BUYING FOR THE SAKE OF BUILDING?

A QUALITATIVE STUDY ON BUY-AND-BUILD STRATEGIES IN THE NORDIC PRIVATE EQUITY MARKET

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Abstract:

We examine how buy-and-build strategies are executed in the Nordic private equity market. Particularly, we analyze the role of buy-and-build in creating value, key elements contributing to a successful strategy, and how the quality of the implementation is reflected in exit considerations. Using a case study of Ratos' buy-and-build implementation in its platform company, HL Display, we attain in-depth understanding of these issues in a real-world context. For a more exhaustive comprehension of the Nordic market, we also conduct interviews with a broad sample of prominent private equity players. Increased competition in the private equity market has intensified the need for operational enhancements to achieve satisfactory returns. To cope with this, we find that buy-and-build plays an important role as it unlocks new value creation potential. Furthermore, we find that a strong market position, a capable management team, and clear processes are critical factors contributing to the success of the strategy. However, findings suggest that the implementation approach needs to be adapted to each individual case. Finally, we find that add-on acquisitions must be rooted in industrial logic for multiple arbitrages to be justified, a requirement more pronounced today than only a few years ago. Companies can no longer solely rely on acquisition-driven performance as investors incorporate organic improvements in their evaluations.

Keywords:

Private Equity, Buy-and-Build, Value Creation, Multiple Arbitrage, M&A

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Abbrevation	Definition
Add-ons	Add-on Aquisitions
AUM	Assets Under Managament
B&B	Buy-and-Build
CAGR	Compound Annual Growth Rate
EBITDA	Earnings Before Interest, Taxes, Depreciation, and Amortization
GP	General Partner
HQ	Headquarter
IC	Investment Committe
KPI	Key Performance Indicator
LBO	Leveraged Buyout
LP	Limited Partner
M&A	Mergers and Aquisitions
MOIC	Money on Invested Capital
PE	Private Equity
POS	Point-of -Sales
RCF	Revolving Credit Facility

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1. Introduction

In a constantly shifting economic environment, the ability to optimize value creation is becoming increasingly important. Value creation, being a continuously developing phenomenon, players in the market need to be adaptable and able to reassess as circumstances change. As the professionalization of private equity (“PE”) firms and the growth of the secondary market have led to the commoditization of conventional value creation methods, firms are now exploring diverse strategies to enhance the value of their portfolio companies (Bonini, 2015; Strömberg, 2008). This is clearly showcased when dividing value creation into three levers: operational improvement, multiple expansion, and deleveraging. Looking at the contribution to value creation in PE deals, Boston Consulting Group (2012) finds that deleveraging went from representing 51% in the 1980s to only 13% in 2012. Contrastingly, operational improvement represented 48% of the value creation realized in 2012, having only stood for 18% back in the 1980s. Using Jensen’s (1989) segmentation of value creating activities between operational, governance, and financial engineering, Biesinger et al. (2020) draw similar conclusions, suggesting that operational engineering has increased in importance and is the most applied type of initiative in PE value creation plans[1]. However, they conclude that a successful value creation journey can rarely be attributed to one but is rather a tailored combination of the three levers. This trend has been prominent in the Nordic PE market, with significantly increased competition over the past decades, ultimately placing pressure on firms to deliver operational improvements. In 2022, the total deal value in Nordic PE was estimated to be EUR 92.5 billion across 1103 deals, compared to EUR 20.6 billion across 347 deals in 2010 (Pitchbook, 2023).

One strategy increasingly employed by PE firms to create value in this competitive landscape is usually referred to as buy-and-build (“B&B”). Typically, this strategy is characterized as an investment in a "platform company”, serving as a foundation for subsequent acquisitions of other companies (“add-ons”) (Borell & Heger, 2013). B&B is recognized as an effective strategy to achieve returns, partly by its ability to realize so-called “multiple arbitrage” by acquiring add-ons valued at lower transaction multiples than the platform company (Borell and Heger, 2013; Hammer et al., 2017; Døskeland and Strömberg, 2018). By incorporating add-on companies into a platform valued at a higher multiple, PE firms can accomplish a greater valuation of the add-on companies than what is justified by their financial contributions on a standalone basis. Often, valuation multiples are based on sales or profit items such as earnings before interest, taxes, depreciation, and amortization (“EBITDA”). However, the strategy also plays an important role

[1] Kaplan and Strömberg (2009) were the first to note the existence of value creation plans

in unlocking operational potential, which is increasingly central when creating value in the PE sector. As a matter of fact, active M&A agendas are generally accepted as the foremost method for enhancing operations in PE buyouts (Boston Consulting Group, 2012), and become increasingly attractive when organic growth is particularly difficult to achieve (Avondale, 2019). In addition to the growth achieved inorganically, the strategy has been shown to create significant organic growth in sales and profitability (Bansraj et al., 2020).

The adoption of B&B strategies has increased significantly over the last decade. In addition, PE firms deploying the strategy have been seen to extend the scale in which add-on acquisitions are performed. Bain & Company (2023) shows that out of all add-on acquisitions taking place, a larger share is performed by platforms that already have done previous add-on acquisitions. As an example, the data shows that 42% of global add-on deals in 2022 are done by platforms that already have done four or more previous acquisitions, compared to 24% in 2012. During the same period, there has been a significant positive correlation between deal size and median EV/EBITDA multiple. Bain & Company suggest that this development implies that add-on acquisition increasingly serves B&B strategies as PE firms have been seen to scale up high-valued platforms by acquiring lower valued add-on companies. The global progression of B&B strategies is also evident in the Nordics. Looking at the add-on acquisitions between 2012 and 2022, the total deal value has increased from EUR 6.9 billion to EUR 36.4 billion, representing a total increase of 428%, implying a compound annual growth rate (CAGR) of 18.1%. This development made add-on acquisitions surpass non-add-on deals in 2022, representing 53.4% of total buyout deal value compared to 28.2% in 2012 (Pitchbook, 2023).

A constantly evolving landscape requires central norms and assumptions to regularly be challenged. Within the scope of this paper, this culminates in a demand for central questions on the topics of B&B, and value creation in general, having to be reassessed. These questions not only include the role of B&B in value creation and key considerations when carrying out such a strategy but also how the agenda translates into potential buyers' evaluation when exiting an investment. Using a dataset with PE deals between the years 1986 and 2020, Heisig et al. (2022) find that the different sources [e.g., organic and inorganic] of EBITDA growth are not differentiated by potential buyers. This arguably implies that the performance of add-ons post-acquisition is not reflected in the exit multiple. Contrastingly, opposing arguments have recently been raised, claiming that factors such as the quality of integration and organic growth post-acquisition indeed are key considerations affecting the multiples. Against this background, the paper aims to answer the following research questions:

1. What role does buy-and-build play in value creation?
2. What are the key elements in a successful buy-and-build strategy?
3. How is the quality of buy-and-build reflected in exit considerations?

To get a holistic, in-depth understanding of these matters, despite the lack of relevant data given the constant development and exemption from public disclosure requirements within the space, we apply a qualitative research methodology. In line with the market in general, the publicly listed acquisition-driven business group Ratos has reassessed its value creation, increasing its focus on operational improvements and B&B. Despite no longer defining itself as a PE firm, Ratos makes its investments in Nordic, non-public equity, which is in the scope of this study. An example showcasing the change in Ratos' value creation strategy, and shedding light on the research questions of this paper, is the company's B&B initiation for one of its platform companies, the point-of-sales ("POS") equipment player HL Display. In 2019, HL Display had turned a negative trend around, having established resilience and significantly improved its profitability after a number of challenging years. At the time of writing this paper, HL Display had made seven add-on acquisitions in two and a half years, reporting a revenue close to SEK 1.9 billion in 2022, making it the undisputed leader in the European POS equipment market. Complemented by interviews with some of the most prominent players in the Nordic PE market, we are using a single case study methodology.

Comparing our findings with existing literature, we add new and updated perspectives in a constantly changing space. Despite value creation being a frequently discovered topic in research, we believe our focus on the rapidly growing phenomenon of B&B and the Nordic market, as well as our exclusive list of interviewees, adds new knowledge to this field. The scope of this paper is limited to the above-mentioned purposes and considers only Nordic financial markets. Further, the case only presents one instance of a B&B, which, despite supplementing interviews with various PE players, arguably limits the generalization of the findings. Lastly, interviewees sometimes were unable to disclose all relevant information due to the internal and external restrictions commonly present in the space.

We find that higher competition in the Nordic PE industry makes it increasingly demanding to create value. To tackle this, PE firms have been seen emphasizing operational improvements in their portfolio companies, often with the help of in-house or external expertise. B&B strategies have been seen to play an important role for PE firms to achieve operational improvement, although historically being mostly driven by the ability to achieve multiple arbitrage. These improvements include, by other things, synergy extraction, product extension, and market expansion. In addition, it is used to reach the desired equity ticket size in order to align with investment mandates and internal policies. B&B is deployed in different ways from one case to another in terms of the level of participation in M&A processes, the extent of predetermined add-ons, and the exhaustiveness of add-on integration.

We also find several key considerations to succeed with a B&B strategy. First, market conditions should align with the company strategy, although there are no clear attributes that are universally better than others. Second, the platform company should be well positioned in the market and have a management team with appropriate spans of control, that is willing to and capable of pursuing an M&A agenda. This includes having high levels of internal stability and well-anchored processes. Third, the level of integration and the plan for implementing it should be tailored to each specific add-on company, whereby the human aspects become most central. It should entail an attractive value proposition for the add-on companies and their key personnel.

Finally, we find that the quality of the B&B implementation is highly reflected in the exit consideration and hence the ability to achieve multiple arbitrage – more so today than a few years ago. First, the exit price is higher if the acquisitions are anchored in industrial logic, something that can be verified by organic improvements and realized synergies. Second, the exit price is dependent on the healthiness and completeness of add-on integrations. One major component is the human capital dynamics post-transaction, in which culture compatibility, employee retention, and key people motivation all show signs of healthy integration. Worth noting, however, is that some groups benefit from less integration – something assessed by investors. This means that add-on companies should be handled according to what is most appropriate in each scenario for it to be reflected positively in the exit price. Third, the future trajectory for a continued B&B journey is also reflected in the exit price. Hence, in cases where the strategy has proven to be successful, it sometimes makes sense to "leave money on the table" for buyers to continue the value-creative B&B journey.

The thesis proceeds as follows: Section 2 reviews the literature, Section 3 outlines the methodology, Section 4 presents the case of Ratos' B&B journey with HL Display, Section 5 summarizes the findings from the interviews with Nordic PE firms, Section 6 discusses the empirics with connections to previous research, and Section 7 concludes the thesis.

2. Literature Review

This section reviews prior literature on related topics for the thesis, including a general overview of PE and returns, value creation within PE-owned companies, B&B as a specific value creation strategy, and the exit stage of PE investments.

2.1. Private Equity and Returns

In the simplest terms, PE could be described as equity investments in private companies. These include buyout-, venture capital-, hedge-fund-, and angel investments, as well as public equity investments done by private companies (Cendrowski et al., 2012), where first is the main focus of this study. Oftentimes, a PE fund is structured as a limited partnership between limited partners (“LPs”), providing capital for the fund, and general partners (“GPs”, i.e., the PE firms), investing the capital with the objective of achieving returns (Wilson et al., 2022). To get up to speed on PE and understand further details on stakeholder dynamics in limited partnerships, please see previous research by Watt and Galgóczi (2009). As the traditional organizational setup does not fit all participants in this study (e.g., Ratos being a publicly listed company investing in private equity assets from its own balance sheet), an entity making private equity investments is henceforward referred to as a PE firm.

Numerous studies have been undertaken to assess returns of PE in relation to public equity (Brown and Kaplan, 2019; Gompers and Lerner, 1997; Sorensen and Jagannathan, 2015), with several showing PE risk- and fee-adjusted outperformance (Kaplan and Schoar, 2005; Sensoy et al., 2014; Harris et al., 2014; Korteweg and Sorensen, 2017). Further, PE funds have been shown to generate operational outperformance of portfolio companies compared to peers in metrics such as growth and margin improvement (Acharya et al., 2013; Wilson et al., 2012). The same conclusion is not shared universally, however, as PE funds in other studies have been shown to generate lower returns than public equity, when, for example, comparing to the S&P 500 (Phalippou and Gottschalg, 2009). The basis for the complications of comparing returns is their dependency on industry and debt market conditions (Gompers and Lerner, 2000; Wang, 2012; Axelson et al., 2013; Jenkinson and Sousa, 2015) as well as macroeconomic factors (Axelson et al., 2013; Haddad et al., 2017).

With increased competition in the industry, PE firms have been seen trying to differentiate themselves through focused strategies. This can be done by narrowing the investment focus on certain industries, ticket sizes, and various operational strategies to employ to create value in the companies they invest in. Several researchers argue that many specialized investment firms generate a competitive advantage that is positively correlated with returns (Cressy et al., 2007; Humphery-Jenner, 2013). Gompers et al. (2009).

