



CORPORATE
FINANCE
FACULTY

Private equity demystified

An explanatory guide

THIRD EDITION

John Gilligan and Mike Wright

Private Equity Demystified – An Explanatory Guide

An initiative from the ICAEW Corporate Finance Faculty

Private Equity Demystified provides an objective explanation of private equity, recognising that for public scrutiny of this sector to be effective it must be conducted on an informed basis. This is recognised by the work featuring on reading lists of leading business schools.

Since the publication in 2008 of the first edition of *Private Equity Demystified* the major economies have moved from growth to recession to evidence of emergence from recession. We have seen the enactment and subsequent implementation of the European Commission's Alternative Investment Fund Managers Directive which covers private equity funds. In addition, the academic world has applied new techniques to old questions as new data sets have become available. Earlier editions reflected the turmoil of the recession and examined the way in which the banking market changed its approach to private equity investments as well as the dynamics of the restructuring industry.

This third edition picks up as many western economies show signs of a resurgence of growth. It examines further developments in private equity, such as its methodologies, management of funds and relationships with limited partners.

The value of the work will continue to be measured in better-informed debate, in private equity's effective engagement with wider stakeholders, in well thought out public policies and in awareness among business owners of private equity as a potential source of sustainable finance for growth.

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Contents

	Page
Preface to the third edition	07
Acknowledgements	08
About the authors	09
List of figures and tables	10
1. THE PRIVATE EQUITY MARKET	13
1.1 What is private equity?	14
1.1.1 What is a private equity fund?	14
1.1.2 What are the objectives of private equity investment?	14
1.1.3 What is the difference between venture capital, growth capital and private equity?	14
1.1.4 Are there any theoretical ideas behind the private equity investment model?	15
1.1.5 What do private equity fund managers do?	16
1.1.6 What risks do investors in private equity funds take?	17
1.1.7 What risks do private equity fund managers take themselves?	17
1.1.8 What rewards do private equity investors earn?	18
1.1.9 What is carried interest?	18
1.1.10 What is leverage and what role does it play in private equity?	18
1.1.11 What impact does the gearing have on the private equity fund manager's return?	20
1.1.12 Does size matter?	20
1.1.13 What impact does leverage have on bankruptcy risk?	21
1.1.14 How do private equity funds control their investments?	21
1.1.15 Leverage in funds versus leverage in investments	21
1.1.16 What market risks does private equity create?	22
1.1.17 A financial canary in the coal mine?	22
1.2 A summary of the core ideas. The 4As: amplification, alignment, active management and attention to detail	22
1.3 A brief history of private equity	23
1.3.1 Asset stripping and financial assistance	23
1.3.2 1980s first buy-out boom	23
1.3.3 1980s 'hand-off, eyes-on'	24
1.3.4 Mid-1980s: new entrants	24
1.3.5 1989: mega deals V1.0	24

1.3.6	Captives versus independents	24
1.3.7	Yield versus capital gain	24
1.3.8	1990s blow up and buy-outs of captive funds	24
1.3.9	Hands-on investors and sector specialisation	25
1.3.10	Globalisation and the growth of global mega-funds	25
1.3.11	2005–2007: boom	25
1.3.12	2007–2008: bust	26
1.3.13	2009–2012: hangover	26
1.3.14	2014: where we are today	26
1.4	How big is the private equity market?	27
1.4.1	How significant are larger deals in the private equity market?	29
1.4.2	The death of the management buy-out?	30
1.4.3	The company auction process	31
1.4.4	Deal initiation and proprietary deal flow	32
1.4.5	What have been the biggest UK deals?	32
1.4.6	What have been the biggest deals in the world?	33
1.4.7	What are the largest private equity funds in the world?	34
1.4.8	How significant are public to private transactions in the private equity market	35
2.	PRIVATE EQUITY FUNDS, FUNDERS AND OTHER MARKET PARTICIPANTS	37
2.1	The private equity fund	38
2.1.1	What is a private equity fund?	38
2.1.2	How are private equity funds structured? ‘Ten plus two’ funds	38
2.1.3	Why are private equity funds partnerships?	38
2.1.4	What are LPs and GPs?	39
2.1.5	Who are the investors in private equity funds?	39
2.1.6	What are sovereign wealth funds?	41
2.1.7	How are private equity fund managers rewarded?	41
2.1.8	Other fees	43
2.1.9	What is co-investment and how does it differ from carried interest?	43
2.1.10	What are separate managed account arrangements?	44
2.1.11	How does a private equity fund differ from a quoted equity fund?	44
2.1.12	How does a private equity fund differ from a group of companies?	46
2.1.13	What are hedge funds and how do they differ from private equity funds?	48
2.1.14	Emerging and converging alternative asset investors	50
2.1.15	Can a private equity fund or private equity manager fail?	51
2.1.16	Where do private equity fund managers operate?	52
2.1.17	Why have European private equity funds been based predominantly in the UK?	53
2.1.18	Fund raising and investors in private equity funds	54
2.1.19	Committed versus invested capital	55
2.1.20	Investor cash flows: the J curve (at cost)	56

