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TRABAJO FIN DE GRADO EN DOBLE GRADO INTERNACIONAL EN ADMINISTRACIÓN Y DIRECCIÓN DE EMPRESAS Y EN ECONOMÍA
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BUY AND BUILD STRATEGY BY PRIVATE EQUITY FUNDS. AN APPLICATION TO THE SPANISH CASE.

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Pamplona-Iruña 12 de mayo de 2022

Módulo: Contabilidad
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ABSTRACT

The objective of this project is to determine the success or failure of a buy and build case from two different perspectives: the fund that carries it out and the companies that were acquired. The analysis is carried out on a Spanish case that took place between 2007 and 2011 in the information technology industry.

To this end, an analysis of the situation of the companies prior to the strategy and the conditions in which they were acquired by the Private Equity fund is carried out. As part of the empirical analysis, a study of the profitability ratios is carried out and I make a comparison between the results shown by the companies after the strategy and the results of an approximation of the case in which the target companies had not been acquired by the platform.

Key words: Private Equity, Buy and Build, Limited Partner, platform, target companies.

RESUMEN

El objetivo de este proyecto es determinar el éxito o fracaso de un caso de *buy and build* desde dos perspectivas diferentes: la del fondo que la lleva a cabo y la de las compañías que fueron adquiridas. El análisis se realiza sobre un caso español que tuvo lugar entre 2007 y 2011 en la industria de las tecnologías de la información.

Para ello se lleva a cabo un análisis de la situación de las empresas antes de la estrategia y de las condiciones en las que fueron adquiridas por el fondo de Capital Riesgo.

Como parte del análisis empírico, llevamos a cabo un estudio de las ratios de rentabilidad y realizamos una comparación entre los resultados que muestran las empresas tras la estrategia y los resultados de una aproximación del caso en el que las empresas objetivo no han sido adquiridas por la plataforma.

Palabras clave: Sociedades de Capital Riesgo, *Buy and Build*, partícipe del fondo, empleado, plataforma, empresas objetivo.

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1. INTRODUCTION

The purpose of this final degree project is to contribute to the buy and build (B&B) literature with an empirical case. By analyzing a single case no general conclusions can be drawn but it can be used to bring attention to the extent and cost at which such strategies are considered successful.

The first time I heard about buyouts was during the fourth year of my degree. One of our lecturers presented a buyout case and mentioned that there was a great deal of debate on how this type of strategy was carried out by Private Equity (from now on, PE) funds. I suggested the tutor the possibility of writing my final degree project on buyouts. It was then that he explained to me what a B&B strategy was. I looked up more about this strategy and, not only found it very interesting, but I also saw a clear opportunity to apply the knowledge that I had acquired during my time at the university.

The first section of this project explains how a B&B strategy is developed. To this end, I first explain the business model of PE funds, especially that of Leveraged Buyouts (from now on, LBOs). Next, I focus on what the B&B strategy consists of and the advantages and disadvantages associated with it.

The second section makes a review of the academic literature on the B&B strategy and the third one presents the Acens case, which is the B&B case analyzed in this project and, therefore, it is the most important section. It begins with a description of the case, explaining how the five acquisitions were carried out, under what conditions and the financial situation of each of the target companies before the deal. The prices paid for each target reveal that the platform overpaid for them. I also compare these entry prices with the exit price of the B&B. I then continue with an analysis of value creation at the company level. For that purpose, I first study the environment and the industry in which this B&B case was carried out. I also analyze and compare three strategies: the one that the PE fund announced it was going to implement, the strategy that the fund recognized ex-post on its website, and the strategy that, in my opinion, was actually applied. To conclude with this section, I perform a profitability analysis in which I compare a weighted average of the target companies' ratios with the platform ratios. With this, I make a comparison between an approximation of how companies would stand if they had not suffered the B&B and their actual situation after the deals.

In the final section I present the conclusions obtained after the analysis. I hope that these conclusions serve to clarify a little about the way and purpose with which the PE funds

carry out this type of strategy. Throughout the project I introduce two fictitious characters that represent two economic agents with very different interests in the success of the B&B. *Paula*, who is an investor in the PE fund and has a short-term view of the success and *José*, an employee in the first of the target companies acquired and whose interests align with the long-term sustainability of the organization he works for. They help us understand the actual implications of the case.

2. BUY AND BUILD STRATEGIES

In recent years, noticeable research has been made on how private equity funds behave, how their actions affect the economy, and which are the benefits as well as the drawbacks of their strategies. In fact, a large share of the economy is managed by private equity funds (Ayash & Schütt, 2016), which is one of the reasons why many economists are conducting different studies on this issue. PE funds belong to the alternative investment funds, which, when compared with traditional ones, are characterized by lower transparency and insufficient regulation. The most common and controversial of their activities are the buyouts, especially the leveraged ones which use a high proportion of debt to acquire controlling ownership of target companies. Another aspect that makes this type of alternative investments of high interest is that the rates of return for the buyouts made by the private equity funds are really high, with an average in 2007 between 20 and 25% (IUF, 2007). Some authors challenge the truth behind these high levels, but this is what PE funds usually commercialize in order to attract and retain investors.

Even though many studies have already been done on private equity buyouts, the literature is scarce when it comes to a specific case within them: the buy and build strategy. This type of agreement has accounted for about 20% of the total value of transactions over the past five years (Bain&Company, 2022). However, we find opposite positions in the literature with respect to the objective with which this strategy is carried out. The first one is a long-term view goal, in which PE funds seek similar goals to those of industrial mergers and acquisitions (M&A), such as creating synergies or increasing market power. On the other hand, some critics argue that PE funds use these deals and reorganize the acquired companies with the objective of increasing benefits in the short term and obtain high returns from the operations. In this final degree project, a Spanish case of a B&B strategy is analyzed with the objective of contributing to the scarce literature existing for this topic.

As it has been mentioned, there are different opinions with regard to the business model of private equity firms. Thus, and with the purpose of carrying out rigorous and unbiased research, this paper is written considering two economic agents with very different points of view.

The first viewpoint is that of a limited partner (from now on LP). LPs are the institutional investors that make most of the monetary contributions to the PE funds. They are attracted by promises of higher-than-average returns. The mechanisms used by the sponsors to achieve those yields have been often questioned. In order to simplify the explanations for this perspective, I will refer to one of the LPs of the case that is identified with the name *Paula*.

The second perspective considered is that of an employee of one of the target companies acquired by the PE fund. For research purposes I will describe how the employee compares his labor situation before and after the acquisition of the company in which he/she works. In this project I will refer to one of the workers of Acens Technologies S.A., which is the target company that was first acquired in the B&B case that is analyzed. We identify him by his name *José*.

Both *Paula* and *José* present different views or expectations for the B&B strategy. Actually, we would not expect any of them to be perfectly knowledgeable of the actual strategy and steps to be made by the B&B conglomerate. *Paula* cares almost exclusively for the rate of returns yielded by her investments in the fund. She is only affected by the platform's performance while it is under the control of PE (short-term). Contrarily, *José* is interested in the long-term sustainability of the company, since, in general, his salary level and future stability depend on the proper functioning of the company.

2.1. The private equity business

In a PE fund we can distinguish between two types of partners: the general partners (from now on GPs) and the LPs. The GPs are professionals with a large experience in finance and are the ones in charge of the management and investment decision-making of the PE fund (Stringham & Vogel, 2018). However, their monetary contribution to the company, and thus, the risk they take, is very low.

The major investments in the private equity fund, almost the 99% of the equity, are made by the LPs, who do so with the objective of obtaining above average returns (Appelbaum & Batt, 2014). LPs are usually defined as passive investors as they do not take part in the management of the private equity business. They neither make investment decisions and

they benefit from a limited liability position. Generally, LPs are pension funds, insurance companies, wealthy individuals and other large institutional investors who make such investments with a view to obtain a return on their capital (Stringham & Vogel, 2018).

The business model of private equity consists of buying controlling shares of a company (either it is public, private or a division of a company) so as to gain full control over it. Private equity funds acquire a company with the potential to generate cash flow in the short term with the purpose of restructuring and finally selling it (IUF, 2007). Normally, the acquisition of the companies is made through leveraged investments (leveraged buyouts, LBO), that are financed with a large portion of outside debt and a relatively small portion of equity (Kaplan & Stromberg, 2009). This strategy is further explained in next section. When it comes to *Paula*, she is affected by the gain generated by the PE from the final sale of the company, as well as on the distribution of dividends that the buyout firm may make during the holding period, as her return depends on the value of its partnership in the fund. A higher value creation in the company will increase the final price that potential buyers will be willing to pay and, therefore, the returns on the fund (i.e. the investment of LPs) will also be higher. *José*, on the other hand, does not depend only on the gains generated at the fund level, but on the way this gain has been generated and on the expectations of the performance of the company in the long term.

2.2. Leveraged buy-outs within private equity

As mentioned before, one of the alternative investments through which PE funds acquire companies is an LBO. The acquisition process typically starts with the PE fund creating a new company (from now on, Newco) which is mainly constituted by cash, with no other assets. Then, this new company borrows a large amount of debt so as to buy the target company. After an LBO, the Newco usually has a ratio of 70% debt to 30% equity (Montgomerie, 2008). After the acquisition, both companies, the Newco and the target company, usually merge, and the liabilities that had been assumed by the Newco become the responsibility of the merged company. Even though the usual situation is the merging of the Newco and the acquired companies, there are other two possibilities: the companies are acquired directly by the PE fund or the Newco acquires them without merging, both coexisting legally, the platform and the target companies.