2.2. Value Creation in Private Equity

PE firms recognize opportunities for enhancements in the companies they acquire, execute strategies to create the desired value, and divest the companies typically within a span of three to seven years of ownership (Døskeland and Strömberg, 2018). Mainly, the value-creating initiatives relate to operational, governance, and financial engineering (Jensen, 1989). In addition to these aspects of value creation, PE firms also add value when sourcing deals and in sales processes from arising proprietary deals and being more prepared than competitors once a company gets on the market (Døskeland and Strömberg, 2018).

Biesinger et al. (2020) conclude that a successful value creation journey rarely can be attributed to one but is rather a tailored combination of the types of initiatives. As the professionalization of PE firms and the growth of the secondary market have led to the commoditization of conventional value creation methods, PE firms are now exploring diverse strategies to enhance the value of their portfolio companies (Bonini, 2015; Strömberg, 2008)

2.2.1. Operational Engineering

Operational engineering is the most common type of value creation, pursued in 84% of all PE deals, and include initiatives related to, e.g., acquiring or selling fixed assets or other companies, reducing costs, improving processes and organizational structures, changing customer offering, and increasing international presence (Biesinger et al., 2020). Since the 1980s, operational engineering has increased in importance among value creation strategies pursued by PE firms (Kaplan and Strömberg, 2009; Biesinger et al., 2020). The focus has broadened over time, going from mostly cutting costs to now including a variety of operations-related aspects (Gompers et al., 2016). One reason for this development is believed to be the increased competitiveness within a more mature PE industry, where operational engineering capabilities could act as a differentiator (Hammer et al., 2017; Braun et al., 2017; Døskeland and Strömberg, 2018). To support this, more PE firms have been seen hiring in-house operational expertise in addition to the use of external advisors to create competitive advantage (Døskeland and Strömberg, 2018). A study by Gompers et al. (2016) finds that PE firms today emphasize revenue growth to a greater extent compared to cost-cutting, which is supported by Biesinger et al. (2020), concluding an increased use of top-line growth initiatives.

Add-on Acquisitions

Using the portfolio company as a platform to acquire other companies (add-on acquisitions) plays an important role in operational engineering, partly driven by limited investment horizons to create value within (Borell and Heger, 2013; Hammer et al., 2017; Døskeland and Strömberg, 2018). In fact, M&A is generally acknowledged as the primary driver for improving operations in PE buyouts (BCG, 2012). Partly, this is achieved by increasing profit margins (Acharaya et al., 2013). Further, add-on acquisitions are often made at relatively low multiples in relation to the platform companies (Døskeland and Strömberg, 2018). By this, PE firms are able to create a multiple expansion (often measured as enterprise value divided by EBITDA), meaning increasing the valuation multiple of the portfolio company (Acharaya et al., 2013). A study by Hammer et al. (2017) of 9,548 buyout deals and 4,937 add-on acquisitions performed by 1,798 PE firms in 86 countries between 1997 and 2012 finds that 43% of PE firms are actively pursuing add-on acquisitions. The same research observes that the likelihood of add-on acquisitions is elevated by the presence of an experienced and reputable PE firm when the portfolio firm has previous M&A experience and is operating in a moderately fragmented industry in times of favorable financing conditions. If add-ons are acquired and merged as an explicit value creation strategy, it is commonly called "buy-and-build" B&B") (Borell and Heger, 2013; Hammer et al., 2017; Døskeland and Strömberg, 2018). Please read about this in isolation in section 2.3.

2.2.2. Governance Engineering

Governance engineering is explicitly pursued in almost 50% of all PE deals (Biesinger et al., 2020). The authors name several governance-related initiatives, such as changes in the management team, the board of directors, the shareholder structure, and the way the portfolio company is controlled and operated. Other initiatives include implementing equity-linked incentive programs for key personnel (Kaplan and Strömberg, 2009), partly because of the desire to mitigate agency programs (Biesinger et al., 2020).

PE-owned companies traditionally have smaller, more actively monitoring boards to meet the performance targets within the limited investment horizon (Døskeland and Strömberg, 2018). As an example, PE-owned company boards meet more frequently than public company boards (Acharya et al., 2009; Gertner and Kaplan, 1996). PE firms usually fill the seats with internal operating partners possessing essential skills or industry expertise to improve competence and governance within the portfolio companies (Biesinger et al., 2020).

2.2.3. *Financial Engineering*

In one out of three PE deals, financial engineering is part of the value creation strategy (Biesinger et al., 2020). This aspect of value creation mainly includes initiatives to optimize capital structures, incentive programs, and net working capital management (Biesinger et al., 2020).[2] Optimizing debt levels by changing capital structure has been shown to be value creative yet decreasing in importance for returns (Kaplan and Strömberg, 2009; Harris et al., 2014; Gompers et al., 2016; Biesinger et al., 2020). Using external debt when acquiring companies enables PE firms to acquire controlling stakes in companies with a lower equity ticket, leading to leveraged return (Modigliani and Miller, 1958; Jensen, 1989). Further, using leverage has the additional benefit of reducing corporate tax through tax shields (Modigliani and Miller, 1958; Berk and DeMarzo, 2019). In addition, PE firms create value by lowering the cost of debt because of their reputational capital (Demiroglu and James, 2010). However, the benefits are balanced with the additional management discipline required to service the debt (Jensen, 1989). The possibility to pursue financial engineering is highly dependent on capital market conditions, including borrowing capacity in the debt market as well as interest rates (Axelson et al., 2013; Gompers et al., 2016).

2.2.4. *Measuring Value Creation*

Measuring value creation is conventionally performed by analyzing two main components: change in enterprise value and change in net debt, where the former often is broken down into EBITDA improvement and multiple expansion. The combined value arising from the components is measured in money on invested capital (“MOIC”). EBITDA growth, mainly driven by revenue, has historically been most central to returns (Zeisberger et al., 2016).

2.3. Buy-and-Build

B&B can typically be defined as an investment in a "platform company", serving as a foundation for subsequent acquisitions of other companies, and is considered by the PE industry as a vital means of value generation (Borell and Heger, 2013). This is not surprising as several scientific studies have found evidence that B&B positively correlates with enterprise- and equity value returns (Nikoskelainen and Wright, 2007). Further, it has been shown to generate significant organic growth in sales and profitability, in addition to the growth achieved inorganically (Bansraj

[2] In this thesis, incentive programs are included in governance engineering, as categorized by Kaplan and Strömberg, 2009

et al., 2020). Despite this, the strategy has not yet been thoroughly examined in the literature (Borell and Heger, 2013).

This strategy shares similarities found in strategic M&A, as the rationale behind the acquisitions is often to create operational synergies (Bansraj et al., 2020). Other rationales behind B&B strategies are to expand quicker, gain capabilities, and achieve a stronger market position. Further, B&B is pursued because of the ability to utilize multiple arbitrage by acquiring add-ons with lower multiples than the platform company (Borell and Heger, 2013; Hammer et al., 2017; Døskeland and Strömberg, 2018). The approach has risen in importance for PE firms trying to mitigate the effect of increasing entry multiples of platform companies (Bain & Company, 2019).

B&B strategies are pursued in different ways depending on various aspects, such as size and frequency of add-on acquisitions. Shown to have been most successful are strategies with small and programmatic acquisitions when implemented by a team with the right M&A skills (Rehm et al., 2012). One benefit of making repetitive acquisitions is the ability to increase the knowledge capital of the platform, especially when the management team has high retention and the add-on acquisitions are similar in character (Aktas et al., 2013). This goes in line with research by Haleblian and Finkelstein (1999), concluding that the more similar the add-ons are to previously acquired companies, the better they usually perform.

Decisions to pursue a B&B strategy are sometimes made before the acquisition of the platform company (Loos, 2006). These decisions can be driven by the view that the market and competitive landscape are favorable for such a strategy. Often, market fragmentation is seen as positive for enabling consolidation through M&A and achieving economies of scale (Bhattacharyya and Nain, 2011). In fragmented markets where industry players are not significantly differentiated in terms of market share, B&B strategies are often motivated by the ability to perform “roll-ups”, where add-on acquisitions drive up the valuation multiple for the group (Hammer et al. 2014). Often, a fragmented industry could also serve as a good foundation for PE firms that would like to achieve market leadership (Døskeland and Strömberg, 2018). B&B is, however, not limited to fragmented market conditions, as the strategy could also create value in concentrated markets. In such instances, the acquisitions are primarily motivated by the ability to achieve economies of scale and scope (Hammer et al., 2014). In horizontal mergers within concentrated markets, the rationale can be to increase negotiation power toward suppliers or customers (Bhattacharyya and Nain, 2011).

A well-executed B&B strategy is often reliant on the integration of add-ons (Steigenberger, 2017), whereby one of many challenges relate to different company cultures (Sudarsanam, 2010). This is aligned with several studies on M&A showing that value creation post-acquisition is highly dependent on how effective the integration is of two priorly separate companies

(Birkinshaw et al., 2000; Schweiger, 2002; Haspeslagh and Jemison, 1991; Larsson and Finkelstein, 1999). Despite the extensive evidence of the importance of integration, some PE firms pursuing B&B strategies are intentionally keeping the platform and its add-on companies decentralized (Steigenberger, 2017). This means that platforms limit the integration of the add-on companies because of the seemed benefits of having the individual entities working autonomously.

2.4. Exits

For PE firms, the route taken when exiting holdings is an essential part of the investment process, especially considering the funds' limited lifetime (Døskeland and Strömberg, 2018). Kaplan and Strömberg (2009) conclude in a study based on exits of leveraged buyout ("LBO") transactions during 1970-2007 that there are three main routes: selling to a strategic player (38%), selling to another PE firm, also known as secondary buyout (24%), and public listing via an IPO (14%). A more recent European sample from exits between 2000-2014 shows a significant increase in secondary buyouts, representing 43% of all exits (Jenkinson and Sousa, 2015).

When selling to another PE firm, there is a tradeoff between realizing "full" potential and leaving potential for creating value by the next owner, sometimes referred to as "leaving money on the table" (Hammer et al., 2017). One reason for doing so, mentioned by Hochberg et al. (2014), is that PE firms sell off assets to ensure performance consistency to attract new LPs. When performing add-on acquisitions, it seems to be particularly beneficial not to fully realize potential due to it often requiring prolonging predetermined holding periods (Hammer et al., 2017). On another note, using a dataset with PE deals between the years 1986 and 2020, Heisig et al. (2022) find that the different sources [e.g., organic and inorganic] of EBITDA growth are not differentiated by potential buyers.

3. Methodology

This section aims to provide a clear description of the research design and methodology used throughout the thesis, followed by an overview of the data used, and ends with a critical methodological evaluation.

3.1. Research Design and Methodology

This paper aims to provide an in-depth analysis of the approaches and applications of value creation, particularly B&B, applied by PE firms in the Nordic market. A common problem encountered when researching PE is the limited data available, given the firms' exemption from public disclosure requirements (Kaplan and Sensoy, 2015). Also, given the constant evolution of value creation, it is hard to find accurate information since what was true a decade ago may not be correct in today's environment. Lastly, the questions examined in this paper are complex, partly stemming from its intangible nature. Hence, the insights required cannot solely be drawn from hard data. To tackle these challenges, we chose a qualitative approach for this study. More specifically, we use the single case study to gain a comprehensive, real-world perspective of value creation and B&B. Siggelkow (2007) suggests that a case study methodology allows for in-depth analyses of specific contexts and organizations. While the depth of the single case methodology comes at a price of less generality, in line with the trade-off explained by Otley and Berry (1994), we find the insights gained from exploring the matters closely vital for the quality of the paper. The case study format facilitates insights into the thoughts of influential people working closely with the topic rather than inferring it from hard data. The study covers Ratos' value creation initiative when implementing a B&B strategy for HL Display as well as value creation in general and B&B in particular in the Nordic PE market.

3.2. Data

The primary sources of data for this paper are interviews, investment materials, as well as publicly available information. For the purpose of the case study, interviews with the people working close to the relevant matters were conducted. To capture a comprehensive view, interviews were held both with the Ratos and the HL Display side, ensuring a balanced portrayal. Complementing the case, adding multiple perspectives on how value creation and B&B strategies are performed in practice, interviews with representatives from a diverse group of eight prominent PE firms in the Nordic market space were also held. This broadens the perspective of the Nordic market and enables more general conclusions from our findings. The firms were selected after careful consideration of their relevance to the topic, given sizeable investments and previous experience from add-on acquisitions.

To facilitate a conversational setting, interviews were carried out using a semi-structured approach (Merriam, 1994), meaning questions were thoroughly prepared before the interviews, yet allowing for individual follow-up questions dependent on the responses of the interviewees. To ensure correct citations and narration, all interviews were recorded, transcribed, and followed up with outstanding questions when needed. The interviews were conducted in person and digitally between October 2nd and November 27th, 2023, and lasted for between 30 and 60 minutes. An overview of the interviewees can be found in 9.1 of the appendices.