2.1.21	Fund management fees	57
2.1.22	Fund extensions	57
2.1.23	Competition for funds by private equity managers	57
2.1.24	What are founders' rights and re-ups?	58
2.1.25	What is 'most favoured nation' status?	58
2.1.26	First closes, early commitment discounts and speed of fund-raising	58
2.1.27	How can individual investors invest in private equity funds?	58
2.1.28	What is the secondary fund market?	59
2.1.29	Why do private equity funds value unrealised investments?	60
2.1.30	How do private equity funds value unrealised investments?	61
2.1.31	Understanding private equity portfolio valuation movements	62
2.1.32	Valuation of limited partner holdings: the J curve revisited	63
2.1.33	What are DPI and TVPI as measures of return?	64
2.1.34	What is the range of returns for investors?	64
2.1.35	Banks and other lenders	67
2.1.36	What are collateralised debt obligations, collateralised loan obligations and structured investment vehicles?	70
2.1.37	Non-bank lenders	73
2.2	Advisers and other service providers	73
2.2.1	Who provides outsourced services?	73
2.2.2	Who are transactions advisers?	73
2.2.3	Who are fund-raising advisers?	74
2.3	Employees and other stakeholders	75
2.3.1	What is the impact of private equity transactions on wider stakeholders?	75
2.3.2	What is TUPE and when is it applied?	75
2.4	Taxation	78
2.4.1	Investors in a private equity fund	78
2.4.2	Private equity executives/fund	79
2.4.3	Investee companies	81
2.5	Refinancing and exits	83
2.5.1	Types of exit	83
2.5.2	What has been the pattern of exits from private equity deals?	84
2.5.3	Secondary buy-outs and new principal agent issues	84
2.5.4	What is a leveraged recapitalisation?	87
2.5.5	What is a secondary fund market transaction and how does it differ from a secondary buy-out?	87
2.6	How did the UK private equity industry respond to public scrutiny?	91
2.6.1	What are the Walker Guidelines?	92
2.7	What is the Alternative Investment Fund Managers' (AIFM) Directive and what are its implications for private equity?	93

3. EVALUATING, STRUCTURING AND RESTRUCTURING A PRIVATE EQUITY INVESTMENT	95
3.1 Who's who in a private equity transaction	96
3.1.1 What is the role of the wider stakeholder?	97
3.1.2 Value and pricing	97
3.1.3 Net present value, IRR and theoretical valuation methods	99
3.1.4 What is 'financial engineering'?	99
3.1.5 How do you design and build financial instruments?	100
3.1.6 What is a 'Newco'?	103
3.1.7 How do you decide whether to buy shares or assets?	103
3.1.8 Pricing a transaction	104
3.1.9 A financeable offer	104
3.2 Senior debt and mezzanine	104
3.2.1 What is debt?	104
3.2.2 How much debt?	105
3.2.3 How did banks increase the levels of borrowing in buy-outs? Capital holidays and bullet loans	108
3.2.4 How did banks increase the levels of borrowings in buy-outs? Payment-in-kind debt	109
3.2.5 Why did banks increase the amount of debt?	109
3.2.6 What is mezzanine?	110
3.2.7 Can Newco repay the borrowings?	112
3.2.8 What security will the banks have?	112
3.2.9 What are the potential sources of cash flow to repay borrowings?	113
3.2.10 Increasing post-tax profits	113
3.2.11 Reducing working capital	114
3.2.12 Fixed assets: to own or lease?	114
3.2.13 What are propco/opco structures? A special case	114
3.2.14 Asset stripping and financial assistance	118
3.2.15 What protection exists for publicly quoted companies?	118
3.2.16 The risks of leverage: financial covenants and events of default	119
3.2.17 Incurrence covenants and maintenance covenants	119
3.2.18 An event of default and corporate failure	120
3.2.19 How can the risks of leverage be mitigated?	120
3.2.20 Has anything changed since the banking crisis?	121
3.2.21 Restoring leverage: asset-based lenders	122
3.2.22 Alternative debt providers and unitranche debt	122
3.3 Institutional and management equity	123
3.3.1 How much institutional equity?	123
3.3.2 Debt:equity ratio	126
3.3.3 Did the largest leveraged buy-outs fail during the recession?	127
3.3.4 How much equity do management get in a buy-out?	128
3.3.5 What is a ratchet?	128