Differences can be appreciated in the type and amount of risk assumed by all the agents involved in the acquisition process. The GPs assume really low risk, as their contribution is about 2% of the investment made. *Paula* welcome this type of investment as, even though her monetary contribution is bigger than that of the GPs, the majority of the

acquisition is financed with a debt that is assumed by the target company. The risk assumed by *Paula* is low when compared to the return levels offered (or, at least, the return levels that PE funds announce) for the investment she makes, and it is limited to her contribution. The higher risk is for the stakeholders of the target company, one of them *José*. If the company is not obtaining good results, there exist different mechanisms (i.e. special dividends) for GPs to increase their return level, as well as that of *Paula*. That is, if things go wrong, or not as good as they should, *Paula* will still receive returns and benefit from her investment. However, the mechanisms used for doing so can be damaging for the company by reducing their reserves, which in turn would have a negative effect on *José*.

The reasons that make the LBO a good investment opportunity for *Paula* are, contrarily, what the workers of the target companies (i.e. *José*) care more about. As stated by the IUF (2007), LBOs are aggressive takeovers in which the target company has to pay the costs of its own acquisition. This leaves the company at risk, as it has a high level of leverage. The company also tends to have high levels of mismanagement. PE funds make decisions with a view to short-term cash flows, which is very detrimental to the company's current employees. The "pros and cons" of this situation (high levels of leverage) are different for the two protagonists of our story and will be further discussed in the following section.

2.3. The buy and build strategy

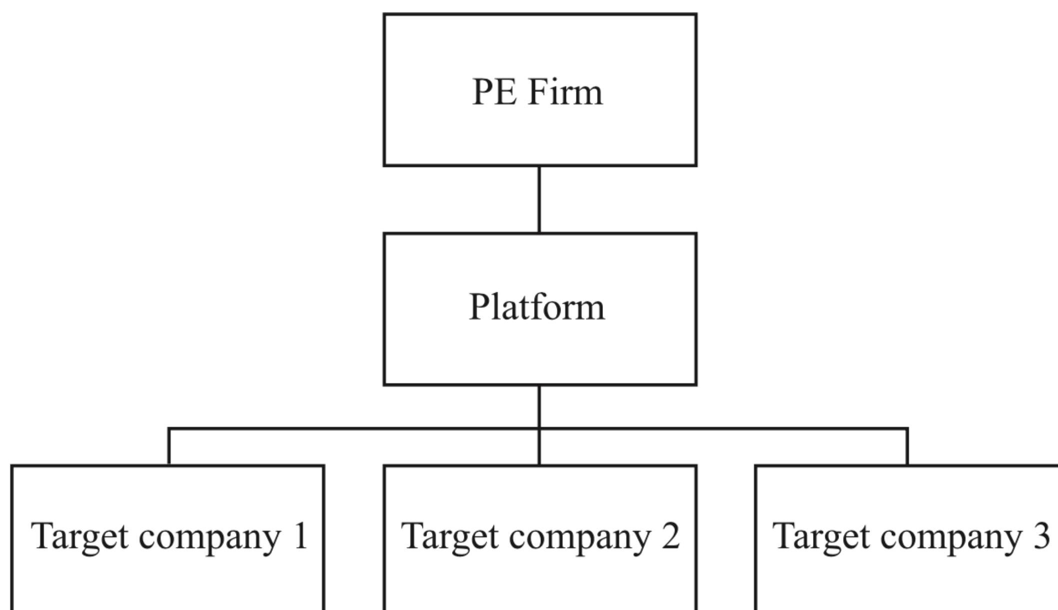
By the end of the 90s, private equity investors faced an increase in the competition from strategic buyers, i.e. other companies in the target's industry or which were attempting to enter it. In this context, financial actors developed new strategies (strategies that were hybrids of traditional strategic and financial approaches) in order to take advantage of additional synergistic benefits (Smit, 2003). One of these new strategies is known as the B&B, which is also referred to as build-up strategy.

2.3.1. Definition of a buy and build strategy

Bansraj et al. (2020) define the B&B strategy as "*a hybrid strategy in private equity that combines the deal structure of LBOs with the long-term synergy focus of serial acquisitions of strategic buyers*". A B&B is an acquisition mechanism consisting of an initial purchase of a firm by a private equity investor, which will be used as a "platform" for further acquisitions (Borell & Heger, 2013). The follow-on acquisitions are referred to as "add-ons" in the literature. The PE fund then usually merges the platform and the

add-ons into a single entity. While the holding period for an LBO is typically between 3 and 5 years, the one for B&B strategy is usually longer (from five to ten years). During the holding period, the PE fund tries to bring operational improvements to the platform so as to increase the value of the new entity before selling it to an industrial company, to another financial investor or by an initial public offering (Borell & Heger, 2013). In the majority of the cases, the platform company and the add-ons operate within the same industry. According to Smit (2001) this strategy mostly occurs in fragmented industries where there is no clear market leader and it is done in order to get advantage from the operating synergies created by the merger of the acquired companies. In a B&B strategy the private equity investor acts as an industry consolidator, which makes such acquisitions with the goal of merging small companies and transforming them into an efficient large-scale network. Another way to conduct a B&B strategy is to form a Newco that will serve as the "platform" to perform the follow-on acquisition of the target companies (Anapolsky, 1998), as shown in Figure 1.

Figure 1: structure of a B&B



Source: Own elaboration

2.3.2. Value creation

The objective of a B&B strategy is one of value creation. Therefore, it is expected that the consolidation of the target companies through the Newco makes the value of the platform greater than the sum of companies' individual values. The disadvantages that the B&B strategy carries with it must also be studied. As in the previous section, the

points of view of both, *Paula* and *José*, will be analyzed with respect to the advantages and disadvantages of a B&B strategy.

One of the potential pros of a B&B are the synergies that arise when combining the production and management structures of the target companies. Firstly, there is a know-how and technology transfer between companies. Another benefit is the reduction of costs, which can be achieved from different sources. One of them is through economies of scale, which happen because costs are spread over a large number of goods. There are different economies of scale, such as financial, network, purchasing and technical economies of scale. In industries with high fixed costs, achieving these economies of scale is critical to reduce production costs (López, 2018). Companies also benefit from economies of scope, which take place when the products or services of the integrated companies are related by a common production technology, product facilities or network (Smit, 2001).

Moreover, the increased size of the consolidated firm results, in most of the cases, in an increased market power and a higher market share (Smit, 2003), which also gives the new entity greater bargaining power with suppliers. As explained above, a B&B usually takes place in fragmented industries and, consequently, the platform benefits from a concentration in the market that supposes a clear competitive advantage over the rest of the competitors.

The above-mentioned advantages of a B&B strategy should be beneficial for our two protagonists, *Paula* and *José*, as they increase the value of the company. However, it is worth mentioning that the reduction of costs, if aggressively achieved, could seriously harm employees.

Another common aspect of a B&B strategy applied by PE is debt leverage. The high volume of debt borrowed by the Newco (or platform) for the purchase of the add-ons allows the company to "*pay less in taxes by deducting interest payments, and it gives managers less freedom to pursue self-enriching projects*" (Borell & Heger, 2013). According to Smit and Maeseneire (2004), in addition to creating tax shields, the highly levered financial structure imposes discipline and strengthens managerial incentives to improve efficiency and cash flow.

The fact that the B&B strategy is carried out by a financial acquirer, and not by industrial acquirers that are experts that work, usually, within the same industry of the target companies, can be beneficial for the company, as they provide financial guidance

(Hammer et al., 2021). The PE fund acts as an additional resource for the company, giving them access to capital and negotiation skills, although not industry skills. Acquired companies also benefit from the fact that PE investors have access to comprehensive and timely information on the current trading of the business in which they invest (Wright et al., 2009).

The B&B acquisition strategy is not without its disadvantages. To begin with, there are the inconveniences typical in the literature of M&A. As I have mentioned a merger can lead to job losses or tighter conditions due to an excessive interest of the investor in reducing costs. Another major disadvantage is that sometimes different firms have conflicts during the merging process. This is due to various reasons, such as the different cultures of the companies, the jealousy between workers and the hard feelings. These, together with the difficulty for communication and coordination between employees, could lead to diseconomies of scale. A further disadvantage is that, due to its increased size, it will be more difficult for managers to have the same degree of control over the company and they may struggle to motivate workers as they may feel that they are "*just part of a big multinational*" (López, 2018). All these situations will negatively affect *José*, since a bad work environment can be very detrimental to him.

The fact that those carrying out a B&B strategy are PE funds (i.e. financial owners) can involve additional disadvantages. One of the aspects that make it possible for a financial buyer to carry out strategies different from those of an industrial buyer is the vision that both have about the future of the company. The former has a short-term vision, while the industrial acquirer has a long-term vision. As explained in the previous section, when making such acquisitions, the purpose of the PE fund is to maintain the platform for several years, while integrating the purchased target companies into it, and, finally, sell it with a certain profit margin. Even though the holding period is usually longer than that of a single-target LBO, as PE funds do not intend to own the companies for a long time, there could be conflicts of interest between the PE and other stakeholders of the company, such as employees, customers or the public administrations. The former may prefer to take those actions that will generate more attractive exit opportunities, while the latter would prefer the application of a business plan with a long-term view.

This last disadvantage is a clear example of the different perspectives *Paula* and *José* have with regard to B&Bs. *José* is part of the group of stakeholders who want managers to make the decisions with a long-term strategy and thereby improve the functioning of the company, not just in the short term. He is interested in the actual economic growth of

the company, so that he enjoys additional rewards and stability. *Paula*, on the other hand, will prefer those decisions that make exit options as beneficial as possible, regardless of the long-term economic effects on the company, as her returns depend partly on that.