The data collection entails some limitations including that interviewees sometimes were unable to disclose all relevant information due to the internal and external restrictions commonly presented in the space. Moreover, the case only presents one instance of a B&B, which despite supplementing interviews with various PE players arguably limits generalization of the findings. Generalization is also limited from a geographical perspective, as the study is limited to the Nordic. More generalization could have been achieved through a broader scope with additional interviewees.

3.3. Methodological Evaluation

Criticism against the case study method exists and is often related to the method's ability to draw general conclusions, as highlighted by, among others, Yin (2014). That mainly has to do with the narrowness of the scope, which requires carefulness not to generalize the dynamics found in one organization (Siggelkow, 2007). While the purpose of this paper is to inform further research rather than drawing generalized conclusions, we address these issues through a structured and consistent approach as described above.

Another criticism against the nature of the methodology is the risk of lack in replicability (Saunders et al., 2012). This can be the case especially if the interviews held suffer from poor execution, e.g., in the way questions are communicated or from biases in the answers received from the interviewees. Raising this issue, Yin (2014) suggests triangulation using various sources of data as an approach to mitigation. Following his line, we have complemented and cross-checked the statements made in the interviews with investment materials and public sources available to us. Also, by interviewing both sides of the platform/owner relationship between Ratos and HL Display and reflecting both perspectives, we limit our exposure to bias in the data. Lastly, all interviews conducted have been recorded, and the materials used are either publicly available or enclosed in this paper. While not assuring that a replication of the study would come to the exact same conclusions, this increases the level of replicability.

4. Ratos Pursuing Buy-and-Build in HL Display

By providing insight into Ratos’ value creation in HL Display, this section aims to shed further light on the issues studied by this paper. The main source of information is interviews conducted with relevant stakeholders from both sides of the transaction, which has been complemented and validated by investment materials and other data available. Starting with an overview of Ratos as an investor, the section further includes empirical insight into Ratos’ value creation strategy, its work with add-on acquisitions as well as an outline of the B&B value creation strategy assumed for HL Display.

Table 1. Overview of Interviewees

Firm	Interviewee	Role(s)
Ratos	Jonas Wiström	Chief Executive Officer
Ratos	Jonatan Gustafsson	Senior Associate
Aira (ex-Ratos)	Joakim Twetman	Chief Strategy Officer, Former President Business Area Industry at Ratos
HL Display	Björn Borgman	Chief Executive Officer

4.1. Introduction to Ratos

Ratos’ story started more than 150 years ago when Per Söderberg founded Sweden’s first individual wholesaler for iron and iron manufacturing, Söderberg & Haak, in 1866. 68 years later, in 1934, the brothers Ragnar and Torsten Söderberg started Ratos (acronym for Ragnar and Torsten Söderberg) with the purpose of serving as a management company, investing the funds generated from the growing family business. Söderberg & Haak later became a subsidiary of Ratos, after which the holding company was listed on the Swedish stock exchange in 1954. At the time of this study, Ratos is still listed on the Swedish stock exchange, currently (2023) on the large cap list of Nasdaq OMX Stockholm.

The Söderberg companies have been crucial to Swedish trade over the last two centuries; Söderberg & Haak provided the steel used for many of the buildings and bridges that laid the foundation of the current infrastructure in Stockholm. Furthermore, the Söderberg family was one of the initiative takers of Stockholm School of Economics, to which Ratos is still (2023) one of the main (capital) partners. Ratos also reshaped the Swedish hotel industry through its partnership with Scandic. Beyond that, the company has spurred development within the Nordic business landscape through its ownership in several leading companies. Over the years, Ratos has made investments in numerous successful, well-known businesses, including Anticimex, Bisnode, SF Bio (Nordic Cinema Group), Haglöfs, and Arcus.

Ratos is still controlled by the Söderberg Family, partly through Ragnar Söderbergs Foundation and Torsten Söderbergs Foundation. The foundations were initiated in 1960 with the purpose of supporting scientific research and teaching in Economics, Medicine, and Law. Together with privately held shares of Söderberg family members, the foundations control approximately 70% of the votes in Ratos. Per-Olof Söderberg, the grandchild of Ragnar, who also founded the insurance and financial advisory firm Söderberg & Partners, serves as the Chairman of the Ratos Board.

In later years, Ratos has gone through a major transition. Seeing great success at the beginning of the 2000s, the share price five folded from its levels in 2000 to its all-time high in 2011. During that period, Ratos considered itself a publicly listed PE company, using high leverage, short investment horizons, showcasing strong value creation abilities in the short term. However, Ratos hit a rough patch during the 2010s, losing more than 80% of its equity value. In hindsight, Ratos realized that too much capital was distributed to shareholders as many of the "good" companies were sold and the underperforming assets were kept, contributing to the negative development.

Figure 1. Ratos' Share Price Development between 2005 and January 2018

Source: FactSet

In January 2018, the chairman of the board, Jonas Wiström, stepped in as CEO to turn the negative trend around. The vision was for Ratos to become a homogeneous business group, creating long-term value rather than an investor looking for short-term returns. At the time of this paper, Ratos considers itself still in the process of this transformation. It emphasizes that the transition of going from acquiring companies in numerous industries to directing its focus on a few selected takes time. The process proceeded well until the fall of 2022 when the M&A and

IPO market activity sharply declined, ultimately delaying Ratos' action plan. Nevertheless, despite unfavorable market conditions, including the Covid-19 pandemic, increasing interest rates, and the Russian invasion of Ukraine, a lot has happened since Wiström took over, and the company has seen a strong development since.

> "When I stepped in as CEO […], we had 13 companies, of which only two performed better year over year, leverage was high, and results were weak. There, we started a journey all about improving profitability, reducing costs, getting the right CEOs, and lower leverage. Looking back at the years 2018, 2019, and 2020, […] we increased EBITA 87% per year on average [CAGR], and we went from a leverage of 3.4x to a net cash position. This was a fantastic accomplishment by a group of 19 employees as opposed to more than 50 employees that we had back in 2017" - Jonas Wiström, CEO of Ratos

As of 2023, Ratos holds companies within the three business areas: Construction & Services, Consumer, and Industry. The Construction & Services vertical aims to capitalize on societal trends such as urbanization, increased populations, and the growing need for renewable energy. Examples of portfolio companies are SSEA Group, Aibel, and Presis Infra. The business area Consumer comprises the home and garden chain Plantagen and Sweden's largest independent online marketplace for safe used car transactions, KVD. Lastly, the Industry business area aims to acquire and develop companies with leading market positions and exposure to structural growth, and includes, for instance Diab, LEDiL, and Semcon. Another company within the Industry business area is HL Display, which we will dive deeper into in this section. In total, Ratos employs more than 15,000 people across its 17 platform companies, with a combined turnover of more than SEK 30 billion.

4.1.1. Investment Process

Ratos aims to acquire and develop companies headquartered in the Nordics that are or can become market leaders. More specifically, they look for high-quality companies with a stable history and with significant profitability, which Ratos generally measure using earnings before interest, taxes, and amortization ("EBITA"). B&B targets can, according to Ratos' website, "often be a necessary puzzle piece to consolidate a fragmented market and operate in an attractive and growing market". Furthermore, Ratos makes sure that the companies have competent CEOs and management teams that can contribute to the Ratos Group.

> "An ideal target is typically asset-light, with low working capital and capex requirements (hence good cash conversion) and has an EBITA margin of at least 10 percent, with a track record of organic growth, operating in a structurally growing market" - Jonatan Gustafsson, Senior Associate at Ratos

Depending on whether an acquisition process is structured (i.e., an external advisor is mandated to run the process) or bilateral, it can look slightly different. A typical acquisition process begins with an initial screening of the potential target, where the financial and qualitative aspects of the company undergo analysis and evaluation. If the case proves attractive, the target's owners or advisors are approached, often resulting in the submission of an indicative bid. Thereafter, the hypotheses developed in the initial screening are validated, and the risks are assessed in a due diligence (DD) process. In the case of larger acquisitions, Ratos usually engages advisors to assist with the DD. Once DD is completed, a final bid is submitted.

4.1.2. Value Creation

In contrast to many of its peers, Ratos makes its investments from its own balance sheet, meaning it finances the equity component of new investments using its own cash flows instead of having constant access to new capital through funds. For the debt component, Ratos uses central financing, which prohibits it from putting holdings into bankruptcy. On the other hand, central financing facilitates more favorable terms, such as lower interest rates. The funds are channeled to portfolio companies as internal loans that can be initiated when they seek to make add-on acquisitions or other capital investments, subject to the appropriate debt levels of the platform. Internal loans can also be used to increase leverage in platform companies. This increases the attractiveness for management teams to participate in stock incentive programs. The central financing not only adds financial flexibility within the group but also helps Ratos manage leverage and align with financial targets. Another feature employed by Ratos that generates financial flexibility is the cash pool, which in practice works similar to a revolving credit facility ("RCF") that the portfolio companies can utilize. Platform companies can both borrow and lend from the cash pool, paying interest and earning interest income, respectively.

Despite the decentralized structure, Ratos is actively and constantly working with its assets, supporting with expertise and capabilities whilst tracking results. It works closely with its CEOs and stays on top of the platforms' trajectory through monthly reports and management meetings. Furthermore, to realize synergies within the business group, Ratos facilitates various networking, collaboration, and development opportunities for its companies. Not only does this create bonds and spur the feeling of being part of something larger, but also enables sharing of experience and best practices between the companies. An example of this is the Business Executive Leadership Program (BELP) that Ratos arranges annually for platform company leadership. Through the program, participants are given the opportunity to develop through knowledge-enhancing lectures, cases, and exercises while exchanging experiences and knowledge with one another.

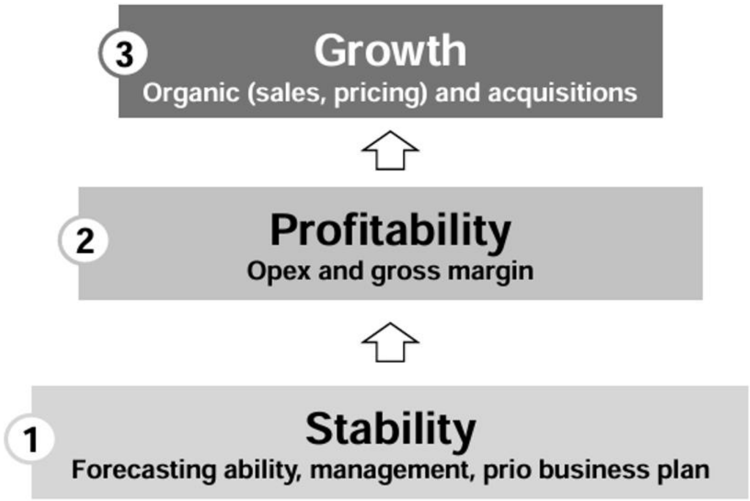
To attract and properly incentivize the best talent, especially the right CEOs, Ratos is actively working with Management Incentive Programs (MIP), through which key employees in platforms are compensated through financially attractive equity incentives. Jonas Wiström means that having the right people in the right place is crucial for businesses to be successful in the long term, in accordance with the third of Ratos' three values: *Simplicity*, *Speed in Execution,* and *It's all about the people*.

As previously stated, Ratos has, over the past decades redefined how portfolio companies should create value. Transitioning from being a publicly listed PE firm to a plain investment company, Ratos today aims to become a homogeneous business group. With a decentralized but active ownership, it intends to hold assets as long as it considers itself the best-suited owner for the portfolio company, enabling increased focus on long-term, sustainable value creation.

Jonas Wiström is confident that organic EBITA growth is the best way to create value going forward. In addition, he stresses that add-on acquisitions with hard synergies and multiple arbitrages are an important complement. However, before starting a growth journey, Ratos firmly believes that platform companies need to have stability and profitability. This is at the heart of Ratos' value creation strategy, with the firm arguing that when a platform company is shaking, add-on acquisitions create problems rather than solving them. It sees several reasons for the need to create stability and profitability before being able to handle an M&A agenda. First, sourcing potential targets and driving acquisition processes takes up a lot of management time. If companies are struggling internally, lots of time will need to be spent on solving such issues. It is also an intense and tough process to integrate acquired companies. Second, Ratos argues that if acquiring a quality business, smaller but operationally better performing than the platform company, the target will typically start performing in line with the acquirer rather than the other way around.

> "Not everyone wants to be the best, yet no one wishes to be the worst. People and companies adjust to their surroundings. Hence, if a company with a 5% margin acquires a smaller firm with a 10% margin, the smaller will likely adjust downward to converge with the acquiring company's 5% margin" - Jonas Wiström, CEO of Ratos

Figure 2. Ratos' Improvement Priority



Source: Ratos Capital Markets Day 2022

4.1.3. Buy-and-Build Considerations

During his many years as CEO of the technical consultancy firm AFRY (previously ÅF), Jonas Wiström accumulated experience from making add-on acquisitions of a magnitude that could be described as close to unmatched. Between the years 2002 and 2017, when Wiström was the CEO, AFRY made more than 50 acquisitions. Bringing his experience to Ratos, B&B has been a central element in many of the portfolio companies in recent years. The increased B&B activity goes hand in hand with Ratos' strategy of being a long-term owner rather than a short horizon PE player, enabling carefulness and patience, making sure platforms are stable and profitable enough to grow inorganically and capabilities for integration are in place.