3.4 Distress and restructuring	129
3.4.1 What are the types of company distress?	129
3.4.2 What is equity cure?	130
3.4.3 What is financial restructuring?	130
3.4.4 What is a 'hair cut' and who bears it?	131
3.4.5 What powers does a secured lender have?	132
3.4.6 What tools are available to restructure a balance sheet?	133
3.4.7 Summary	134
3.4.8 What are the differences in restructuring publicly traded debt?	134
3.4.9 Equity investors: the impact of distress	135
3.4.10 Equity investors: what are the options?	136
3.4.11 What is the position of management in a restructuring?	137
3.4.12 What is a good leaver/bad leaver?	137
4. A WORKED EXAMPLE	139
4.1 A detailed worked example of a leveraged buy-out	140
4.1.1 Operating profit projections	140
4.1.2 A note on valuations	141
4.1.3 Cash flow projections	141
4.1.4 A profit bridge	142
4.1.5 Funding requirement	144
4.1.6 What are the transaction fees and expenses?	144
4.1.7 What are contingent fee arrangements?	145
4.1.8 A funding structure	145
4.2 The impact of leverage on profits and cash	148
4.3 Restructured balance sheet	153
4.4 PIK loanstock: what is the 'equity illusion'?	154
4.5 Taxation: how much tax is paid by a private equity-backed company?	155
4.6 Summary of company corporation tax	157
4.7 What is investment due diligence?	158
4.8 What is vendor due diligence and how does it impact risks/rewards?	158
4.9 Sensitivity analysis	159
4.10 Exits and returns	159
4.11 Closing remarks	163
5. CRITICS AND THE RESEARCH	165
5.1 Is private equity about majority acquisitions of large listed corporations?	166
5.2 Does private equity create systemic risk?	166
5.3 What happened to the 'wall of debt'?	166
5.4 Is there excessive debt and are gains from leverage?	166
5.5 Does the industry suffer from short-termism and do private equity buy-outs result in underinvestment?	167
5.6 Is there a lack of employee consultation in private equity-owned firms?	168
5.7 Is there tax avoidance and why are tax havens used?	169

5.8	Is there a culture of secrecy?	169
5.9	Is there overpayment of executives?	169
5.10	Is there sufficient permanent capital in private equity funds?	170
5.11	Is there a misalignment of incentives?	170
5.11.1	Fund level fees	170
5.11.2	Transaction fees	170
5.11.3	Zombie funds	171
5.11.4	Late fund stuffing	171
5.11.5	Equity illusion	171
5.11.6	Time value of money	171
5.11.7	Funding acquisitions	171
5.11.8	Credit default swaps	171
5.11.9	Valuation of unrealised investments	171
5.12	Do the conclusions to be reached about private equity depend on the evidence base?	172
5.13	What are the areas for further research?	172
APPENDIX: SUMMARIES OF STUDIES OF BUY-OUTS AND PRIVATE EQUITY		175
REFERENCES		199
GLOSSARY		210

Preface to the third edition

For over two decades, from the early 1980s, the developing private equity industry largely flew below the radar of public scrutiny. In 2007 the private equity industry came under intense public scrutiny including a House of Commons Select Committee enquiry. We published the first edition of *Private Equity Demystified* in August 2008. There followed a period of unprecedented financial turmoil. The second edition built on the first edition to reflect the effects of the recession and examined the way in which the banking market changed its approach to private equity investments. It also included more discussion of both mid-market buy-outs and the dynamics of the restructuring industry. There was an update to the second edition in 2012 to reflect the developments in private equity as the recession came to an end. This third edition examines further developments in private equity, as many western economies again experience economic growth. The European Commission's Alternative Investment Fund Managers Directive which covers private equity funds is also being implemented. A burgeoning body of academic evidence also continues to provide systematic insights as to the impact of private equity.

