Expectations for the CFO from an owner and board perspective

Deloitte CFO Agenda Aarhus 2014
25 September 2014
Agenda

Introduction to Odin Equity Partners

Value creation in Private Equity

The CFO role from an owner and board perspective
Introduction to Odin Equity Partners

Odin Equity Partners

- Odin Equity Partners ("Odin") was founded in 2005 as the first independent Private Equity fund in Denmark with focus on smaller and medium-sized enterprises.
- We manage two funds with a total commitment of DKK 2.2bn. Our investors include several Danish pension funds and international investors.
- Odin’s geographic focus is Denmark, Southern Sweden and Northern Germany. We do not have a specific industry focus.
- We invest in niche companies with revenue of DKK 200-500m typically as the first institutional owner.
- Our objective is to build stronger, bigger and better companies through step change in revenue and profitability.
- We have carried out 16 platform investments (currently 12 in the portfolio) and completed numerous add-on investments to these.
- In short, our aim is to be the preferred partner for businesses and business owners who are considering succession or generational changes.

About me

- I joined Odin in Feb06 and was named Partner in Nov10 and Managing Partner in Mar14
- I head up our internal Investment Committee and sit on the board of a number of our portfolio companies.
- Before joining Odin Equity Partners, I was at The Boston Consulting Group advising corporate clients on strategic development.
- Before BCG, I worked 8 years for Shell International with focus on corporate M&A and business development.
- I hold a MSc in Business Administration and Commercial Law from Copenhagen Business School.
Odin currently manages 12 portfolio companies in a variety of industries.

Fund 1

Qubiq
Scan
PEDAX
HEATEX
TRANSMEDICA
HYDRA tech

Fund 2

SYSTEM FRUGT
DB
W Ostergaard Aarhus
SFK
SSG
SH GROUP AS
WEISS
We define our ownership period in three phases with distinct milestones and key focus areas

### Laying the foundation
- Develop detailed ownership agenda and value creation plan (based on DD).
- Establish corporate governance incl. ‘industry specific’ board with 2-3 external members.
- Execute on ‘enablers’ for future growth incl. improvements in people, processes and systems.

### Driving value creation
- Execute the strategic plan for value creation.
- Review effect and success of value creation initiatives.
- Continuous follow-up and adjust the strategic, operational, and financial plan.

### Optimizing ‘Exit’
- Assess market dynamics affecting Exit.
- Build understanding of strategic rationale for Tier 1 buyers.
- Develop operational momentum before launching Exit process.
- Drive Exit with appropriate advisors.

### Key milestones
- What are the opportunities for step change in revenue and profitability.
- Are the capabilities needed to drive the value creation plan in place.
- How do we prioritize the different value creation initiatives.
- How do we build strategic value while maintaining operational focus.
- Who is the right future owner – what is the strategic logic.
- When do we push the button - how do we maximize shareholder value during the final phase of ownership.
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Value creation in Private Equity

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Generically, value creation in Private Equity can be grouped in five main drivers:

**Leverage effect**
- Repayment of debt

**Sales growth**
- Geographical expansion
- New product development
- Acquisitions

**Margin improvement**
- Sales excellence
- Operational efficiency
- Outsourcing

**FCF effect**
- NWC reduction
- CAPEX management

**Multiple expansion**
- Strategic position
- Cash conversion

**Examples of initiatives**

**Total value creation**

*ILLUSTRATIVE*
The latest Capital Dynamics study (2013) of Danish PE investments highlights operational improvements as the key drivers of value creation.

Value drivers for companies owned by Danish PE funds

<table>
<thead>
<tr>
<th>Money multiple</th>
<th>Leverage effect</th>
<th>Sales growth</th>
<th>Margin improvement</th>
<th>FCF effect</th>
<th>Multiple expansion</th>
<th>Combination factor</th>
<th>Total value creation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>0.93</td>
<td>0.91</td>
<td>0.88</td>
<td>0.04</td>
<td>0.21</td>
<td>0.12</td>
<td>3.09</td>
</tr>
</tbody>
</table>

Operational improvement

Source: Capital Dynamics and Center for Entrepreneurial and Financial Studies at Technical University of Munich (2013)

Highlights

- The sample consist of 64 Danish PE exits between 1995 and 2011.
- The average holding period in the sample was 4.6 years.
- 63% of the value was created by operational improvements.
- 30% of the value was created by leverage effects.
Operational improvements are more important for value creation in smaller vs larger investments and Danish vs European funds

**Value creation in small vs large deals in Denmark**

- Danish deals with an enterprise value below EUR 100m
  - Value creation in the smaller companies relied more on operational improvements than larger deals
  - Leverage effects 29%
  - Operational improvements 68%
  - Market effects 3%
- Danish deals with an enterprise value above EUR 100m
  - Value creation in the larger companies relied less on operational improvements than smaller deals
  - Leverage effects 32%
  - Operational improvements 55%
  - Market effects 13%