2.3.3. Critics to the B&B strategy and the business model of PE

Much criticism has emerged regarding the way in which PE funds create value through the LBOs, and the purpose for which they do so. It is also the case for the B&B strategy. Many of these criticisms come from labor unions, which try to protect employees who are affected by these types of strategies (i.e. *José*).

GPs' Compensation

One of the main sources of criticism is the way GPs' compensation is structured. The LPs and the GPs agree to the compensation of the latter in the Limited Partnership Agreement (LPA). This compensation is made up of three parts:

The first one consists of the carried interest, which is a percentage of fund returns. Fund returns are generated through the gain on sale (GOS) of the target company and ordinary dividends that are generated on the basis of yearly results, but also on special dividends that are based on previous cushions of reserves or retained earnings (RE). The GP gets around 20% of the fund return, as long as there is a minimum hurdle rate, which is usually around 8%. This agreement seems a bit biased, as if the fund returns reach the agreed percentage, the GPs get 20% of the profits, even though they have only put in 2% of the investment. The PE literature suggest that if GPs realize they are not creating enough value on the platform, they may be incentivized to distribute special dividends, which are not based on results, to reach the minimum required and get their 20% on profits (Phalippou, 2017).

The other two components of the GPs' compensation are the fees that they charge to LPs for the management of the B&B and fees or expenses that are charged to the target companies. These last expenses are also criticized as they are charged by GPs on acquired target companies which are owned by the GPs (Phalippou et al., 2016; Appelbaum & Batt, 2016).

Much of the GPs' compensation, such as management fees and advisor fee, depends on the volume of business operations. That is, the higher the volume of operations, the greater the GPs' compensation. This brings me to the next question, do GPs have an actual interest in creating value or one of creating just volume?

We see, therefore, that the PE fund can benefit from a B&B, and consequently consider it a successful case, even though the strategy is not value-enhancing for the target companies. For this reason, it is crucial to conduct a study from the perspective of both *Paula* and *José*, and to analyze whether the strategy is creating value in companies.

Inorganic growth vs organic growth

The B&B strategy is criticized for being an inorganic growth strategy. If by the acquisition of the add-ons and their combination in the platform the PE only generates inorganic growth (i.e. a purely mathematical addition of sales), in principle, it should not be enough, since the acquired target companies could equally operate from a separate standpoint. It is criticized that, somehow, with the B&B strategy the PE fund is "buying sales", rather than generating additional ones through organic growth that would require previous investment. New investment is often locked by the capital structure that redirects all resources to the service of the debt.

Price and debt

It is common that PE funds are willing to overpay for target companies when carrying out a B&B, especially when these acquisitions are largely financed with debt (Axelson et al., 2013). As explained above, this debt is finally assumed, not by the PE fund, but by the target company itself. If the debt is large, it will imply a great risk to the company. This practice has been highly criticized. By assuming so much debt, all cash flows generated by the company are destined to pay the interest and the amortization of the debt. In this way, the target company's ability to grow or to cope with industry disruptions is being blocked. In the case of the B&B strategy, although there is growth when buying other companies, it is not organic growth.

In addition, when there is a lot of overpayment, the target company's accounts will include a great amount of goodwill, which will affect the result of some profitability indicators (i.e. return on assets (ROA)) and will increase the level of asset risk[1].

3. REVIEW OF ACADEMIC LITERATURE ON B&B STRATEGY

Lots of academic economists have carried out studies regarding the business model of PE funds, however, there is still a lack of literature when it comes to B&Bs, as this acquisition mechanism is not sufficiently explored scientifically. This section makes a revision of the

[1] Asset risk exists when a high percentage of assets corresponds to an only asset whose value is highly uncertain. Goodwill is a perfect example of this.

existing academic literature regarding B&B strategy. The investigations made on the B&B strategy have covered different aspects, such as the sources of the value creation in the platform, the role of PE investors, the holding periods and the success factors, among others.

Borell and Heger (2013) analyzed the sources of value creation in a B&B. With a sample of 844 companies involved in a B&B between 2000 and 2008 they found that "the selection of well performing firms prior to each acquisition plays a key role for the performance improvement of the portfolio firms after the transaction". They concluded that there were additional value enhancing potentials that PE funds could explore through B&B.

Hammer (2018) analyzed the role of B&Bs in explaining PE holding periods and concluded that the B&B acquisition strategy prolongs buyout durations. The author suggested that the strength of the effect depends on the number of acquired target companies and on the complexity of the B&B strategy. The importance of these results for LPs is emphasized by the author "*as they show that high returns of a B&B strategy come at the expense of committed capital being tied up for longer time spans*".

Bansraj et al. (2020) analyzed the operating performance of a B&B and they found evidence that this acquisition strategy realizes operational improvements, which was interpreted as operational synergies.

Hammer et al. (2016) collected a sample of 788 European PE portfolio companies and 1.051 acquisition events to analyze the effect of PE ownership on the M&A behavior of companies. They showed that PE fund managers (i.e. financial acquirers) actively enlarge their portfolio companies by stimulating inorganic growth through additional acquisitions, and that when doing so, PE managers face a trade-off between the quantity and complexity of add-ons "*because they have a limited holding period and incentives to exit an investment as quickly as possible*". The results of this paper suggest that PE funds prefer quantity over complexity. In other words, when it comes to a B&B strategy, the PE funds opt for a greater number of acquisitions than other types of investors.

Finally, it is worth mentioning Hoffmann (2008) in his study for the B&B strategy in Germany. These are some of the key findings of his research project:

- *"On average, B&B created significant value, especially by capturing synergy potential between the different companies involved*".

- *"Agency instruments, such as due diligence, management incentives, monitoring, and financial burden through the high leverage of the capital structure, were key prerequisites for successful value creation".*
- The most important success in B&B was the management team. Moreover, it was found a positive effect of debt on management decisions and the sophistication of the financial controlling system was also identified as a partly relevant success factor.

To sum up, some of the studies have focused on the comparison between industrial and financial acquirers. Others have also studied the value creation made through this strategy, but in a more general term, by analyzing a large sample of companies involved in a B&B. I do not see however that a specific investigation has been carried out to assess the contribution that a B&B strategy has to what the evolution of the target companies would have been separately (i.e. if they had not been acquired in the B&B). There is not enough evidence on whether the value of the platform is greater than the sum of the individual value of the companies. This paper sits in this part of the literature by studying the contributions of the B&B strategy in a more detailed way. Given the limitations of a final degree project, I cannot employ a sampling approach, so I will try to contribute by applying a case methodology by studying a specific B&B case.

4. CASE STUDY: THE ACENS CASE

This section develops an empirical analysis of a specific B&B case occurring in Spain. The purpose of this case analysis is to assess the success or failure of a B&B strategy. The success or failure of this strategy can be relative, so it will be analyzed at two different levels, namely the LP level (*Paula*) and target company level (*José*). For that purpose, I make a comparison between the value of the platform and the aggregation of the individual value of the target companies. To properly set the parameters for the comparison, I first have to evaluate the strategy that the fund implemented to carry out this B&B. In this sense I come across three different versions: the strategy that the fund announced it would implement when the B&B was presented in the media, the strategy that the PE fund recognized ex-post on its website, and finally, the strategy that in my opinion was actually implemented.

The objective is to find out whether the B&B strategy has generated additional value (organic growth) in this case through the synergies and other intended effects explained in section 2.3.2., or if it was limited to inorganic growth that did not provide any

additional value. In addition, the before and after B&B strategy scenarios for *Paula* and *José* are analyzed, so as to find out whether the "value created" through this strategy is equal for all stakeholders of the company (i.e. employees like *José*) or only for investors with a short-term perspective (i.e. LP investors like *Paula*).

As stated before, although I would have liked to build a sample to carry out this analysis, it would have taken me a length of time that is not feasible in a final degree project. That is why I have decided to carry out a case method, which will, on the other hand, allow me to make a much more detailed analysis.

4.1. Main features of the Acens case

The Acens Technologies case follows the typical pattern of a B&B case. Nazca Capital, a PE fund created and operating in Spain, set up Nazen Technologies S.L. in January 2007 as a platform to develop a B&B strategy that consisted of the acquisition of up to five companies of the information technology (IT) industry between 2007 and 2010. Nazca sold the platform company to Telefónica de España S.A., a subsidiary of Telefónica S.A., in August 2011 in what the PE fund considered a "successful" exit, as reflected on its website. All the target companies that were acquired in this strategy belong to the information technology (IT) sector.

To carry out the empirical analysis I have used the information from the accounting data series together with their whole annual accounts (pdf format from Spanish Companies House) of the five target companies up to the last available year, which has been either the year of its acquisition or the previous one. The data series for each target company has been obtained from the Sabi database. Sabi (Iberian Balance Sheet Analysis System) is a tool that allows to access and manage the general information and annual accounts of more than 2.7 million Spanish companies and more than 800,000 Portuguese companies. I have also used the accounting data of the platform since its creation in 2007, as well as the annual accounts and the management report of both the platform and Telefónica de España S.A. in 2016. Telefónica de España S.A. is the subsidiary of the Telefónica Group that executed the acquisition of the platform in 2011. As it is a case method, the analysis to be carried out is mostly descriptive. The methodology applied consists of the calculation of traditional accounting ratios to analyze the success or failure of the B&B strategy.