In this third edition we have taken the opportunity to make a thorough revision of earlier editions. Two major innovations are particularly notable.

First, as the industry has become increasingly international we have extended the coverage of the trends in private equity beyond the UK;

Second, as the economy and the industry emerge from recession, we have developed a new section revisiting the accusations laid at the feet of private equity by its critics at the height of the last boom in 2007. Drawing on the increasing evidence now available, we show that many of the criticisms of private equity were misplaced. We argue that in contrast to the forecasts of the critics, private equity has acted to contain risk, not disseminate it; has created alignment between managers and shareholders, not a misaligned bonus culture; and provides important models for corporate governance and risk management that have a wider applicability.

Nevertheless, some challenges remain regarding the relationships between private equity firms and their investors, notably regarding fees and the valuation of unrealised investments.

John Gilligan
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All errors and omissions are entirely our own responsibility.

In the absence of any tangible reward we offer our sincere thanks to all of these people.

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List of figures and tables

1. THE PRIVATE EQUITY MARKET

Figure 1.1:	Effects of leverage – no debt	18
Figure 1.2:	Effects of leverage – 50% debt	19
Figure 1.3:	Effects of leverage – 90% debt	19
Figure 1.4:	Effects of leverage – 50% debt: 50% repaid	20
Figure 1.5:	Global private equity investments	27
Figure 1.6:	Global private equity funds raised (\$bn) 1984–2014	28
Figure 1.7:	Value of European buy-outs (€m) 1985–2013	28
Figure 1.8:	European buy-out market by number of transactions 1985–2013	29
Figure 1.9:	£100m buy-outs as a percentage of the market by number and value (UK) 1985–2013	30
Figure 1.10:	Buy-in versus buy-out by number (Europe) 1985–2013	30
Figure 1.11:	Buy-in versus buy-out by value (Europe) 1995–2013	31
Figure 1.12:	Percentage share of public to private buy-outs by number and value (UK) 2004–2013	35
Table 1.1:	Selected large UK buy-out firms and their predecessors	25
Table 1.2:	Largest UK buy-outs to date	32
Table 1.3:	The world's largest buy-outs	33
Table 1.4:	Estimate of the world's largest private equity funds (all time)	34

2. PRIVATE EQUITY FUNDS, FUNDERS AND OTHER MARKET PARTICIPANTS

Figure 2.1:	Structure of a typical private equity fund	38
Figure 2.2:	Investors in private equity	39
Figure 2.3:	Geographic origin and country of management of European funds raised in 2013	40
Figure 2.4:	The relationship between costs and income	42
Figure 2.5:	The mechanics of carried interest	42
Figure 2.6:	Forms of diversification undertaken by world's largest private equity managers	51
Figure 2.7:	Investment \$bn by country January 2006–July 2014 (exc. US; countries with at least \$5bn invested)	53
Figure 2.8:	Private equity investment cycle	55
Figure 2.9:	Illustrative investor cash flows	56
Figure 2.10:	Illustrative fund management fees over time	57
Figure 2.11:	Percentage of value realised and not realised by vintage of funds	60
Figure 2.12:	Illustrative equity valuation bridge	63
Figure 2.13:	Value per £ invested in UK private equity firms: distributed and undistributed value by fund vintage as at 31 December 2013	64
Figure 2.14:	Distribution of returns to mid–large buy-out funds by vintage of fund – total value per £ invested (funds over six years old)	65
Figure 2.15:	Distribution of returns to private equity funds by vintage of fund – cash distributed per £ invested (funds over six years old)	65
Figure 2.16:	Schematic of a CDO/CLO/SIV	70
Figure 2.17:	Flow of risks from original lenders through securitisation to bond markets	72
Figure 2.18:	Illustrative advisers to a transaction	73
Figure 2.19:	Detailed structures in a typical private equity fund	79
Figure 2.20:	Different common buy-out structures	82
Figure 2.21:	European divestment numbers by type of exit	84

Figure 2.22:	European primary and secondary buy-outs by number	85
Figure 2.23:	European primary and secondary buy-outs by value	86
Figure 2.24:	Typical simplified fund structure to illustrate different secondary transactions	88
Figure 2.25:	Average time to exit in private equity-backed buy-outs by year of exit in the UK	90
Table 2.1:	Top 20 fund-of-funds investors in global private equity 2013	40
Table 2.2:	Key differences between private equity and quoted equity funds	44
Table 2.3:	Key differences between private equity and trading groups of companies	46
Table 2.4:	Key differences between private equity and hedge funds	48
Table 2.5:	Private equity and portfolio firm compliance with the Walker Guidelines	92