In addition to the multiple arbitrages from acquiring smaller businesses at lower multiples, decreasing the entry multiple for the investment in total, Wiström emphasizes lower risk as an important upside to add-on acquisitions. In contrast with platform acquisitions, the acquirer is already active in the same industry, hence possessing more knowledge about the dynamics. This also implies that synergies can be realized and measured more accurately. Moreover, rather than an entirely new management team, the new company becomes a part of the existing system.

However, Wiström points out that add-on acquisitions also have risks attached. Ratos is aware that some people prefer working at smaller firms, close to the top management with less bureaucracy. Similarly, the CEO of a smaller firm may not like to no longer be on top in the organization when becoming part of a group. To address this, Ratos thinks it is vital that targets look at being acquired as something exciting. That is often achieved through the acquirer being an obvious superior to the target, making the experience of being acquired positive. If, instead, the experience is negative, key talent will leave, and huge integration issues will arise.

> "If Harvard were to acquire SSE, even the proudest SSE students would have said 'yes sir!'. If, however, Stockholm University were to do it, SSE students would have said 'preferably not'. The same goes for companies." - Joakim Twetman, Former President Business Area Industry at Ratos

On a positive note, getting acquired can also offer people in smaller businesses career paths that they would not otherwise have access to. Being at the pinnacle of their smaller organizations, employees in targets are not seldom stuck in their development. Becoming part of something larger enables these people to tap into fresh potential.

In terms of integration, there should be a clear plan in place before a company is acquired. This goes hand in hand with the abovementioned key personnel risk of a smaller firm being acquired by a larger company. There should be a clear integration plan in place in order to minimize friction during the transition period. This includes all aspects of integration, from mapping up how the new organization should look like to potential changes to the value chain or manufacturing process. Furthermore, Ratos emphasizes the significance of a clear and coherent organizational structure, a characteristic commonly found in stable companies. Identifying the appropriate place of the acquired company within the organizational framework is a crucial aspect of the integration plan. Apart from cultural issues and integration, important considerations when evaluating and valuating targets are well-anchored estimates of synergies. Jonas Wiström finds the presence of hard synergies with high confidence immensely important when evaluating targets. Post-acquisition, the forecasted performance estimated by the portfolio company is used as a benchmark when evaluating the target.

Structurally, in line with the decentralized ownership model Ratos employs, portfolio companies are in charge of their own M&A agenda when pursuing add-on acquisitions. However, Ratos indirectly controls all acquisitions. This is done by taking board seats in the portfolio companies and by having larger add-on acquisitions subject to decisions from the Ratos board. Furthermore, Ratos' investment team supports the portfolio companies throughout the investment process. For add-on acquisitions, targets are often found by the platform company together with Ratos' investment team, after which the potential deal is presented to the platform company board and/or investment committee to get go-ahead. All bids, indicative and final, exceeding SEK 100 million in enterprise value (EV) are subject to a decision by the Ratos board.

4.2. Ratos and HL Display

In 2018, HL Display started to grow its profits again after a few years of poor performance. Due to profitability-focused efforts, margins had reached a level that was in line with and even above peers by early 2019. The company, supplying the retail industry, had significantly decreased its exposure to cyclical customer segments and expected resilient growth going forward. This after a decade of volatile trading, strategic missteps, and a general decline in the retail industry. The point-of-sale ("POS") equipment industry being huge but very fragmented, market consolidation had long been a topic of discussion at HL Display and Ratos. The market was very local, not only in terms of manufacturers and distributors but also in regard to sales and customers (HL Display is active in all parts of the value chain). All markets had their own dynamics, with competition between "local heroes" ultimately leading to very few players being able to leverage economies of scale. Essentially, Ratos found the market ticking many of the boxes for a B&B opportunity, but up until this point, HL Display had not been ready to take the step.

> "When building a house, you make sure the foundation is in place before making the roof. When the roof is there, you can add the swimming pool and so on. But you will not build the pool before the foundation is in place" - Joakim Twetman, Former President of the Business Area Industry at Ratos

Table 2. Summary Statistics of Ratos and HL Display

Company *(SEKm)*	**Ratos**	**HL Display**
Total assets	37,175	2,197
Leverage (xLTM EBITDA)	2.5x	0.3x
Revenue	29,875	1,889
EBITDA	2,958	232
# of employees	18	976

Source: Company reports

4.2.1. Early Days of HL Display

In the 1950's, when retail stores in Northern Europe started to sell products off shelves rather than over the counter, a new demand for price communication solutions arose. Using an iron, Harry Lundberg started making label holders and merchandising stands out of his basement in Borlänge, marking the start of HL (acronym for Harry Lundberg) Display.

Significantly improving product exposure and by that in-store sales, the company quickly took off and expanded geographically already in the 1990's as the same development played out in other countries. HL Display started expanding eastward, tapping into the white space by setting up new sales offices in one country after another. After being listed on the Swedish Stock Exchange in 1993, the company became a stock market rocket, getting frequent media attention. At one point, HL Display even started to report on a monthly rather than quarterly basis due to the significant interest in the stock.

> "When the world went from selling over the counter to displaying them on shelves, these products [pricing lists] were needed. […] It was like printing money" - Björn Borgman, CEO of HL Display

4.2.2. The Point-of-Sale Equipment Market

HL Display plays in the POS equipment market, which includes production and sales of products within store communication (e.g., price labels, label holders, merchandising stands) and shelf automation (e.g., shelf dividers, pushers, baskets). See Appendix 9.3 for an overview of HL Display's product offering. The sales in the market take different shapes depending on whether the customers, e.g., grocery stores, have a centralized or decentralized structure. As a Swedish example, the large grocery group Axfood (Willys, Hemköp) manages the purchasing centrally. On the other hand, ICA, the Swedish market leader, uses a decentralized structure where the storekeepers own and manage their own stores. Hence, suppliers need to negotiate contracts on a per-store basis.

The products are, in general not very complex. Usually, they are made of plastic, and the constructions are, in most instances, very basic. It is, therefore, somewhat easy to set up production and obtain satisfying results in terms of product quality. Hence, products are homogeneous. Consequently, the production and distribution of POS equipment is often made locally in markets where store purchasing is decentralized. This has resulted in a fragmented competitive landscape where many local markets are run by so-called local heroes.

However, product homogeneity gives rise to more demand for service, especially from larger customers that negotiate contracts centrally. Despite the otherwise fragmented market, a few players have been able to leverage scale benefits to improve their value proposition to gain market share.

> "The capacity to efficiently manage product inventory and deliver it to stores in a well-organized manner is crucial. This is where HL Display's competitive advantage over smaller players in this relatively unconsolidated market lies." - Björn Borgman, CEO of HL Display

4.2.3. Tough Start under Ratos' Ownership

After the share price hit its all-time high in June 1998, the rapid growth from the 1990's started to moderate, and in the 2000's, the share was very volatile. After a rocky decade, HL Display was acquired and delisted by Ratos in 2010, after which several difficult years followed.

Figure 3. HL Display's Share Price Development during Its Time as a Listed Entity

Source: FactSet

As the market got saturated and online shopping started to gain popularity, opening new sales offices was no longer enough to fuel growth. The previously very high structural growth stagnated, partially driven by many retail players moving to e-commerce. Meanwhile, Ratos decided to slim down HL Display's product offering to focus on the high-margin segments, which in hindsight turned out to be a mistake. As the products offered by HL Display generally represent a small share of the customers' cost base, clients are not very price-sensitive. However, convenience is highly valued, especially that of having one supplier for all POS equipment purchased. Accordingly, the reduced product offering ultimately led to customers switching to other suppliers.

4.2.4. New Leadership

Upon the negative trajectory, major changes in leadership took place in 2016 as Nina Jönsson (current CEO of ICA Gruppen) and Björn Borgman (current CEO of HL Display) joined the management team to "turn the ship around". Realizing the demand for convenience and a "one-stop-shop" for all POS equipment solutions, the new management reinvented the complete product offering and started to get the business back on its feet.

Another important change implemented was to focus on the grocery customer segment. Previously, HL Display had distributed its products broadly to various retail categories. However, as e-commerce sales rapidly increased and stores were closed, this came with a lot of uncertainty. Groceries having low exposure to macroeconomic trends, and particularly a permanently lower e-commerce penetration, the change in customer focus significantly reduced HL Displays exposure to the economy.

On top of that, point-of-sale equipment represents a very small share (~2.5%) of the cost grocery stores have in terms of goods not for resale, with e.g., fridges and freezers representing far more significant cost items. Hence, they were not very price-sensitive and prone to negotiate but rather inclined to value broad assortment, good service, and tailor-made solutions. By knowing that, the new HL Display management saw an opportunity for margin improvement. Focusing on having the best-in-class value proposition, HL Display was able to increase its margins significantly to stable levels north of 11% in EBITA.

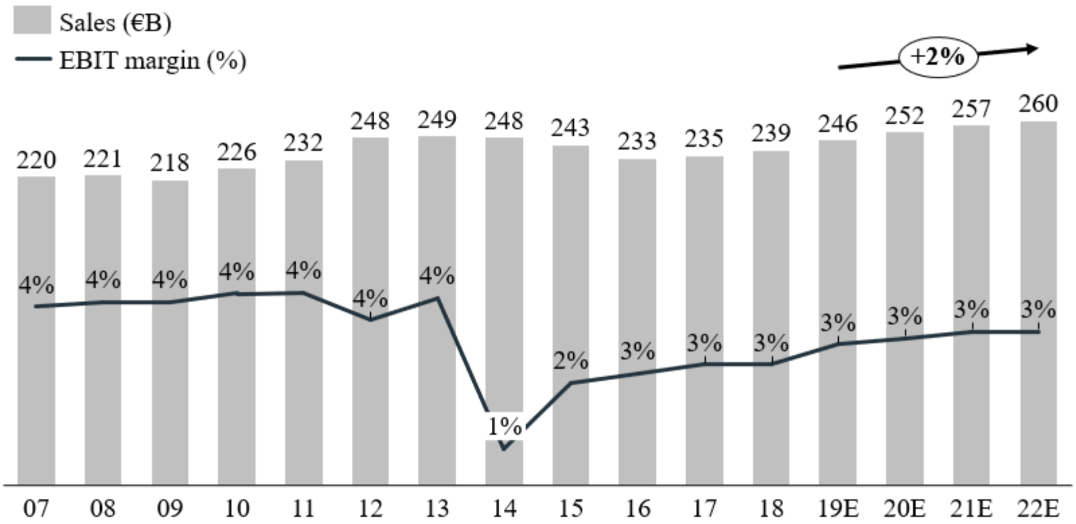
> "The narrow niche we operate within accounts for approximately 2-2.5% of a store's investment. Therefore, when they [stores] seek to trim costs, they look at refrigerators, cash register systems, and lighting. The cost of our plastic pieces is not critical to them. What matters is that everything functions seamlessly, arrives on time, and operates without issues. For us, it is a blessing in disguise which, however, demands perfection in the service element." - Björn Borgman, CEO of HL Display

In 2019, HL Display was a resilient, non-cyclical company with industry-leading margins, producing ~80% of the products sold in-house. The organization was clearly structured with separate sales forces and area managers per region and with strong distribution capabilities, being able to consistently ship products everywhere in Europe within less than 72 hours. At this point, HL Display had an ~80% exposure to the grocery sector and was the clear market leader, being more than twice the size of its closest competitor but still having less than 20% market share.

4.2.5. Initiating Buy-and-Build

In 2019, Joakim Twetman oversaw HL Display from the Ratos side. Seeing clear improvement under the new management after years of underperformance following Ratos' investment in the company, Twetman and his team looked brighter on HL Display's future. Prior to this, Ratos had initiated an exit process, being pessimistic about the growth outlook of the market. However, the growth prospects for the grocery market started to look better to Ratos. Simultaneously, HL Display improved performance even more and additional margin initiatives were identified.

Figure 4. Ratos' Forecast of Leading Grocery Retailers in 2019



Source: Ratos Investment Materials

Ultimately, Twetman and his team concluded that HL Display had reached a critical mass, having attained a size more than twice as large as its closest competitor. Now a stable business in a non-cyclical, growing market, Ratos found the company ready to employ an M&A agenda.

HL Display management had come to similar conclusions, realizing its position as the obvious player to consolidate the market. Considering his options to grow the business, Björn Borgman knew the underlying market growth was moderate, in line with the grocery stores. Also, given the very simple products, focusing efforts on innovation was not a very lucrative option. Neither did Borgman see a lot of potential in further organic penetration of current markets. However, considering the inorganic growth case, he knew that many local players, often run by the second or third generation owner, were struggling to get the business lifting. With a strong organization, he felt confident that HL Display had all the capabilities needed to efficiently integrate targets and realize synergies, ultimately enjoying multiple arbitrages with low target valuations. Not being able to rely on structural nor organic growth, consolidation seemed like the way to go.