4.1.1. Nazca, the PE fund

The PE company that carried out the Acens Technologies case is Nazca Capital. The website of the company emphasizes that Nazca was founded in 2001 with the objective of becoming the main manager of PE funds to invest in small and medium-sized Spanish companies. It also explains that the strategy of Nazca is based on the creation of value through: organic growth, acquisitions, strategic definition, organizational and operational improvements, and reinforcement of management teams.

As I have already said it is important to determine to what extent the value of the platform exceeds the aggregation of the value of the acquired companies.

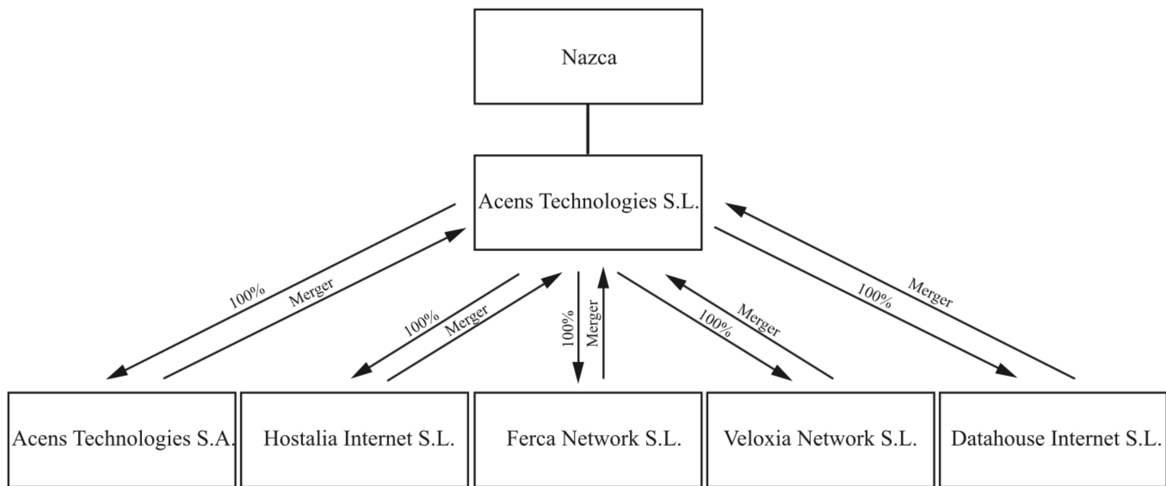
4.1.2. Execution of the B&B

To execute the B&B, the PE fund created a Newco which served as the platform. A summary of the B&B case is illustrated in Figure 2. The arrows from the platform to each of the targets represent the acquisition, and the opposite ones represent the merger of each of the companies into the platform. The Newco was set up on January 11, 2007 with the name of Nazen Technologies S.L. That same day the Newco acquired 91% of the stake in Acens Technologies S.A., the first of the five target companies incorporated to the B&B. The activity of this company consisted of the provision of computer services, including internet connectivity services and the design and programming of computer applications, among others. On October 30 of the same year, the platform acquired Hostalia Internet S.L., an internet service and content provider. These two target companies were merged into the Newco on 17 October 2008. Along with this first merger, the platform changed its legal name to Acens Technologies S.L. As its common in these cases, the platform “stole” the name from the first target company. Considering the size of this company with respect to the other targets of the case, it is no coincidence that the platform decided to “adopt” its name. In the press releases that announced the buyout, Nazca mentioned that this first target company was one of the leaders in the market. So, it is possible that this name change was a strategy of the PE fund, as it was already a well-known name in the industry, and therefore among customers.

On July 3, 2008 Acens Technologies S.L. acquired two additional companies, Ferca Network S.L. and Veloxia Network S.L. The first one was dedicated to the provision of services on the internet, while the main activity of the second was the sale and distribution of computer equipment. These two target companies were merged into the platform one year later, on November 6, 2009. Finally, the acquisition of Datahouse Internet S.L. in

2010 and its subsequent merger on July 2011 completed the execution of the B&B. This last target's activity was the provision of telematics services to the full extent.

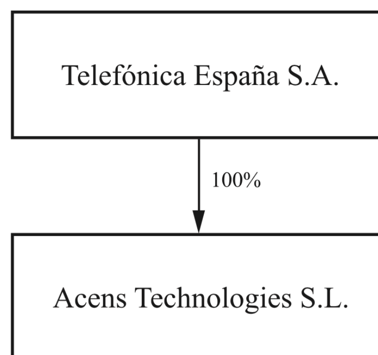
Figure 2: the structure of the Acens Technologies case



Source: Own elaboration

On August 1, 2011 Nazca announced on its website that it had reached an agreement with Telefónica de España S.A. for the sale of Acens Technologies (Figure 3). In that same announcement, the PE fund explained how the project started from three axes of growth: the expansion of the sector itself, the change of business mix towards niches with greater added value and the selective acquisition of companies. On its website Nazca presents this case as an investment with successful results both in the growth of sales and in the increase of profitability of the company.

Figure 3: the exit of the Acens case



Note: there was no merger. Acens Technologies, S.L. remains as a subsidiary of Telefónica de España, S.A.

Source: Own elaboration

4.1.3. Financial condition of the targets before the B&B strategy

To analyze the effect that the B&B strategy has had on the target companies, it is convenient to begin with a study of their economic situation prior to their acquisition. Table 1 presents the following accounting fundamental data for each of the five target companies for up to 6 years before the B&B: sales, operating income, goodwill and interest expenses. The available data for the years 2002 to 2007 are presented, with the exception of Datahouse Internet S.L. This company was established in 2006, so I have only been able to take data for 4 years (2007 to 2010).

Table 1: Pre-B&B accounting information (in thousand euros)

Evolution	2002	2003	2004	2005	2006	2007
Acens Technologies S.A.						
Sales	5,146	6,522	8,037	10,609	14,407	17,406
Op. Income	-2,522	-1,686	-103	947	2,865	4,175
Goodwill	0	0	0	0	0	0
Interest	27	41	15	3	23	85
Hostalia Internet S.L.						
Sales	132	623	925	1.470	2.318	-
Op. Income	-3	117	84	110	200	-
Goodwill	0	0	0	0	0	-
Interest	1	2	1	2	4	-
Veloxia Network S.L.						
Sales	271	547	769	1,002	1,317	1,890
Op. Income	8	88	85	80	82	308
Goodwill	0	0	0	0	0	0
Interest	7	14	7	12	13	7
Ferca Network S.L.						
Sales	626	826	672	976	1,191	-
Op. Income	66	159	102	97	205	-
Goodwill	0	0	0	0	0	-
Interest	1	0	n.d	2	8	-
Evolution	2007	2008	2009	2010		
Datahouse Internet S.L.						
Sales	730	985	1,061	1,059		
Op. Income	376	300	501	-320		
Goodwill	-	-	-	-		
Interest	3	0	0	0		

Source: Own elaboration with data from Sabi

Table 1 shows a very favorable evolution of sales of the first four targets, which increase yearly (with the exception of Ferca in 2003). Operating income also increased sharply in

2007 (2006 when this is the last available year) compared to 2002. None of the companies had any goodwill recognized in their balance sheets, which means that they did not engage in any inorganic growth, that is, the risk of overpayment is null. Financial expenses in all cases are very small compared to the operating results. In sum, Nazca bought growing companies with a favorable evolution within the industry and which did not show any of the two more common risks in LBOs: high leverage and overpayment.

The first company acquired, Acens Technologies S.A., stands alone for its importance in terms of size. The data shows that it is a profitable company with strong growth. In fact, the company's sales grew at an average rate of 27% between 2002 and 2007. Given this favorable situation of the companies before the B&B, if Nazca followed a good strategy, we would expect the B&B gave good results and a significant creation of value.

As for the last acquisition, sales grew in 2010 with respect to 2007. It should be noted that the company had a negative operating result the year in which it was acquired by the platform (2010). However, it was a recently created company, so it is natural that the company had not yet reached its break-even output (i.e. the point at which revenue and total costs are the same). Moreover, one of the "strengths" that this company had, and the actual reason why it was acquired by the platform, is that it had developed a novel product called "cloud computing". This product would allow Acens to offer a new service.

4.2. Financial terms of the five buyouts

4.2.1. Financial conditions of the entries: prices paid for the targets and capital structure of each acquisition.

It is important to analyze the conditions of the acquisitions of the target companies, that is, those under which each of them was carried out. For that purpose, and as I do not have direct access to the prices of the acquisitions, I have approached them with the information available in Sabi. As this database provides the annual accounts of the companies, I have also analyzed the way in which each purchase was financed. Table 2 shows the data that have been used for the calculations.

In 2007 the first two companies were acquired, *Acens Technologies S.A.* and *Hostalia Internet S.L.* This investment is shown in the non-current financial assets section of the platform with a value of 45.67 million euros. Since the platform was created with the only purpose of executing the B&B strategy (i.e. it is an empty Newco), I have assumed that the entire amount of the section reflects the prices paid for the two companies. As mentioned in section 4.1.3., the target company *Acens Technologies S.A.* is considerably

bigger in size than the other four targets. For that reason, although I do not have the data of the prices paid in each transaction, I can confirm that a much higher price has been paid for it than for Hostalia Internet S.L. The platform's balance sheet shows equity of 16.83 million euros. This means that the 2007 acquisitions were financed in 37% with equity (provided by Newco) and in 63% with debt, which, according to what Nazca published on its website, was provided by Banco de Investimento. This can be seen in the long- and short-term debts of the platform, which amount 24.36 and 5.52 million euros, respectively.