3. EVALUATING, STRUCTURING AND RESTRUCTURING A PRIVATE EQUITY INVESTMENT

Figure 3.1:	Participants in a leveraged buy-out	96
Figure 3.2:	Equity value, enterprise value and asset value	98
Figure 3.3:	Types of financial instrument: risk and reward	100
Figure 3.4:	The basic building blocks of financial engineering	101
Figure 3.5:	Outline structure of a leveraged buy-out	103
Figure 3.6:	Relationship between length of loan, interest rate and multiple of free cash flow	106
Figure 3.7:	Illustrative security value of a failing company's assets	106
Figure 3.8:	Impact of capital holidays of various lengths on the cash requirement of loans (seven-year loans)	108
Figure 3.9:	Percentage of UK buy-outs ending in receivership/administration by vintage year	111
Figure 3.10:	Structural subordination	113
Figure 3.11:	Illustration of the restructuring into a propco/opco structure	115
Figure 3.12:	Schematic illustrating banking covenants	119
Figure 3.13:	IRR versus time of exit at various exit multiples	123
Figure 3.14:	European deal structures (deals €100m or more, %)	127
Figure 3.15:	The limits of the most common restructuring options	133
Table 3.1:	Calculation of enterprise value and equity value	98
Table 3.2:	Pricing ratios	99
Table 3.3:	Creating a hierarchy of financial instruments by varying risk and reward	102
Table 3.4:	Stylised comparison of security in a retailer and a manufacturer	107
Table 3.5:	IRRs calculated at varying exit years and varying exit multiples of original investment	124
Table 3.6:	Multiple of money calculated at varying years of exit and IRRs	124
Table 3.7:	Impact of varying yields on the capital gain required to generate an IRR of 25%	125
Table 3.8:	Largest private equity-backed receiverships	127

4. A WORKED EXAMPLE

Figure 4.1:	Actual and forecast sales and profit	141
Figure 4.2:	EBITDA and operating cash flows	142
Figure 4.3:	EBIT: profit bridge	143
Figure 4.4:	Sources of funds	145
Figure 4.5:	The funding package is analysed by funding requirement, security available, source of funds, detailed financial instrument and type of financial instrument	146
Figure 4.6:	Profit: EBITA, EBIT, NPBT	149
Figure 4.7:	Difference between interest accrued and interest paid	149
Figure 4.8:	Cash flows – before and after finance costs	150
Figure 4.9:	Forecast values of interest cover and cash cover	152
Figure 4.10:	Forecast security cover	152
Figure 4.11:	Taxable profit and accounting profit are different	155
Figure 4.12:	The book value of assets is different to the tax written down value because of accelerated capital allowances	156
Figure 4.13:	Representation of goodwill	157

Table 4.1:	Operating profit projections	140
Table 4.2:	Actual and forecast operating cash flows	141
Table 4.3:	EBIT: profit bridges	143
Table 4.4:	Funding requirement	144
Table 4.5:	Sources of funding	146
Table 4.6:	Illustrative financing structure	147
Table 4.7:	Summary of projected profit and loss after funding	148
Table 4.8:	Reconciliation of projected interest charges	150
Table 4.9:	Summary of cash flows after funding	151
Table 4.10:	Summary of projected balance sheets	153
Table 4.11:	Alternative balance sheet presentation	154
Table 4.12:	PIK debt and the equity illusion	154
Table 4.13:	Restatement of profit for tax purposes	155
Table 4.14:	Calculation of goodwill	157
Table 4.15:	Enterprise value and equity value at exit	160
Table 4.16:	Allocation of net equity value	160
Table 4.17:	Projected share of exit enterprise value by investor	161
Table 4.18:	Reconciliation of the cumulative effects of operating performance and financial engineering on projected equity value at exit in years 2 and 3	161
Table 4.19:	Split of proceeds on exit	162
Table 4.20:	Projected returns (IRRs) by participant (exit year 3, P/E = 12)	162
Table 4.21:	Private equity investor blended returns – sensitised by year of exit and exit P/E ratio	163
5. CRITICS AND THE RESEARCH		
Figure 5.1:	Buy-out types, strategy and timescale	168