At a Ratos board meeting in May 2019, Twetman and his team suggested that Ratos should put the long-discussed market consolidation plan for HL Display into work rather than considering exit opportunities.

4.2.6. Setting the Scene

In initial discussions concerning the B&B strategy, the HL Display management team mediated an eagerness to enter the United States market. Knowing the independent regulation in the different states of the US, Twetman and Ratos argued strongly against this.

> “Everyone wants to expand to the US. The thing is, the US is as much of a market as Europe is. Did you know there are countries in the US? They are called states” - Joakim Twetman, Former President Business Area Industry at Ratos

Another acquisition strategy presented for, but not agreed upon by Ratos, was to acquire the largest competitor. In the process of becoming a stable business, HL Display developed a great company culture. Under the new leadership, it had become a clearly structured organization with better processes than most peers and with lots of great people who were very good at their jobs. However, while HL Display was very respected in the business, there were other companies that were equally good and respected. Twetman and Ratos realized that a mega-merger would lead to discussions around which processes to embrace for the merged entity, which typically results in disputes with both firms considering their processes superior. They knew that, in such cases, firms tend to forget what is most important, namely the customers.

> “If you have a good, large company and merge that with another large company, that is also good but in other aspects, you will only dilute what is good in each of the companies” - Joakim Twetman, Former President Business Area Industry, Ratos

Ratos looked at B&B as a means to execute a strategy rather than a value creation strategy standalone. Hence, it aligned the M&A agenda with HL Display’s strategy and targets, more specifically, the long-term goal of becoming the European champion. Becoming the European champion in the fragmented POS equipment space required both geographical expansion to new markets and increased presence in current ones. Important was also that targets could easily be integrated with HL Display and its successful processes.

Ratos and HL Display saw several ways of consolidating the market. They defied three ways to grow the business inorganically, all filling an operational purpose, allowing for synergy realization: These were to acquire 1) distributors that could be integrated to cut costs or improve operations, 2) smaller competitors that could strengthen position in individual markets, and 3) product manufacturers in adjacent segments to broaden offering. It quickly became clear that the integration looked very different depending on the type of acquisition. Acquiring distributors was considered relatively easy as they generally already sold HL Display’s products, making the transition smooth. Adjacent product manufacturers were also easily integrated, only having to add additional products to the assortment. However, it was hard to find such companies sizable enough to be worth pursuing. Acquiring smaller competitors was, on the other hand, driving most integration challenges among the three. This was evident, both culturally, previously having competed, and operationally, in terms of, for example different locations, brands, and processes.

Figure 5. HL Display's M&A Framework

Source: Ratos Investment Materials

HL Display's management, having limited previous M&A experience, Ratos helped structure the process and provided four requirements narrowing down the aspects to consider when evaluating targets. These requirements demanded that the deals were 1) made with a purpose anchored in the company strategy and 2) synergistic, with not only top-line synergies but also containing hard synergies such as cost that can be taken out. Furthermore, targets had to be 3) well-performing but 4) significantly smaller than HL Display itself.

4.2.7. Implementing Processes

Once aligned on the B&B agenda, HL Display faced a long initial stretch. Twetman and his team knew that company management commonly underestimates the time it requires to pursue inorganic growth. Given Ratos' distinctive approach, which places the onus on the platform company to drive processes, HL Display's management needed to actively and genuinely have a willingness to make acquisitions for the strategy to succeed.

> "Many managers think they know what to expect when making an acquisition, even when previously not having done any" - Joakim Twetman, Former President Business Area Industry at Ratos)

Ratos wanted to avoid hiring an in-house M&A for HL Display, with the associated expenses being one reason for that. However, more importantly, they knew that having a separate M&A team risks creating discrepancies between the processes of acquiring and integrating companies. As M&A professionals are hired solely for the purpose of acquiring companies, they will not bear any responsibility for the company's performance post-acquisition. That can potentially work well if you have strong business area managers who can identify targets and instruct the M&A team on which companies to acquire. However, if target companies are not previously identified, there is a substantial risk that companies not fitting into the organization are acquired.

To avoid this problem while speeding up the processes, rather than hiring an M&A team to be in charge of the M&A agenda, Ratos let HL Display use an M&A advisory bank to help with the “heavy lifting”. The advisor did a good job visiting companies and driving HL’s internal processes.

Meanwhile, Ratos continued to align with HL Display on synergy evaluation. Top-line synergies generally being hard to quantify, Ratos wanted HL Display to shift focus towards cost synergies that were measurable could be followed up and accounted for. This was a crucial point where the M&A agenda really took off for HL. Up to that point, HL Display management had had problems wrapping its head around the technical and transaction-related aspects of M&A. However, what Twetman and his team thought of as the most complex issues of making add-on acquisitions, estimating synergies, planning integration, and figuring out the optimal way of running operations, came naturally to HL Display. Twetman perceived that HL Display started feeling ownership of the M&A agenda once realizing that.

> “When that procedure was established, the whole dynamic changed” - Joakim Twetman, Former President Business Area Industry at Ratos)

The HL Display management was initially often willing to pay more than Ratos for the companies they were looking into. Joakim Twetman believed this was a consequence of HL Display’s lack of experience in equity instruments and its operational-focused thinking. It was eager to close deals quickly, making arguments such as “this company trades at this multiple”, while Ratos was more prone to negotiate better terms. Twetman argued that there is no such thing as a fixed cost or multiple for a certain company but rather buyers’ and sellers’ perceptions of what something is worth. He claimed the key as a buyer is to start as low as possible but high enough to create interest from the buyer. Furthermore, he stressed the importance of the people. In line with one of Ratos’ values, *it's all about the people*; he suggested that good M&A deals boil down to the people of the companies involved being eager to do something exciting together. While some valuation and negotiation are needed, the most important thing is to agree on a personal level, which also includes making tough decisions before going into business. Eventually, when realizing these things, HL Display started to be more patient, suggesting lower multiples when pitching deals to Ratos.

> “If it’s exciting and the parties like each other, the seller will not care very much whether she gets 55 or 60 million from the deal” - Joakim Twetman, Former President Business Area Industry, Ratos)

4.2.8. Value Creation Post-Implementation

To the date of this thesis, HL Display has made seven acquisitions in approximately two years, six of which were smaller competitors acquired to strengthen their position in the market. A contributing factor for this is that HL Display found that such targets gave the quickest and most tangible synergy realization, mainly through insourcing production through increased utility in existing HL Display factories. Furthermore, HL Display has been able to combine warehousing and distribution as well as streamlining organizations and operations in general, ultimately yielding hard synergies. Björn Borgman claims that the clear organizational structure with appropriate spans of control and the simple operating model of HL Display have been keys in managing integration and realizing synergies efficiently. In addition, a distributor, Display Italia, was acquired in September 2021. As an already existing distributor of HL Display, with processes in place, the target required very little integration. The acquisition increased HL Display's presence in the Italian market, and moreover, it promoted profitability by cutting a link in the value chain.

Table 3. HL Display's Acquisitions since Initiating B&B

Date	Geography	Target
Mar-23	Germany	Oschsle Display Systems
Mar-23	Germany	Werba Print & Display
Feb-23	Sweden	Akriform Plast
Dec-22	Ireland	Allied POS
Sep-21	Italia	Display Italia
Apr-21	Netherlands	CoolPresentation
Mar-21	UK	Concept Group

Source: Company data

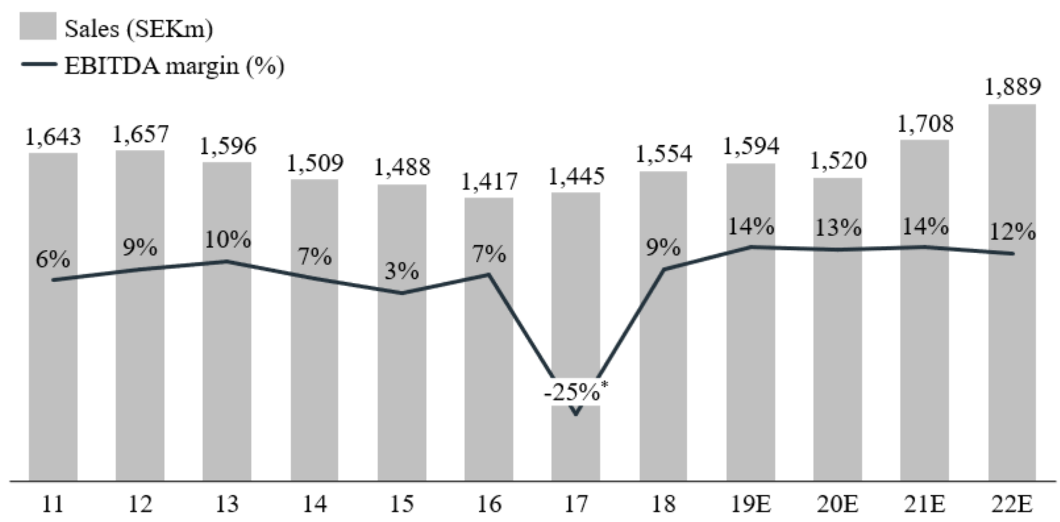
Throughout the time that HL Display has been pursuing its B&B strategy, there have been numerous events significantly impacting local and global economies[3]. Björn Borgman sees the fact that HL Display has managed to handle these events while resiliently maintaining strong performance and pursuing an active M&A agenda as proof of strength and stability. HL Display has established a structured acquisition approach consisting of four steps: 1) Screening, 2) Viability, 3) Execution and 4) Closing. The processes are overseen by an internal investment committee, Alpha, consisting of the top management and 1-2 representatives from Ratos, making sure that new targets are constantly sourced and evaluated.

HL Display has been able to grow EBITA organically in all targets post-acquisition. More specifically, it has been able to realize major synergies through successful integrations, often

[3] E.g., Covid pandemic, Russian invasion of Ukraine, volatile energy prices

including insourcing of production, consolidation of warehousing and distribution, and consolidation of headcounts within commercial and operational roles. Since 2019, the company has increased reported EBITA from 140 MSEK to 200 MSEK per 2022 and increased group EBITA margin from 8.8% to 10.7%. During 2023, the financial performance is not yet publicly disclosed but includes even more acquired EBITA and synergy realization. The complexity of the add-ons made has also increased over time, starting with simpler acquisitions of smaller local players to increasingly transformational acquisitions. In early 2023, HL Display acquired two German targets (Oechsle Display Systems and Werba Print & Display), which included more organizational heavy lifting. That has been delivered on while simultaneously improving the organic growth and margins in the acquired entities. Ratos and the HL Display's board of directors have, all in all, been very pleased with the development of HL Display since the decision was made to keep the company in the portfolio.

Figure 6. HL Display's Long-Term Development



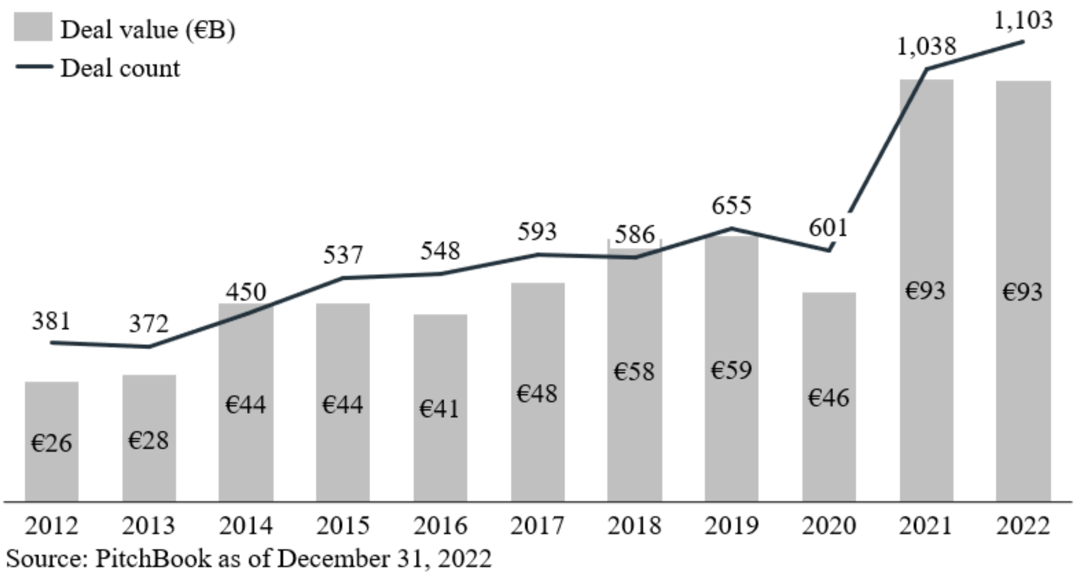
*Goodwill impairment of SEK 437m significantly burdening reported earnings
Source: Company reports

5. Buy-and-Build in a Nordic Private Equity Context

This section presents empirical results from interviews with Nordic PE firms. The results are displayed separately for each firm and are grouped into four isolated sub-sections directly linked to the research questions of this paper. These themes are value creation in Nordic PE, the role of B&B in Nordic PE, key elements to succeed with a B&B strategy, and B&B quality's impact on exit considerations. Note that the results presented in this section are exhaustive to give an accurate view of the interview answers without selection bias nor firm comparisons. Key takeaways are listed at the end of each sub-section and are further reflected in the Discussion. Before the qualitative results, statistics on direct and add-on deals are added for context and overview of the market.