Table 2: Evolution of the platform (in thousand euros)

Acens Technologies S.L.					
Evolution	2007	2008	2009	2010	2011
Total Assets	46,712	64,641	64,523	65,766	64,442
Financial Assets	45,666	9,681	930	4,342	2,534
Intangible fixed assets	0	38,513	46,764	47,097	50,582
Goodwill	0	38,014	45,869	42,867	48,724
Equity	16,833	28,106	32,658	37,712	33,919
Long-term debt	24,357	22,914	21,088	18,717	2,180
Short-term debt	5,522	8,695	6,362	5,464	2,581

Source: Own elaboration with data from Sabi

In 2008 there was a sharp increase in the value of the platform's intangible fixed assets, which totaled 38.51 million euros. Of that total, 38.01 (i.e. 59% of total assets) corresponded to a goodwill generated during the 2008 merger of the platform with the two companies that were acquired in 2007.

In 2008 the platform acquired the companies *Veloxia Network S.L.* and *Ferca Network S.L.* In the accounts of that year, the company's financial assets amount to 9.68 million euros. Since the first two target companies had already been merged, we know that this amount is the price paid for the two new acquisitions. By comparing equity with that of the previous year, we see an increase of 11.72 million euros. Therefore, it seems that both acquisitions were financed entirely with equity. In addition, there is a decrease in long-term debts with respect to 2007. The merger of both companies with the platform took place a year later. In 2009, goodwill of the platform totaled 45.87 million euros, an increase of 7.86 million euros over the previous year. Again, a large part of the price that was paid for the third and fourth acquisitions was recorded as goodwill once the companies had been merged.

Finally, *Datahouse Internet S.L.* was acquired in 2010. I calculate the price of this acquisition as the difference in the value of the platform's financial fixed assets between 2010 and 2009. This calculation gives an approximate price of 3.41 million euros for the purchase of this last target company. I assume that this latest purchase was, for the most part, funded by the company's equity for two reasons. In the first place, there is an increase in equity other than RE. In addition, the value of both long-term and short-term debt accounts of the platform decreased in 2010. This company was merged with the platform in 2011. In the accounts of the platform for that year the goodwill increased by 5.86 million euros with respect to 2010.

4.2.2. Did Acens overpay for the target companies? Following the trail of goodwill.

When a business combination gives rise to a disproportionate goodwill in the balance sheet of the acquiring company it sets off the alarms, since it increases the possibility of having capitalized an asset without value as a result of overpayment. I decided to focus on this point. In 2011, the year in which all the acquired companies had already been merged with the platform, the company had an intangible fixed asset of 50.58 million euros, 96% of which was goodwill, representing a 75.6% of its total assets.

Table 2 presented the evolution of goodwill until 2011, but what happened from that year on, when the platform was acquired by Telefónica de España S.A.? Did this goodwill have real value?

By looking at the platform's annual accounts in the years following the exit of the B&B, we can track the evolution of the goodwill once the platform became a subsidiary of the Telefonica group. It is not until the year 2016 that we see a write-down in the value of goodwill. Section b in point 2 of the annual accounts of Acens Technologies S.L. for the year ended 31 December 2016 (see Appendix 1) discloses about the application of a new Standard affecting goodwill. Royal Decree 602/2016 of December 2 modifies the registration and valuation of intangible assets. The new Standard establishes that intangible fixed assets must be subject to systematic amortization within a maximum period of ten years. Previously, some intangible assets like goodwill were considered assets of indefinite useful life and were only subject to impairment. The decree has a transitional provision which allows for the application of amortization retroactively, following a linear criterion of recovery and a useful life of ten years from the date of acquisition. In 2016 Acens Technologies S.L. applied this provision and amortized goodwill against reserves.

Table 3 presents the adjustments that the company made in 2016. The company registered a decrease of 37.87 million euros in the value of the goodwill, representing the accumulated amortization that they have calculated for that year.

Table 3: Adjustments in the Balance Sheet of Acens Technologies S.L.U.

Balance Sheet as of December 31, 2015 (in thousand euros)	
Reserves (reduction)	24,750
Profit for the year (reduction)	3,654
Intangible fixed assets / Goodwill (reduction)	(37,872)
Deferred tax liabilities (reduction)	1,593
Deferred tax assets (increase)	7,875

Source: Annual accounts report for the financial year 2016 of Acens Technologies S.L.U.

However, this change was not included until 2016, so the accumulated depreciation of intangible assets in 2015 affects the platform's accounts for the first time in 2016. Most of this amortization (9/10) was charged directly to reserves, since only a tenth of it belongs to the 2016 income statement.

Table 4: Acens Technologies S.L. accounts (in thousand euros)

	Balance at 31.12.15	**Balance at 31.12.16**
Goodwill	48,723	5,979
Total Assets	68,769	35,132
Equity	38,800	12,500
Operating Income	5,688	3,982

Source: Own elaboration with data from Sabi.

Finally, Table 4 shows a comparison of some of the balance sheet's accounts of Acens Technologies, S.L. between 2015 and 2016. Thus, we can better see the effect that the application of this rule had on Acens Technologies S.L. The value of goodwill decreased from 48.72 million euros to 5.9 million, i.e. in one year its value fell by 88%. This in turn had a large effect on total assets, which were halved. By applying the rule retroactively, the depreciation for the years prior to 2016 was taken directly into reserves. This is reflected by the impact it had on equity. Finally, only the amortization of 2016 was sent to net income. We see how this affected the operating income, which was considerably

lower in 2016 than in 2015. In my opinion, Telefónica was aware that a large part of that goodwill had been generated due to the overpayment practiced by platform during the B&B, so it was suffering from serious impairment. Telefónica took advantage of this new regulation to write it down without a similar effect on its income statement. Although it unavoidably destroyed equity, it only affected a small part of the operating income.

4.2.3. Conditions on the exit: exit price vs. entry price

A first way to analyze the success of this B&B case is to see if it generated a return for the fund. For this, it is important to analyze the difference between the joint price paid by the platform for the five target companies and the price obtained with its sale to Telefónica de España S.A. in 2011. Following the calculation of the entry prices as explained in section 4.2.1. together they totaled 58.76 million euros.

Table 5: Controlling investments of Telefónica de España, S.A. (in thousand euros)

2016 (thousand euros)	Participation %	Capital	Reserves	Results	Cost	Valuation correction
Teleinformática y Comunicaciones, S.A.U. (Telyco)	100%	8,321	5,910	(2,456)	38,372	-
Iberbanda, S.A.U.	100%	2,000	4,716	2,468	138,295	129,082
Telefónica Soluciones de Informática y Comunicaciones de España, S.A.U.	100%	2,000	(5,615)	1,764	102,787	102,787
Telefónica Telecomunicaciones Públicas, S.A.U.	100%	1,199	14,162	(21,681)	63,003	63,003
Acens Technologies, S.L.U.	**100%**	**22,825**	**(12,429)**	**2,104**	**56,200**	**-**
Telefónica Servicios Integrales de Distribución, S.A.U.	100%	2,108	21,741	6,598	8,867	-
TOTAL		38,453	28,485	(11,203)	407,524	294,872

Source: Annual accounts report for the financial year 2016 of Telefónica de España S.A.

On the exit side, the price that Telefónica de España, S.A. paid for Acens Technologies S.L. can be obtained from the 2016 annual report. Table 5 shows information on the main controlling investments of Telefónica de España S.A. as of December 31. Acens Technologies S.L.U. (in bold) had a cost of 56.2 million euros, so this is the price that Telefónica paid for the company in 2011.

According to my calculations, the "exit" price of the B&B is lower than the "entry" price (56.2 < 58.7), so no value seems to have been created in the sale. When the acquisition was announced, (the price of the acquisition was not yet public), there was much speculation about the final price that had been paid in the transaction. *Cotizalia*, the economic section of *El Confidencial*, announced Nazca's intention to put Acens Technologies, S.L. in the stock market at an initial price that ranged between 130 and 150 million euros. This information was probably filtered by Nazca itself, in order to push up a potential Initial Public Offering (IPO). Weeks later, *Expansión* published that sources close to the operation had placed the valuation of Acens Technologies S.L. in a range of

75-90 million euros. This value far exceeds the 56.2 that Telefónica actually paid for the equity of Acens. This may be because selling prices in M&A operations are often expressed as an enterprise value (EV), which is the equity of the company plus the book value of its debt. Therefore, it may be the 75 - 90 million euros were referring EV and not pure equity, meaning that the debt was included in the price. This might explain why there is such a large difference with respect to the cost that Telefónica recorded in its accounts for the operation.

At first glance this transaction may seem to have a negative impact on *Paula*, who is basically interested in the returns of the fund that would be generated out of the exit transaction in which Nazca sells the platform to Telefónica. However, this might not be the case.

As previously explained, LPs like *Paula* contribute the funds with which the PE acquires the target companies. However, the acquisition of Acens Technologies S.A. was 63% financed by debt. That is, of the price paid for the total of the target companies (58 m), 28.83 million euros were financed with debt, and not by equity provided by the fund. Therefore, while the exit price is lower than the price paid by the platform, the PE fund only paid 29.92 million euros. Following this, the operation would generate profits of around 26.27 million euros (56.2 of the price paid by Telefónica minus the 29.92 that was financed with the funds) for the PE fund Nazca. *Paula* will thus be satisfied with the results that Nazca obtained with this B&B strategy, even though no economic value was actually created in the company.

