and economic incentive alignment. In terms of active ownership, PE funds have previously decreased the board size and increased PE fund representation to improve decision making ability. Furthermore, the funds hire independent board members with industry and functional experience. Imperatively, the investment strategy will dictate the profile of independent board members. For instance, an add-on acquisition of Saxo.com would suggest the inclusion of independent board members with e-business experience. Independently of the investment strategy, previous analysis suggests hiring of independent board members with experience from transforming voluntary chains into capital chains. On management level, we have observed two instances of PE funds employing new CFOs who previously worked under PE ownership. This indicates that employing a CFO with knowledge of a PE funds’ financial agenda has been perceived important by the funds.

In addition to including management and previous store owners in the ownership of the capital chain, previous cases include warrant and bonus programs in an attempt to further align interests between management team and owners. In the case of Matas, the inclusion of an IPO bonus program ties the bonus structure to the desired exit strategy of the PE fund. Depending on the actual exit strategy of a given PE fund, such program could further align interests between management and PE fund.
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