The Nordic PE industry has shown significant growth during the last decade, with an estimated EUR 93 billion in deal value across 1103 deals in 2022. This compared to 2012, with EUR 26 billion in deal value across 381 deals, representing a compound annual growth rate of 13.4% in deal value and 11.2% in number of deals (Pitchbook, 2022).

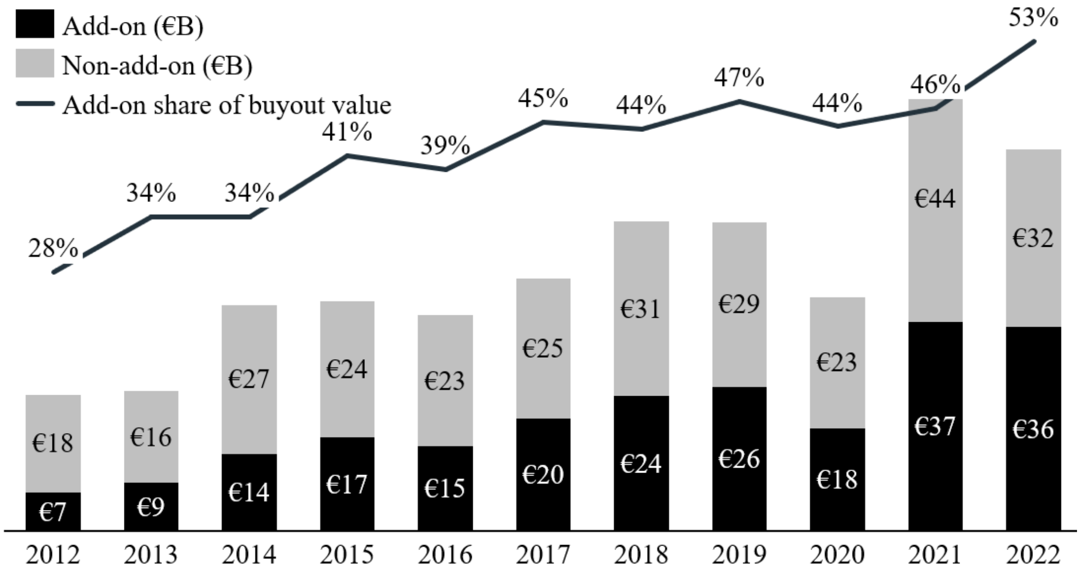
Figure 7. PE deal activity over time in the Nordics



Source: PitchBook as of December 31, 2022

Looking at the same period, limited to buyouts, in the Nordics, the add-on share of total deal value has increased significantly. In 2022, the deal value is estimated at EUR 36 billion, with a compound annual growth rate of 18.1% from 2012. Add-on acquisitions now account for the majority of the total buyout industry, compared to less than 30% in 2012 (Pitchbook, 2022), indicating that Nordic PE firms have substantially increased the adaptation to B&B strategies. Similar development is also evident in the European market, as shown in the Appendix 9.4.

Figure 8. Add-on Buyout Activity over Time in the Nordics



Source: PitchBook as of December 31, 2022

To gain a deeper and more exhaustive understanding of the implications of B&B in a Nordic PE context, the interviews have been conducted with some of the most prominent firms in the space. The firms collectively represent a significant share of the Nordic PE market and cover a broad spectrum in terms of both industry focus and size of investments. Table 4 lists the interviewees in the sample and Table 5 provides an overview of the firms included.

Table 4. Overview of Interviewees

Firm	Interviewee	Role(s)
Altor	Karl Svenningsson	Director
Axcel	John Kleven Falck	Investment Manager
Bridgepoint	Oliver Krogh Hallin	Associate
Impilo	Gustav Jungdalen Lundgren	Investment Director
Nordic Capital	Fredrik Näslund	Partner, Chief Investment Process Officer, Head of Technology & Payments
Triton	Sara Damberg	Investment Professional
Verdane	Joakim Kjemperud	Principal
Verdane	Victor Dahl	Associate
Anonymous	-	Investment Manager

Table 5. Overview of the Private Equity Firms in the Sample

	Altor	Axcel	Bridgepoint	Impilo	Nordic Capital	Triton	Verdane	Anonymous
Office(s)	Stockholm Copenhagen Oslo Helsinki Zurich	Stockholm Copenhagen	Stockholm Amsterdam Frankfurt London Luxembourg Madrid New York Paris San Francisco Shanghai	Stockholm Copenhagen	Stockholm Copenhagen Oslo Helsinki Frankfurt Jersey London Luxembourg New York Seoul	Stockholm Oslo Helsinki Frankfurt Amsterdam Milan Jersey London Luxembourg New York Shanghai	Stockholm Copenhagen Oslo Helsinki London Berlin Munich	-
Year founded	2003	1994	1984	2017	1989	1997	2003	-
Founder(s)	Harald Mix; Fredrik Strömholm	Christian Frigast	Spin-off (NatWest)	Fredrik Strömholm	Robert Andreen; Morgan Olsson	Peder Prahl	Bjarne Lie	
# of Investment Professionals	~60	~25	> 100	~20	~90	~70	~65	-
# of active funds (Nordic)	5	3	3	n.a.	6	3	6	-
Total AUM, EURm	~10,000	~3,000	~40,000	~1,000	~30,000	~20,000	> 4,000	-

Sources: Company data, FactSet

5.1. Value Creation in Nordic Private Equity

The PE firms give their view on value creation, how it has developed in the Nordic market, and the importance of and dynamics between the aspects of value creation: operational-, financial, and governance engineering. Understanding how the firms look at value creation is fundamental to making sense of what is emphasized in their internal work and what strategies they deploy. In this, we lay the foundation for diving into the role of B&B, specifically, when creating value.

Altor

Altor suggests that the most substantial shift in the value creation of PE players occurred in the late 1990s and early 2000s. Prior to this, PE firms were often able to carve out businesses relatively cheaply from large corporates and make great returns without too much operational intervention. However, with significantly heightened competition, hence more efficient markets, the emphasis on operational engineering has significantly increased to achieve desired returns. In more recent years, Altor has seen PE firms becoming increasingly focused, previously having been broader generalists. By specializing in, e.g., specific sectors, geographies or in impact, the players in the market have more capabilities to bring strategically and operationally. In that sense, Altor finds that PE firms have become better owners, demonstrating improved operational effectiveness.

"It has become harder [for PE firms] to motivate [their] existence if not being specialized" - Karl Svenningsson, Director at Altor

Axcel

Axcel has seen funds with vintage around 2010 enjoying significant multiple arbitrages, not least within tech and healthcare. This demonstrates that returns previously could be realized without significant improvements in the companies. However, Axcel sees a strong indication that those times are past, and that similar development is unlikely in the coming years. It is experiencing increased competition with more sizable funds in the market while at the same time seeing many PEs struggling with selling their current holdings at desired valuations. The latter has resulted in investors having their assets tied up and not being able to reinvest in new funds, ultimately leading to increased competition also in terms of financing.

In this demanding market climate, Axcel experiences an increased pressure to work closely and actively with its companies in areas such as commercial excellence, sustainability, digitization, or B&B. This is showcased by many of the larger PE firms initiating dedicated operational teams that are solely focused on working with value creation in portfolio companies. Also, in mid-market funds, such as the ones managed by Axcel, investment teams are working more hands-on with operations.

Bridgepoint

In Bridgepoint's view, Nordic PE has moved toward focusing value-creating efforts more on operations in the past ten years. It sees a number of funds taking the approach of having in-house operational teams used as consultants deployed in the companies and involved in the investment phase to help identify value creation levers. Bridgepoint uses another approach, instead leveraging its broad network of industrial advisors for insights.

Operationally, Bridgepoint sees several ways of creating value, which ultimately comes down to getting as much equity value as possible from a transaction. Besides improving financial metrics through growth, profitability, and cash generation is important, Bridgepoint highlights that the potential benefits of repositioning a company can be very powerful.

> "Let's say you reposition a company from doing a lot of license sales into having a recurring revenue model. [...] Not only will you have improved its financial position but also realized a higher multiple when selling the company, as the new revenue model is associated with lower risk" - Oliver Krogh Hallin, Senior Associate at Bridgepoint

In terms of financial engineering, Bridgepoint still finds leverage an important element of value creation but one that has become increasingly commoditized as the Nordic PE market has matured. Hence, financial structures are usually not an advantage to other PE firms but rather come down to how much risk the firm is willing to take. Nevertheless, as an investment that goes well will see larger returns on equity if levered, it remains crucial.

Another trend identified in the market is the increased employment of B&B strategies. Bridgepoint finds the drop in structural M&A activity in the current market environment to be a driving factor in the development. Less sizeable companies are for sale, and the ones who are often do come with a hefty price tag. Ultimately, this results in large differences in expectations between buyers and sellers. Adding new platforms to the funds being a less attractive option, PE players are instead looking to drive deployment of funds through add-on acquisitions in their current assets.

Impilo

In many smaller, founder-led companies, there are usually no external boards in place, which Impilo always supports by getting unbiased directors with the right competencies in place. If pursuing a secondary transaction from another PE firm, on the other hand, there are usually basic governance structures and processes established in the companies, not requiring as much support.

The way operational engineering is performed depends on the stage of companies invested in. In cases of small-sized companies, especially if being a result of previous negative performance, more focus is usually on growth and getting the company to full capacity given its capabilities. To continue creating value after that, activities with larger capital investments are performed. This could imply different things, including expanding facilities and growing organically or inorganically via add-on acquisitions. Also, if investing in a company with sustainable but low profitability, slightly increasing the margins may not be a deciding factor for the future of the company. That is a situation where B&B could be relevant as long as there is a rationale behind it.

> "We consider ourselves in the mid-market segment, and there are of course other players ranging from small or micro-cap to the large-cap segments. Depending on where you are as a firm, you often need to use different [value creation techniques] from the toolbox" – Gustav Lundgren, Investment Director at Impilo

Nordic Capital

Looking at internal figures, Nordic Capital identifies a split between contributors to value creation. The most important attribute to value creation is growth in revenue and profit. In fact, this is estimated to represent 70-80% of the value created, of which organic growth comprises the majority but is complemented by M&A. The remaining value creation arises from a relatively equal weighting of leverage and multiple expansion. This split has been true for quite some time, with no significant development in recent years. Spinning back the time two decades, however, there seems to have been a remarkable shift in the industry. Before that time, there was less competition in the PE industry, which enabled higher returns. This was achieved by buying assets cheap and selling expensive, without necessarily improving the performance of the companies. Nowadays, with higher competition, especially from international peers, companies are acquired expensively and hopefully sold even more so in relation to their underlying performance.

> "The industry is so competitive, requiring you to have some things 'up your sleeve', whether that is value creation from cost takeout, new management, or large customers. You often try to find an angle, where things like tuck-in M&A could play an important role" - Fredrik Näslund; Partner, CIPO and Head of Technology and Payments at Nordic Capital

When acquiring assets, Nordic sees potential in creating value in companies from several perspectives, in which financial, operational, and governance aspects all become relevant ingredients. At the time of entering, the financial leverage is already in place and is, therefore difficult to change during the holding period. As a foundation for operational enhancements, Nordic Capital has a support division consisting of an in-house operational advisory team and an external network of well-proven consultants, "black belts", with functional expertise within areas such as pricing, go-to-market, product management skills, sales efficiency, etc. The latter has widened in expertise from the 2000's, a time when the firm mostly assisted with simpler things like working capital management, which is not sufficient in today's competitive environment.

In addition to the in-house advisory team and the functional "black belts", Nordic Capital has operating chairpersons as the link between the deal teams and the portfolio companies. Often, this person has more than 20 years of industry experience and can translate investments into action when working together with management teams. Further, Nordic Capital uses a structured cadence model for creating consistency and efficiency when governing companies. This is heavily related to the work with the board – including the frequency and agendas of board meetings. Nordic Capital put in place incentive programs and value creation plans at the beginning of a holding, which should fit on a whiteboard not to get too complicated – this to align key people and support a clear vision. Rather than implementing all initiatives at once, the value creation plans are broken down into shorter "sprints", with actions to implement between board meetings - this to get smaller "wins" and momentum. Finally, and essential to the governance model, Nordic Capital holds the investment professionals who brought the investment, accountable for the returns, whereas the operational team's role is to support the portfolio companies' management team with operational excellence and resources.