GPs will also be very satisfied with these results. By contributing only 2% of the fund, GPs easily achieve very high returns, and, like *Paula*, they benefit from this transaction. However, although this B&B case is "successful" from the PE fund's point of view, it may not be equally successful from the target companies' standpoint. Whilst the B&B was profitable for the PE, it did not create value for the companies.

José is involved in this standpoint as an employee of Acens Technologies S.A., the first acquisition of the case. Unlike *Paula*, *José* is affected by the way in which the company he works for was acquired. As explained, the acquisition of this company was financed 63% by debt. That debt was assumed by the target company when it merged with the platform. This is negative for *José*, since *his* company assumed the debt of its own acquisition.

Although these data are not very encouraging, the profitability analysis will confirm whether or not there was value creation for the company. So, we will have to wait to know in what position *José* was after the B&B.

4.3. Environment, industry and strategy

In section 4.2.3. we were able to recognize the success of this case at the PE fund level. However, it is also necessary to carry out an assessment at the company level. As mentioned above, in order to assess whether the Acens case was a success or a failure, a prior analysis of the environment conditions under which it was carried out is necessary. "*Value is created when the firm earns a return on its investment in excess of the return required by its capital suppliers*" (Palepu et al., 2019). This requires analyzing the environment and industry of the company, as well as the strategy with which this B&B case was executed. The extent to which each of these three factors could have influenced the result of this B&B case will be assessed.

In relation to the environment in which this case took place, it is important to highlight the years during which this B&B was carried out. Newco was created in 2006 and the first two acquisitions were made in 2007. As everyone knows, in 2008 one of the biggest ever European economic recessions took place, which was even more devastating for some southern countries, such as Spain. The years leading up to the crisis were years in which maximums had been paid. In addition to making the first two acquisitions of the strategy in years when prices were at their highest levels, the economic recession had a serious impact on a large part of Spanish economic activity. It affected the development of the economy for many years. This crisis coincided with the second year of the B&B holding period. Therefore, it is important to consider the negative effect the crisis could have on the economic activity of the company.

The companies in this B&B case belong to the IT industry. They offered computer and internet services, and hosting and housing services, among others. By offering this type of services, the geographic location of the company does not constitute a great differential factor and the competition is at an international level. Nazca explains in its website that the market opportunity was based on: the growing demand for outsourcing the IT infrastructure of SMEs and that the market was very fragmented.

Apparently in this industry there are two ways in which companies can compete: focus on small companies, which offer little margin and in which, due to the great competition, it is increasingly difficult to make money. On the other hand, there is the option to invest

in quality, and focus on customers with large projects. To be able to offer this second type of services it is necessary to make important investments in training and R&D. In this type of sector, where the majority of assets are intangibles, investment is crucial for developing new products and to be able to continue offering a high-quality service in line with the latest technological advances. However, as explained above, this did not seem to be the route followed by Acens Technologies S.L. In Spain, the investment that is made in Research and Development (R&D) can be capitalized. However, in Table 2 we have been able to see that this company did not capitalize any R&D, as goodwill covered the majority of the intangible fixed assets. While it is true that other types of investment, such as employee training are more difficult to be capitalized, we do not see the income statement showing any especial effort on this type of investments.

To analyze the strategy, I will differentiate between: the intentional strategy, the post-strategy recognized by the fund on its website and the actual strategy. The first one, the intentional, refers to Nazca's intentions when it announced that it was going to carry out with this B&B. After being acquired by Nazca, Acens Technologies S.L. published a press release on its website explaining the transaction and Nazca's strategic intentions. It said that the strategy would be based on providing "*increasingly specialized, higher value-added and more personalized services*". A sales growth of more than 20% per year was targeted. For that, the commercial area of the company would be strengthened. In 2011 this area was expected to have approximately 100 more employees.

On the other hand, we have the strategy that Nazca recognized on its website once the platform had already been sold to Telefónica. The PE fund explained the strategy that had been followed during the B&B and the results obtained with it: double the organic growth, an increase of 40,000 customers and an annual increase in sales of 22%.

Obvious differences can be found between what Nazca intended or recognized and what it actually managed to do during the holding period. As for the provision of more specialized services, the fact that the platform did not capitalize, or it did not register any investments in training or R&D stands out. As already mentioned, most of the platform's intangibles (and also total assets) were goodwill that ultimately had no real value. Furthermore, despite the fact that Acens had a highly qualified internal Customer Service (CS), it decided to outsource the provision of this service in order to reduce costs. The problem with outsourcing was that the agents did not have the right qualification and training, and this lowered the quality of the service.

As for the reinforcement in the commercial area of the company, Figure 4, which is drawn from the platform's annual accounts report for the year 2009, shows the average number of employees for the years 2009 and 2008 distributed by category. The number of employees for "*comerciales*", which stands for salespeople, increased markedly, going from 8 employees in 2008 to 122 in 2009. However, it seems that this was at the expense of the number of "*titulados, técnicos y administrativos*" which are the graduates, technicians and administrators of the company.

Figure 4: Average number of employees in Acens Technologies S.L. for 2009

ACENS TECHNOLOGIES, S.L.

MEMORIA DE LAS CUENTAS ANUALES CORRESPONDIENTES AL EJERCICIO ANUAL TERMINADO EL 31 DE DICIEMBRE DE 2009
(Expresada en Euros)

El número medio de empleados durante los ejercicios 2009 y 2008 distribuido por categorías es el siguiente:

	2009	2008
Consejeros y altos directivos	4	5
Titulados, técnicos y administrativos	42	140
Comerciales	122	7
	168	152

Source: Annual accounts report for the financial year 2009 of Acens Technologies S.L.

This is a clear signal that the company opted for the second way of acting in the industry, in which low margin sales are prioritized. This increase in the number of salespeople was offset to some extent by a reduction in the number of technicians and administrators of the company. In this way, the company was prioritizing sales over the quality of the service it offered.

Table 6 allows me to make a comparison between the evolution of the targets and that of the platform. For that purpose, I present up to 8 accounting fundamentals. On its left side, I have considered the aggregation of all target companies for two different years, 2002 and 2006. As the last target Datahouse Internet S.L. was not created until 2006, the aggregation for 2002 includes only 4 companies.

With regard to the platform (right side of the table), I have included data for two years, 2008 and 2011. We must not forget that in 2008 the platform was made up of the only two companies that had been merged at that time, Acens Technologies S.A. and Hostalia

Network S.L. It is not until 2011 when the five target companies have already been merged into the platform.

First, we see that sales grow much more in the pre-B&B period (which concerns the aggregation of the individual evolution of targets) than in the post-B&B period (that of the platform). While in the pre-B&B sales are multiplied by 3.08, in the post period we see that sales remain practically the same, with an increase of 1%. Therefore, here we see that the annual 22% increase in sales that Nazca announced on its website does not correspond with the real evolution that the company had.

Table 6: Evolution of seven accounting fundamentals. Targets vs. platform (in thousand euros)

	∑ Targets		Platform	
	2002	2006	2008	2011
Sales	6,174	19,016	26,224	26,393
Sales Growth		308%		101%
Operating income	-2,482	3,316	5,477	-2,787
Total Liability	3,845	8,481	36,536	30,522
Total Assets	11,765	16,084	64,641	64,441
Equity	7,919	7,603	28,105	33,919
Goodwill	0	0	38,513	48,000
Interest expenses	35	48	1,895	993

Source: Own elaboration with data from Sabi

This is even more remarkable if we consider that in 2008 the platform was made up of only two companies, while in 2011 the platform had already incorporated the five target companies. Even though there were three more companies, the total number of sales barely increased. This enhances what has been discussed in the previous section. Although Acens Technologies S.L. (platform) chose a more commercial strategy to try to push up its sales, it did not achieve the expected effect. It seems, then, that the inorganic increase in sales together with the intended increase resulting from the higher intensity of the commercial area have been overshadowed by the loss of customers due to poor quality of service.

According to the website of the fund, during the five years in which this case was developed, the number of clients increased from 20,000 in 2007 to 60,000 in 2011. If so, however, this would mean that the sales margin fell significantly (more customers but same sales). This would again reflect that the company opted for the second way of competing, with more clients, but who offer little margin.

As far as the operating income is concerned, the evolution is clear: for the aggregate of the targets the evolution is very favorable. In 2002 they had a negative operating result, which could be partly justified by the fact that some were recently formed companies. After four years we see that this negative result becomes positive. For the platform the situation is the opposite and goes from "more" to "less", from a positive income in 2008 to a negative one in 2011. While it is true that the economic crisis took place during this period, we should analyze the extent to which this could be so decisive in the operation of the platform. This idea will be further developed when the profitability analysis is conducted.

We turn now to the fundamentals taken from the balance sheet. First, we can see that total assets are of a much larger dimension for the platform than for the sum of the targets. As explained before, this increase in assets is due to the overpayment of the different buyouts incorporated in the B&B that was subsequently carried forwards to Telefónica de España S.A. and recognized as goodwill. We see that the total liabilities are also significantly higher for the platform than for the aggregation of the targets. Despite the fact that, in proportion, the total liabilities in both cases represent around 50-60% of the total assets, the situation is completely different for each of them. This is because most of the platform's assets were made up of goodwill. As explained in the previous section, this goodwill was eventually written-down by Telefónica in 2016, with the change of regulations. So, even though the debt ratio is similar in both cases, the platform is not "backed up" by the total asset value it holds, placing it in a much riskier position.