**Value creation in Danish vs European funds**

- Exits from Danish PE funds
  - Value creation in Danish funds is mostly due to operational improvements
  - Leverage effects 30%
  - Operational improvements 63%
  - Market effects 7%
- Exits from European PE funds
  - Value creation in European funds is mostly due to operational improvements as well, however, less so than in Danish funds
  - Leverage effects 33%
  - Operational improvements 50%
  - Market effects 17%

Source: Capital Dynamics and Center for Entrepreneurial and Financial Studies at Technical University of Munich (2013)
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The CFO role from an owner and board perspective
## The CFO plays a vital part of the governance model

### Governance structure

<table>
<thead>
<tr>
<th>Co-investors</th>
<th>Odin</th>
<th>Limited Partners</th>
<th>Board of Directors</th>
<th>Management (CEO and CFO)</th>
</tr>
</thead>
</table>

### Key stakeholders

- **Odin**
  - Majority shareholder
  - Appoints key board members
  - Key driver in defining the value creation agenda

- **Board of Directors**
  - Include external members with relevant industry and/or operational knowledge
  - Challenge and support management in developing the strategy and aligning with the value creation agenda

- **Management**
  - Consists of CEO and CFO
  - Executes the strategy
  - Drive operational development, strategy execution and risk mitigation
The role of the CFO changed considerably during our ownership period going from ‘Transactional’ to ‘Strategic’

- There are distinct differences in the skill set that is required from the CFO in the initial ownership period, during the growth phase, and at exit.

- The required skill set is under continuous development from an initial focus on the basics of the CFO role, such as controlling/reporting, to focusing more on building processes and systems to finally becoming a commercial and strategic partner to the CEO.
When ‘Laying the foundation’ Odin and the board seek ‘The Accountant’ and when ‘Optimizing Exit’ we look for ‘The Strategist’

<table>
<thead>
<tr>
<th>Laying the foundation</th>
<th>Driving value creation</th>
<th>Optimizing ‘Exit’</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Ensure speedy and accurate financial information.</td>
<td>• Continuously control operational performance.</td>
<td>• Support the CEO in preparing the organization for Exit.</td>
</tr>
<tr>
<td>• Develop enhanced reporting package, incl. risk mgmt.</td>
<td>• Drive increasing efficiency in financial processes to lower NWC and capital employed.</td>
<td>• Understand market dynamics to assist in assessing timing.</td>
</tr>
<tr>
<td>• Establish relationship with financial partners.</td>
<td>• Support the prioritization of value creation initiatives, incl. development of KPIs.</td>
<td>• Engage with advisors to build strong Exit story.</td>
</tr>
<tr>
<td>• Strengthen internal processes to fully leverage professional board.</td>
<td>• Communicate financial progress to stakeholders, incl. shareholders and debt providers.</td>
<td>• Manage the due diligence process together with CEO and Odin.</td>
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<tr>
<td>• Support development of strategic plan.</td>
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CFO tasks

<table>
<thead>
<tr>
<th>Skill set</th>
<th>The Accountant</th>
<th>The Financial Consultant</th>
<th>The Strategist</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Deep understanding of financial performance.</td>
<td>• Ability to fully understand the business.</td>
<td>• Strong strategic understanding of the business.</td>
<td></td>
</tr>
<tr>
<td>• Focus on structure and processes.</td>
<td>• Driver of change.</td>
<td>• Strong communicator both internally and externally.</td>
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<tr>
<td>• Ability to motivate back office staff and influence strategic direction.</td>
<td>• Focus on operational and financial risk and reward.</td>
<td>• Ability to step in as CEO when needed.</td>
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</table>
A recent study by Deloitte (2013), emphasises the diverse skill set sought from the CFO in the different phases of PE ownership.

Very few CFOs possess all competencies sought throughout the ownership period and hence ~70% are replaced between Entry and Exit.

Source: Deloitte: The role of the PE backed CFO
Key take aways

• In PE, the governance model ensures alignment between Odin, the board and management (CEO and CFO).

• Value creation in a Danish setting, centers around sales and margin improvements. The smaller the investment, the more important are operational improvements.

• In small and medium-sized companies, the role of the CFO changes throughout the ownership period from ‘transactional’ with focus on basic finance functions to ‘strategic’ with a focus on operational improvements.

• The CFO must deliver on the specific tasks in each phase of ownership, which requires a very diverse skill set.

• Very few CFOs have the skill set needed across all phases and consequently, ~70% of CFOs in companies with PE ownership are replaced between Entry and Exit.

• I can only recommend you to continue broadening your skill set and/or ensure superior operational competencies in your finance organizations from the beginning of the ‘journey with PE’.
---- Thank you for listening ---