Triton

Triton has, in recent years, identified a clear trend of consolidation through B&B, across many industries. Often, “value” has been driven by the ability to achieve multiple arbitrage, where the hype has been so significant that it has led to instances where add-on acquisitions have not had sufficient rationale. Today, however, it seems like PE firms are doing more due diligence regarding add-on targets’ fit in the platform.

In every investment, Triton is active across all three aspects of value creation. Before each transaction, Triton lays out a full value creation plan - much of which is about the operational components that are believed to drive growth and improve margins. In the case of small- to midsize acquisitions, there is typically a need to professionalize the businesses early on. Much of this work refers to establishing structures and processes such as financial reporting and KPI tracking. Further, Triton always takes board seats and hires external chairmen. Usually, the firm also adds another chairperson with specific industry experience.

In terms of financial engineering, Triton utilizes its in-house financing team, which is involved in all transactions, to optimize the value creation arising from issuing debt by negotiating loan terms and advising on optimal leverage for each individual deal. As dealing with high interest rates characterizes today’s credit markets, this setup becomes even more important.

The split amongst the contributors of value creation highly depends on the individual case. In one investment in the HVAC sector, Triton saw very little room for margin improvement and identified high risk with setting ambitious organic growth targets. In that case, the value creation story was simply about a B&B journey of small, cherry-picked add-ons, with the focus on extracting multiple arbitrage. In another case in the dental distribution space, much more focus was on operational improvements. By acquiring a white-label dental producer, among other add-on companies, the platform was able to expand its product and geographical offering, while utilizing synergies from the high-profit white-labeling business to drive up margins for the group.

Verdane

According to Verdane, creating value is significantly more challenging in today's competitive landscape. This prevailing trend in the Nordic PE industry manifests itself across various stages of the investment process. First, heightened competition in the market means that fewer assets remain unmonitored by competitors. Consequently, locating potential targets without inflated valuations becomes increasingly difficult. Other factors crucial to securing favorable deals, such as becoming the "preferred buyer" for target companies, face considerable challenges in this more competitive industry. One contributing factor is the growing interest from international PE players in the Nordics.

Moreover, PE firms in the Nordics are placing greater emphasis on operational improvements within their portfolio companies. Notably, there is an apparent trend among Nordic PE firms to prioritize scaling efforts, aiming to attract attention from international investment firms. Verdane adopts a sophisticated approach to enhance operations, primarily driven by its in-house operational team, Elevate. Leveraging functional and thematic expertise, the firm provides portfolio companies with customized assistance to unlock their full business potential. This includes initiatives related to go-to-market strategy, customer success, data analysis, and product development, among others.

Verdane also underscores the significance of governance and financial engineering. The firm argues that while monitoring portfolio companies is important, having an exceptional board of directors is even more crucial. For portfolio companies, Verdane taps into its network to bring valuable talent onto the boards, drawing from relevant experience within certain products, technologies, customer bases, or the industries at large. In cases where the governance structure remains relatively immature, Verdane deems it essential to establish a professional organizational setup and a comprehensive management team, creating a solid foundation for future growth.

Verdane believes that each of their investments must present a compelling case on an all-equity basis. While leverage is a valuable tool to enhance returns, it should not be over-relied upon. Larger buyout funds, however, operate differently, with taking on debt being central to their investment theses.

Anonymous (Nordic growth equity firm)

The firm argues that there are two ways of approaching value creation. First, looking at it from the perspective that almost all value creation is created during the holding period. With this, the underlying performance of the company invested in is not of the highest relevance but rather the initiatives taken during the holding period. Within this category are, among others, investments in distressed companies in need of (drastic) turnaround journeys. Second, viewing the transaction itself as the most important component of value creation. By investing in companies with high quality and intrinsic value with favorable deal terms, the rest of the holding is more about polishing. The growth equity firm most often takes the second approach, supporting with smaller pivoting during the holding period. As a final remark, the firm believes that the remaining value is created from well-executed exit processes done at the right time.

> "If already having an operational machinery with 50-80 employees – how much can really an external investor representative in the board room impact the path of tangent of the company? When selecting a company to invest in to generate a return, the company's trajectory is like an Atlantic Ocean steamship. I believe personally that a large chunk of the success of an investment is based on making

the right shot initially compared to having a belief that significant value creation is achievable through operational excellence" - Investment Manager, Nordic growth equity firm

Simultaneously, the firm has noticed the entrance of more sector-niched PE firms, which is a sign of a trend of increasing focus on operational engineering. This focus has taken share from financial engineering, which has been largely commoditized. Governance engineering is important in each PE investment and needs to be case-adapted. The firm itself has standardized processes for onboarding and monthly reporting. However, the reported KPIs are dependent on what is thought to drive the value the most in each independent case.

Key findings

- Value creation is increasingly demanding as the Nordic PE industry has become more efficient with higher competition of incumbents and new entrants.
- The significance of operational engineering has grown in recent years as a means of distinguishing oneself in the market. This has resulted in a shift towards more targeted funds and an increased dependence on both in-house operational teams and external industry expertise.
- B&B is a value creation trend in itself, today working as a means to achieve operational improvements while historically mainly driven by multiple arbitrage

5.2. The Role of Buy-and-Build in Nordic Private Equity

We asked the firms to discuss the concept of B&B, the role it plays in the overarching investment strategies, and how the strategy is practically implemented. Against the background of how the PE firms view value creation in general displayed in 5.1, this section narrows down the focus on B&B strategies specifically. This is done in order to answer the first research question: "What role has B&B in value creation?".

With the purpose of better understanding how the various PE firms emphasize B&B, they were initially asked to rank its importance to the overall investment strategy as well as how frequently M&A is performed. Table 6 provides an overview of the answers.

Table 6. Estimations by Private Equity Firm

Firm	B&B role in the overall investment strategy (1 - 4)	Share of portfolio companies with M&A agenda (1 - 4)
Altor	3	2
Axcel	4	3
Bridgepoint	4	3
Impilo	3	3
Nordic Capital	2	3
Triton	3	4
Verdane	3	2
Verdane	3	2
Anonymous	1	1

B&B role in the overall investment strategy: Not at all (1), Existing (2), Important (3), Central (4)
Share of portfolio comapnies with M&A agenda: Few (1), Some (2), Most (3), All (4)
Source: Interviews

Altor

Altor considers three different types of B&B. First, acquisitions aimed at increasing the presence in existing segments and markets. These cases often include synergies between the firms. Second, acquisitions to enhance competencies and broaden offerings to the customer base. Third, expansions to new geographies within the same vertical. While not considering it a B&B strategy in its classic definition but rather a different M&A category, Altor also mentions transformative acquisitions in the context.

While B&B remains very important to Altor's investment strategy, its significance varies across sectors. In the Business Services sector, B&B often serves as a central element of the value creation. Conversely, in for example the Industrials sector, it functions more as a value creation contributor to complement organic growth and margin improvement initiatives. In contrast to some smaller funds that sometimes use B&B as a means to deploy capital, Altor predominantly employs the strategy purely to create value. The approach taken is often to finance add-on companies through increasing leverage in the platform company rather than injecting more capital from the fund.

Axcel

Axcel has identified B&B as one of its main value creation themes. This is evident by the vast majority of the assets in Axcel's Fund XI being B&B cases. The approach often employed by Axcel is to identify markets that are attractive and compatible with a B&B strategy. Desirable attributes could be large markets, high degree of fragmentation, stable demand, and new territory, i.e., a market in which consolidation is not yet happening.

Axcel summarizes the concept of B&B as the idea that one plus one should sum up to a value of more than two. This can be achieved in various manners, operational synergies being one example and multiple arbitrages another. Beyond being a value creation contributor, Axcel states that B&B can also be a means to reach a meaningful equity ticket, either by financing the platform without debt and increasing leverage or by injecting more equity when add-on acquisitions are made. However, in such instances, it is important that a clear M&A runway can be defined.

Bridgepoint

Bridgepoint's approach to working with B&B depends a lot on the platform company at hand. With mature companies that have already made acquisitions and have internal processes in place, the firm takes a passive stance. However, in cases when companies have no previous experience of M&A, Bridgepoint is actively helping out with structuring as well as execution. The level of involvement is also dependent on the type of acquisitions, where smaller add-ons often can be handled independently by the platforms, whilst Bridgepoint wants to be involved in the events of larger transformational acquisitions.

Runways for M&A agendas as part of a B&B are commonly identified by Bridgepoint already in the investment phase. The reason for that is twofold: First, speed in execution is crucial. If you spend the first year of the holding period figuring out what to do, a large part of the ownership horizon is wasted. Second, it is important to feel confident in the M&A story for the B&B to be successful. This is a crucial aspect when getting a deal through the internal investment committee ("IC").

Impilo

In about half of the Impilo deals, B&B is very central to the value creation strategy, already at the outset. When it is not, the value creation strategy is more heavily weighed on the organic improvements, where M&A can be decided upon later if it makes sense at that point in time. Impilo remembers one case where they had done a successful organic journey, doubling revenue and profitability, but still pursued M&A right before exiting the company. This was not planned in the base case at the time of entry but was pursued because of the add-on company's great fit with the portfolio company.

There are several ways of doing M&A that can be pursued simultaneously in a B&B strategy. In a dentist chain Impilo invested in, B&B strategy included a hybrid of acquisitions of similar dentist clinics that were operating quite independently and smaller clinics that were integrated and worked very well for improving capacity utilization within the fleet of clinics.

Nordic Capital

Nordic Capital claims that B&B became a popular phenomenon within PE in the 2010's when interest rates, and hence the cost of capital, were very low. PE firms employed the strategy, often without any other strategic rationale than potential multiple arbitrage. However, Nordic Capital finds it crucial that add-on acquisitions "make sense" and fill a clear synergistic purpose for the platform. B&B is seldom the foundation in the investment thesis for the firm but rather used as a complement and means to accomplish an industry structure.

> "There are numerous instances where private equity firms have acquired assets and lumped them into some 'paper structures' that ultimately do not make any sense. We have never liked that type of buy and build. I have never been a fan of it, and it is becoming increasingly evident that it does not work. Nowadays, you need to add something that makes operative sense and generates synergies"
> - Fredrik Näslund; Partner, CIPO and Head of Technology and Payments at Nordic Capital

The importance of B&B in Nordic Capital differs from case to case. For example, investments in technology tend to be less M&A-focused, partly due to having various tech platforms often being problematic. In other instances, such as in the case of Nordic Capital's platform Sortera, B&B makes a ton of operational sense to reach a critical mass, achieve synergies, and/or expand to new geographies or verticals.

When applicable, even before making an investment, Nordic Capital identifies and talks to most of the potential add-on targets. In many cases, targets are also approached right at the start of the holding period; Trustly, which acquired a smaller peer with U.S. presence, being one example. Today, the U.S. is the largest market for Trustly, which would not have been possible without a local U.S. team.

Triton

Triton usually does not think about different B&B strategies internally. Rather, the firm starts by analyzing what value there is to be created and thereafter thinks about what role a B&B strategy could play in such a journey. Perhaps there is a value creation case for increasing a company's geographical presence or improving its product offering, in which doing so by acquisitions is seen as more resource-efficient than doing it organically. It can also be driven by pure-play multiple expansion or when the PE firm has identified a significant synergy opportunity it wants to realize.

Triton may motivate a B&B strategy because of the desire to deploy more capital. In cases where an individual company is very small relative to the investment mandate, several potential add-on targets are evaluated already at the time of the initial investment in the platform to be acquired early on. In not-as-extreme cases, there is at least a clear roadmap on how to reach the desired ticket size during the holding period.

Verdane

Similar to excluding financial leverage when constructing the base case in an underwriting process, Verdane typically envisions the business as standalone without factoring in add-on acquisitions. However, M&A quite often becomes an integral part of the value creation journey, and B&B is even considered important to the investment strategy.

B&B can be pursued in different ways. One way is to acquire several smaller companies and tuck them into the larger platform company. Another way is to acquire companies with similar or larger sizes than the platform. When B&B is pursued, Verdane usually takes an active role. A typical M&A process often starts with the platform company flagging an interesting subsegment/technical feature to investigate. Verdane then qualifies potential targets, initiates deal discussions, and, at a later stage, involves the platform's management in advanced discussions on aspects like product or technical details, cross-selling opportunities, and suitable levels of integration.

Sometimes, there are strong specific rationales for a B&B strategy. For example, in tech-enabled businesses where Verdane operates and invests, the add-on acquisitions could be to expand the product offering, such as adding a customer-facing software feature. In these types of transactions, integrating back-end is key. Also, B&B can be pursued to achieve market expansion. When working within the fast-moving technology sector, you need to act fast. Then, B&B could be the preferred strategy over organic expansion. In certain geographies, substantial barriers to entry make it preferable to enter via acquisitions rather than organically. These barriers may be related to well-entrenched establishment and popularity among domestic products and brands. It can also be because of significant cultural differences when entering a new market thar requires unviable efforts to navigate within organically. Sometimes, there are several rationales simultaneously, such as when a Nordic company wants to enter Germany (market expansion) as well as open up for cross-selling opportunities. In other cases, B&B is simply financially motivated, without the intention to integrate the add-ons with each other or the portfolio company.