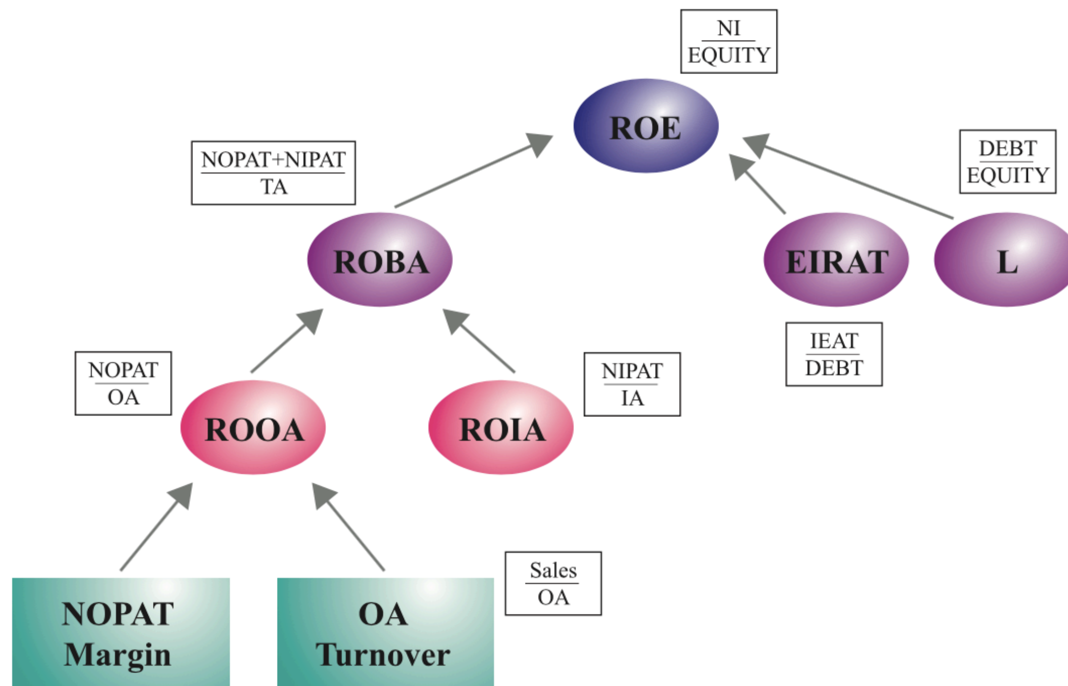
Finally, we also see a big difference between the financial expenses of the aggregate of the target companies and the platform, which makes sense after having compared the debt levels of both. This shows that the very debt with which the first acquisition was made has a negative effect on the acquired company, since it is now merged into the platform and the financial expenditure of that debt affects its operating income. This brings me back to the question of how fair this type of financing is, since the debt is not borne by the PE fund that has implemented the B&B strategy, but by the companies that have been acquired and merged during the strategy.

4.4. Assessment of the success or failure of the B&B strategy through profitability analysis.

"*The goal of financial analysis is to assess the performance of a firm in the context of its stated goals and strategy*" (Palepu et al., 2019). The profitability analysis allows me to determine the relative position of the company, since it relates the profit obtained with

the effort made in obtaining it, measured as resources invested. I will therefore compare the profitability ratios of the target companies to those of the platform, with the objective of determining whether the companies are better after B&B strategy or if they would have been better if they had not been acquired by the platform. I have followed the profitability decomposing approach in Palepu et al. (2019) and Archel et al. (2018).

Figure 5: Decomposing profitability: the profitability tree



Source: Own elaboration. Idea taken from Palepu et al., (2019)

To execute this analysis, I have used the following information: I have first calculated the ratios of each of the five companies with the data of their accounts, which have been obtained from Sabi. I have taken into account the ratios of the companies the years before they were acquired by the platform, concretely 2005 and 2006 (except Datahouse, for which the ratios corresponding to 2009 and 2010 are taken into account). In order to analyze them as a single global company, I have calculated a weighted average of the ratios. The weighting has been carried out taking into account the size of each of the companies as measured by their total assets. As for the platform, the ratios have been calculated from the data of the company’s annual accounts.

Tables 7 and 8 present the different profitability ratios for the aggregation of target companies and for the platform, respectively. There are two key ratios: ROBA and ROE.

ROBA, which stands for Return on Business Assets, is obtained from the division of Net Profits After Tax (NPAT) by Total Assets (TA). This economic version of profitability shows the ability of the company's assets to generate value and regardless of how the company has financed these assets. Table 7 shows that the aggregation of the targets had a positive ROBA, and that, in fact, it almost doubled in a year. The platform shows a very different evolution. Its economic profitability was declining, to become negative in 2011. This negative ROBA indicates that the platform not only did not get any return on its assets, but that these assets generated losses.

Following with Figure 5, ROBA disaggregates into two ratios: Return on Operating Assets (ROOA) and Return on Investment Assets (ROIA). These ratios correspond to the profitability generated by either the functional assets (those linked to the main activity of the company) or the extra-functional assets (not strictly necessary for the development of the main activity), respectively.

Table 7: Profitability ratios for the aggregation of the target companies.

	∑Targets	
	31/12/06	**31/12/05**
ROBA	**21,8%**	**11,4%**
ROOA	**21,8%**	**11,0%**
Margin	18,7%	9,3%
OA Turnover	127,1%	120,1%
OA/TA	96,7%	98,3%
ROIA	**78,4%**	**46,5%**
IA/TA	3,8%	2,2%
ROE	**45,1%**	**18,6%**
EIRAT	-0,5%	-0,3%
L	111,5%	60,9%
Financial Leverage Gain	23,3%	7,2%

Source: Own elaboration with data from Sabi

The aggregation of the target companies showed a favorable evolution in both ratios. ROIA was much higher than ROOA in both years, meaning that the company's investment assets were more profitable than the operating ones. However, we see that ROOA's ratios are almost identical to ROBA's. This is because the vast majority of the

target companies' assets were functional (96,7% and 98,3%), and thus ROIA does not play a significant role. We see that these companies had good economic profitability.

As far as the platform is concerned, it can be seen that ROOA was progressively decreasing, being negative in 2011. The ROIA increased a lot from 2008 to 2009 (which makes the ROBA also increase a little that year), but it fell again to very low percentages in the two following years. Both ratios are unfavorable for the platform, which shows the poor economic profitability of the company. This, compared to the ratios that the aggregation of the companies had before they were acquired, shows that there was destruction of value in the companies as a result of the B&B.

I further disaggregate ROOA into two very relevant ratios: Operating margin (NOPAT margin) and OA turnover. Operating margin is calculated as NOPAT by sales, and it represents the percentage of sales that has turned into operating profits. The evolution of the Operating margin is favorable when it comes to the target companies. In one year, they doubled the profit margin they made from each sale. That is, with a margin of 18.7% in 2006, for every 1€ of sales they obtained a profit of 0.187€. Although the margin of the platform is better than that of the targets for 2008 and 2009, in 2011 it turned into a negative value of -10.2%. That is, for every 1€ sold the platform lost 0.102€. This means operating expenses exceeded total sales. During the B&B, Nazca carried out a notorious reduction in the platform's costs, for example by outsourcing the CS. We can therefore conclude that this negative margin is not due to higher costs, but because the company could have been selling at a very low price, probably with the aim of increasing its final sales.

The second component of ROOA is the Operating Assets Turnover ratio (OA Turnover), which is calculated as sales by the average operating assets. This ratio represents the efficiency in the use of operating assets. Looking at Tables 7 and 8, we see that the turnover of the target companies is almost 2.5 times greater than that of the platform. This is due to the fact that the denominator includes a huge goodwill as part of the OA.

Return on Equity (ROE) is calculated by dividing net income by shareholders' equity. It is the profitability of the investments made by the owners of the company as financing contributions to the business equity (Archel et al., 2018). It measures the management's ability to generate income to compensate shareholders for their investment in equity. Targets show a good ROE in 2005 (18.6%), which highly increased to 45.1% in 2006. On the contrary, the platform shows a much lower ROE in 2008 (13.4%), and since then the value of the ratio decreases to end up being negative in 2011 (-11.4%). The negative

ROE is a consequence of the negative net income that the platform had in 2011. This shows a very clear difference between the performance of the targets before and after the B&B strategy.

Table 8: Profitability ratios for the platform.

	PLATFORM			
	31/12/11	31/12/10	31/12/09	31/12/08
ROBA	**-4,5%**	**5,3%**	**10,0%**	**8,7%**
ROOA	**-4,5%**	**5,7%**	**9,9%**	**10,2%**
Margin	-10,2%	11,6%	21,1%	20,8%
OA Turnover	44,1%	48,7%	47,2%	49,1%
OA/TA	99,3%	93,9%	99,6%	84,1%
ROIA	**1,1%**	**-0,2%**	**33,5%**	**0,6%**
IA/TA	0,7%	6,1%	0,4%	15,9%
ROE	**-11,4%**	**6,6%**	**15,8%**	**13,4%**
EIRAT	-3,4%	-3,6%	-4,2%	-5,2%
L	87,3%	75,8%	99,8%	134,3%
Financial Leverage Gain	-6,9%	1,3%	5,8%	4,7%

Source: Own elaboration with data from Sabi

ROE depends on ROBA, the debt ratio and the cost of debt. Since I have already analyzed ROBA, I can go further in the study of ROE by analyzing the debt ratio (L). This ratio indicates the proportion of external financing that the company has against its assets. Both Tables 7 and 8 show significant values for this ratio. However, if we look closer at its composition, the interpretation is very different. While it is true that the aggregate of target companies had a high debt ratio, most of their debt was short-term debt. In the case of the platform most of its debt was long-term debt. It should also be recalled that a large part of the platform's assets was goodwill that had no "real value". In conclusion, although both had similar debt ratios, the platform was exposed to much greater risk.

Finally, the financial cost (EIRAT) is a ratio that is calculated as interest expenses by the total liability of the company. The ratio is presented in negative values in both tables because financial expenses have been entered with a negative sign for the calculations. We see from Table 7 that the aggregation of the target companies has a low EIRAT, with values (in absolute terms) of 0.5% and 0.3%. The platform, once again, shows us a much more unfavorable situation, with values well above those of targets (between 3.4% and 5.2%). Moreover, the platform had a negative financial leverage ratio in 2011 (-6.9%),

meaning that the financial costs of debt were greater than the overall return made on the investment. This is a clear indication that the financial structure of the platform was very risky.

To sum up, all the ratios analyzed are much more favorable for the aggregate target companies, which is a proxy of the case where they have not been acquired by the platform. In fact, the ratios show that the evolution of the platform is unfavorable, with decreasing trends in most of them. Moreover, many of the ratios present negative values, which sets off the alarms. The company is showing worse economic and financial returns compared to the scenario in which it would not have been acquired by the platform. The results of the profitability analysis are in accordance with those obtained from Table 6.

This clearly puts *José* in a much worse position than before B&B's strategy. If the company does not get good results and is in a risky situation, this jeopardizes *José's* continuation in the company.

While it is true that Nazca sold this company to Telefónica de España S.A. and, in fact, obtained a profit from the sale, we see that the situation of the companies has worsened considerably with respect to their situation before they became part of the B&B. We do not know the actual reasons why Telefónica decided to acquire this company. What is certain is that it pushed down the price. As these are companies in which, as indicated above, its most important assets are intangibles like patents and computer systems, perhaps Telefónica had an interest in some of the company's assets. But this is mere speculation. What I can conclude is that the platform did not present a good evolution, and the profitability analysis shows me that it was doing quite poorly, especially in its last year in which it was acquired by Telefónica. Therefore, the B&B strategy was not successful at the company level.

5. CONCLUSIONS

In this work I have tried to contribute to the literature on B&B, by carrying out the analysis of a single case of B&B in Spain. For this, I have used the case method. Although it has certain limitations, this methodology has allowed me to carry out a more detailed analysis of the Acens Technologies case, which took place in the years between 2007 and 2011.

The analysis has covered the entire period during which the B&B strategy was executed, from the analysis of the prices paid for each of the target companies to the analysis of the sale of the platform. In fact, in order to carry out an analysis as rigorous as possible (within

the time limitations in a final degree work), the accounts of the platform have also been analyzed five years after its sale to Telefónica.

In addition, I have carried out an accounting analysis of the company, which has included a profitability analysis in which I have made a comparison between the profitability that the companies would have had if they had not been acquired and the profitability of the platform.

All this analysis has led me to the following conclusion: A B&B is an inorganic growth strategy, but this type of growth is insufficient. There must be good strategic direction, and, after the analysis, this does not seem to be the case for Acens. While I have seen that at the level of the PE fund the case has been successful, it has been a failure at the company level. Part of this difference has to do with the way in which the strategy was financed. The fund owned 100% of the company, and yet, as we have seen, a large part of the acquisitions' price (>60%) was financed by debt. This allows the fund to make a profit even when the company does not. There are several reasons that have led me to this conclusion:

In the first place, it has been shown that the platform overpaid for the target companies, and this was reflected by a large goodwill which, years later, was amortized and brought to reserves. I have also seen that the strategies that the PE fund presented and later recognized are quite different from the strategy that was actually carried out. Finally, the profitability analysis shows that the platform was worsening until it had a negative economic and financial profitability in 2011. I also see that the financial structure of the company was bad, with a high negative dependence, and with a debt that was "supported" by goodwill that had no real value. Therefore, although Nazca announced this B&B case as a successful one (since the fund did make a profit), the strategy was prejudicial to the target companies. The questions raised at the beginning of this project get more strength: What is the real purpose for which PE funds carry out this type of strategies? Do they really contribute to the value creation of the companies that are involved in these B&Bs?

Finally, and as a limitation of the study since I use a single case methodology, I do not have a control sample, so I cannot control what would have actually happened to the companies if they had not suffered the B&B.

Obviously, these results are not generalizable. However, I believe that they can serve as a first step in this analysis. I think an analysis done with a sample instead of a single case could be of great interest and contribute to the literature of PE funds' buyouts.

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7. APPENDIX

Appendix 1: Point 2 Section b of the 2016 annual accounts of Acens Technologies, S.L.U.

ACENS TECHNOLOGIES, S.L.U
MEMORIA DE LAS CUENTAS ANUALES CORRESPONDIENTES AL EJERCICIO ANUAL TERMINADO EL 31 DE DICIEMBRE DE 2016

de informar verazmente sobre el origen y la utilización de los activos monetarios representativos de efectivo y otros activos líquidos equivalentes de la Sociedad.

b) Comparación de la información y aplicación de nuevas normas

De acuerdo con la legislación mercantil, se presenta, a efectos comparativos, con cada una de las partidas del balance, de la cuenta de pérdidas y ganancias, del estado de cambios en el patrimonio neto y del estado de flujos de efectivo, además de las cifras del ejercicio 2016, las correspondientes al ejercicio anterior. En la memoria también se incluye información cuantitativa del ejercicio anterior, salvo cuando una norma contable específicamente establece que no es necesario.

Real Decreto 602/2016, de 2 de diciembre

En diciembre de 2016 se aprobó el Real Decreto 602/2016 , de 2 de diciembre, por el que se modifica el Plan General de Contabilidad aprobado por el Real Decreto 1514/2007, de 16 de noviembre, Modificación de la Norma de registro y valoración de los activos intangibles (en particular, el fondo de comercio). En línea con las modificaciones al Código de Comercio introducidas por la Ley 22/2015, de 20 de julio, se establece que los inmovilizados intangibles son activos de vida útil definida y por tanto, deberán ser objeto de amortización sistemática en el periodo durante el cual se prevé, razonablemente, que los beneficios económicos inherentes al activo produzcan rendimientos para la empresa. Cuando la vida útil de estos activos no pueda estimarse de manera fiable se amortizarán en un plazo máximo de diez años, sin perjuicio de los plazos establecidos en las normas particulares sobre el intangible. En relación con el fondo de comercio, se amortizará en su vida útil y se especifica que se presumirá, salvo prueba en contrario, que su vida útil es de diez años y su recuperación es lineal. Anteriormente estos activos intangibles y el fondo de comercio eran activos de vida útil indefinida y no estaban sujetos a amortización sistemática, únicamente a deterioro.

Respecto a la amortización del fondo de comercio y de los elementos del inmovilizado que previamente se hubieran calificado como de vida útil indefinida, y según permite la Disposición transitoria única del Real Decreto 602/2016, la Sociedad ha aplicado los nuevos criterios de amortización de forma retroactiva tal y como está previsto en la normativa al valor en libros del fondo de comercio optando por amortizar con cargo a reservas los importes resultantes de conformidad a las reglas de transición. Conforme a estas reglas, se ha calculado la amortización con cargo a reservas para los ejercicios anteriores a 2015 siguiendo un criterio lineal de recuperación y considerando una vida útil de diez años desde la fecha de adquisición. Para los activos cuya fecha de adquisición es anterior al 1 de enero de 2008 (fecha de primera aplicación del vigente Plan General de Contabilidad), se ha considerado desde esta fecha.
De acuerdo con la Disposición adicional segunda, en esta opción, debe presentarse información comparativa ajustada a los nuevos criterios. De esta forma, los saldos correspondientes al ejercicio anual terminado el 31 de diciembre de 2015 que se muestran en las presentes cuentas anuales, han sido modificados respecto a los mostrados en las cuentas anuales correspondientes a dicho ejercicio como consecuencia de las modificaciones introducidas por el Real Decreto 602/2016. Así se han re-expresado las cifras anteriores al 1 de enero de 2015 contra las cuentas de reservas. A continuación se presenta un detalle de los efectos de la aplicación de los nuevos criterios de amortización en los ejercicios 2015 y anteriores.

El efecto acumulado al 1 de enero de 2016 es el siguiente:

10

Source: Annual accounts report for the financial year 2016 of Acens Technologies S.L.U.

Appendix 2: Point 5 Section c of the 2016 annual accounts of Acens Technologies, S.L.U.

c) Fondo de comercio

El Fondo de comercio se asigna a una única unidad generadora de efectivo (UGE) de la Sociedad de acuerdo con el segmento del negocio. El desglose del epígrafe de Fondo de comercio a 31 de diciembre de 2016 es el siguiente:

	Valor Bruto	Amortización Acumulada	Valor Neto Contable
Fondo de comercio de Fusión de Ethernet	99	(89)	10
Fondo de comercio de Fusión de Acens (Nota 1)	30 820	(27 738)	3 082
Fondo de comercio de Fusión de Hostalia (Nota 1)	7 094	(6 385)	709
Fondo de comercio de Fusión de Ferca (Nota 1)	3 875	(3 293)	582
Fondo de comercio de Fusión de Veloxia (Nota 1)	3 981	(3 384)	597
Fondo de comercio de Fusión de Datahouse Internet (Nota1)	2 854	(1 855)	999
	48 723	(42 744)	5 979

El Fondo de comercio de Ethernet recoge los costes incurridos en relación con la compra de una cartera de clientes durante el año 2006.

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Source: Annual accounts report for the financial year 2016 of Acens Technologies S.L.U.