Anonymous (Nordic growth equity firm)

Explicit B&B strategies play an insignificant role in the firm. Only one prior investment deployed such a strategy when there was a clear opportunity to consolidate a fragmented subsector within the retail industry. In a few other investments, the firm has made smaller add-on acquisitions because of unique market opportunities. This is referred to as “opportunistic M&A”

that partly has been driven by the ability to achieve multiple arbitrage. Add-on acquisitions are, however, always put in comparison with organic alternatives to achieve the same outcome.

Key findings

- B&B strategies are pursued differently across and within PE firms. This is evident in the level of PE involvement, the exhaustiveness of add-on integration, and the extent to which M&A agendas are predetermined when acquiring the platform.
- While approaches somewhat differ, B&B plays a significant role in the value creation for the majority of Nordic PE firms.
- The main role of B&B is to enhance operations, achieve multiple arbitrage, and to reach a certain equity ticket, aligning with the investment mandate.

5.3. Key Elements in a Successful Buy-and-Build Strategy

We asked the PE firms to elaborate on implications they consider favorable, contributing to a successful B&B strategy. This includes not only elements related to targets, such as market dynamics and company characteristics, but also post-acquisition considerations, such as integration and strategy. Answers to these topics help address the second research question: "What are the key elements in a successful buy-and-build strategy?"

Altor

To ensure the viability of a B&B strategy, Altor stresses the necessity of having a clear industrial logic. Emphasizing the importance of underlying growth, Altor believes that pursuing a B&B strategy should never be an attempt to "compensate" for stagnant or declining organic growth. Instead, a robust foundation of organic growth is deemed essential, ideally with the platform company outpacing industry growth. Altor further highlights that some investors tend to neglect to question the purpose of integrating add-on companies. During the integration process, it becomes crucial to define objectives and assess associated risks. In addition, firms must ensure that the organizational structure of the platform is clear, with appropriate spans of control, for successful integration and realization of synergies.

The ability to quickly integrate add-ons into performance management systems is also essential. This has been one of the main success factors for the Altor-held platform Eleda, which has executed several successful add-on acquisitions within critical infrastructure. However, not all acquisitions should be fully integrated, according to Altor. A key consideration is examining the location of customers and the value chain. If customers and suppliers are local, maintaining a more decentralized structure often makes practical sense.

> “You can’t just place 30 companies under the CEO and expect everything to work out. Establishing a functional organizational system with appropriate spans of control is vital. For me, that is the essence of integration” - Karl Svenningsson, Director at Altor

Axcel

Before employing a B&B strategy, Axcel believes it is important that the platform has a good reputation in the industry, not least considering that people within a sector typically socialize. Succeeding with acquisitions having a bad reputation is, therefore often very difficult. Another prerequisite highlighted by Axcel is that the vision for a platform should be established in consensus with its organization, management, board, and co-owners. Furthermore, an M&A playbook needs to be developed to make sure that processes, including sourcing, due diligence, onboarding, and integration, are systematically and constantly ongoing. Finally, it is important that there is a value proposition to the targets beyond the price paid, i.e., that they will gain from joining the platform.

Axcel suggests that adaptability is crucial, as the optimal B&B approach can largely depend on the specific case. Service companies, for instance, may frequently face challenges in realizing hard cost synergies due to limited purchasing capacity. Conversely, there may be significant potential for top-line synergies, such as cross-selling opportunities. This, in turn, dictates the extent to which integration is necessary. Industrial companies that can integrate production and supply chains would likely find it more sensible to undergo integration. Regardless of the chosen level of integration, Axcel emphasizes the critical need for clear and structured processes for following up on performance post-transaction.

> “For X Partners [Axcel holding, consultancy company] we believe it is meaningful not to integrate, keeping the current cultures, all being great companies that are leading in their respective niches and regions. We see limited benefits in integrating” - John Kleven Falck, Axcel

Bridgepoint

Bridgepoint suggests that the possibility of succeeding with a B&B strategy is greater in a mature market, where targets are more inclined to engage in acquisition discussions, not being able to ride the structural growth. Also, B&B is often more suitable in cases of fragmented markets. Moreover, high levels of maturity within platform companies are also preferable. That is because management teams of rapidly growing companies often have their hands full handling what is going on organically, not having the capacity to also manage M&A.

While appreciating beneficial characteristics of B&B, such as maturity and fragmentation in the market, Bridgepoint stresses the importance of understanding the internal dynamics and the company's ability to succeed in pursuing opportunities in the market. Given that the number of targets in a market is limited, the B&B case will be at risk if the platform company is unable to unlock certain opportunities.

A central theme Bridgepoint often comes across when looking at B&B cases is integration. It considers this a case-dependent issue, suggesting there are some situations where it makes sense to keep companies as standalone business units. Not only does integration require lots of work, but is also associated with risks of damaging the business. However, not integrating often limits the hypothetical benefits that can be realized. Key considerations when determining the appropriate level of integration are the magnitude of expected synergies, internal company cultures, and strength in local footholds. Beyond that, it is crucial to respect the people involved in the process and to bear in mind there is no universal way to perform integration.

Impilo

Generally speaking, B&B benefits from healthy market conditions, often implying underlying end-market growth. In terms of the platform, the most important factor is the management team, who will be running the acquisitions and perhaps integrating the companies. Impilo finds it extremely important that the management is capable of converting leads into acquisitions by having skills in their dialogs with potential targets. This skill is considered much more important than having prior financial and M&A-related experience. Social capabilities become increasingly important when the targets are smaller and if the plan is to integrate the add-ons. In those cases, the M&A process is a lot about personal relationships and connections that need to be established. In healthcare, which is Impilo's focus sector, this is particularly important as integration can be sensitive when often directly impacting patients and healthcare staff.

The suitable level of integration is highly case-dependent. Sometimes, it is perfectly logical to keep add-ons completely separated or only integrate part of the business. In other instances, it is the best alternative to integrate the add-on company fully. The latter could, in the healthcare industry, mean that the offering or customers (patients) are moved to an existing business.

Furthermore, a key consideration is to have structured follow-ups on the integration metrics to get clarity on what works and what does not. In doing so, the platform company can learn from experience, finetune and calibrate the integration process going forward. The same emphasis is put on following up synergy realization. This is especially important in investment cases where synergies are a significant part of the rationale.

Nordic Capital

First of all, Nordic Capital emphasizes the fundamental aspect of having a management team capable of running the core business while simultaneously pursuing M&A and integrating add-ons. In addition, it is essential to retain key talent of the companies that are acquired. When having skilled managers in the platform and a clear "purpose" established, it is usually easier to accomplish this. Third, there must be a strong rationale for deploying the strategy in the first place. One of which could be customer-focused, where the logic for B&B could be driven by its ability to improve the value proposition of the platform. Another rationale could be that M&A is believed to result in significant benefits in terms of margins, growth, or other financial metrics.

Triton

Triton demands portfolio companies that are making acquisitions to have a person as Head of M&A. This role usually does not exist at entry for the small- to medium-sized companies, meaning it needs to be employed during Triton's ownership. The firm believes in having a Head of M&A for several reasons. First, for valuation purposes, as add-on targets often give a higher price tag when Triton directly approaches them, assuming a higher willingness to pay. Second, the discussions reach a more advanced level between the parties if they are both working in the same industry. Third, it is good for reliability purposes as targets get to ask genuine questions about what it is like having Triton as owner. Fourth, platform companies will be in a much better position to successfully integrate the add-ons if they are involved from an early stage. While not handling the personal contact, Triton typically acts in the background, providing input on matters such as valuation and incentive programs. However, when larger acquisitions, especially transactions requiring capital injections from the fund, Triton is more thoroughly involved.

Add-ons do not necessarily need to be fully integrated. In fact, there are many benefits of running a decentralized model if the circumstances are right. Triton has previously had success with strong and well-functioning national leaders, each working independently, having its own local brand and customer relationships. Then, the headquarters ("HQ") is often lean and helps with supporting functions, such as reporting, financing, M&A, and procurement.

Verdane

Verdane sees a clear correlation between certain target characteristics and the probability of achieving a successful B&B in the technology sector. First, the company is better suited for a B&B strategy if it is well positioned in the market, both in terms of competitive advantage and overall attractiveness within the peer group. Second, the technology platform must be strong, to be leveraged when acquiring add-ons. Third, there needs to be a strong management team that is dedicated to putting down significant time and effort to drive the value creation strategy. If this is not in place at entry, it needs to be established before pursuing the strategy.

In terms of market conditions, Verdane argues that the suitability for B&B is extremely case-dependent. In some fragmented industries, such as the accounting industry, pursuing a roll-up strategy with small and frequent acquisitions is very logical. B&B could also work very well in concentrated markets, as with Lingit, a Norwegian portfolio company of Verdane. The platform company operates in the niche software market of reading and writing assistance, which has one dominant market leader in each of the Nordic countries. Verdane managed to acquire the market leader in each country and without too much technical integration to drive up the former small multiples. This was mainly by significantly making the businesses within the Lingit group more commercially adapted.

Anonymous (Nordic growth equity firm)

Despite not having extensive experience in B&B strategies, the firm views certain aspects as important to M&A in general. One of these is for key personnel in the add-on to commit to the post-acquisition journey. This can be accomplished through them rolling over some of their ownership to keep “skin in the game”. In addition, the use of earn-outs and warrant programs can be effective to keep them incentivized. Most importantly, however, is for the key personnel to be intrinsically motivated to continue the journey as part of the platform.

Key findings

- While B&B can successfully be pursued under various market conditions (e.g., level of fragmentation and growth), the conditions are highly relevant in navigating the implementation of the strategy.
- Platform companies should ideally be stable, well-reputable, and leaders in their markets. Further, management teams should have appropriate spans of control and be capable of driving M&A processes.
- A clear integration plan should be tailor-made to each individual add-on, containing an attractive value proposition for the targets and its key personnel, as well as integration to the platform-wide performance management systems.

5.4. Buy-and-Build Quality’s Impact on Exit Considerations

To better understand how PE firms achieve multiple arbitrages by pursuing B&B strategies, we asked them to elaborate on the factors going into justifying higher transaction multiples. In particular, the firms were asked about how the quality of B&B is assessed and whether it should be reflected in the exit consideration. Perspectives on this subject matter form the base for answering the third and last research question: “How is the quality of buy-and-build reflected in exit considerations?”

Altor

For a B&B agenda to be viable, Altor argues that there must exist an industrial logic to create a larger group. It is vital that tangible synergies can be identified and that the strategy goes beyond the opportunity to acquire companies cheaply to gain multiple arbitrage. Altor suggests that in the absence of industrial logic and organic growth during a B&B journey, PE firms will have a difficult time attracting buyers. In turn, this will often lead to the implied multiples declining to the levels at which the components (add-ons) were acquired.

Axcel

Some years ago, multiple arbitrage standalone was enough to achieve returns from B&B, according to Axcel. Nowadays, however, it is crucial to be able to showcase some kind of industrial logic between the companies in a group. In Axcel’s view, this must be proven not only by speculations but also by hard proof of synergies, for example, through demonstrating organic growth and maintained financial performance in add-ons post-integration. Proving sensemaking from an industrial point of view is now demanded from investors, otherwise punishing the exit multiple. Human aspects, such as employee retention rates after add-on companies join the platform, are also important to exit considerations.

Bridgepoint

The ability to realize synergies is a key consideration when Bridgepoint evaluates add-on targets in B&B journeys. If an add-on company is able to lift to the same standard as the platform, a higher multiple is motivated for the combined entity. It could be argued that a lower multiple is appropriate for a platform that has not been able to realize synergies or has acquired worse-performing companies, diluting the platform. However, not only multiples but also financials drive enterprise value. A company not reaching expected earnings post-acquisition would therefore be “penalized twice” if also being considered valued at lower multiples. Nevertheless, exit prices ultimately come down to a negotiation between the parties.

While crucial to show that a platform company successfully can generate organic value via inorganic growth (acquisitions), Bridgepoint considers it important to “leave money on the table” when selling an asset. Ideally, PE firms want to showcase a continued M&A journey to motivate an attractive future trajectory for the next owner.

> "Integration is becoming a bigger topic of due diligence as more buy and build is done. [...] Have they integrated acquisitions properly? Is there a huge amount of work for the next owner to sort out? At the end of the day, these aspects will go straight to valuation." - Oliver Krogh Hallin, Senior Associate at Bridgepoint

Impilo

When buying platforms previously having deployed B&B, Impilo always separates organic and inorganic growth. Hence, the firm does not accept the management nor the board to hide total underlying performance behind M&A. This is important regardless of future M&A plans being in the pipeline. In any case, there needs to be a conviction that the underlying businesses still perform well. This is reflected in Impilo's targets when pursuing B&B, where there almost always are organic key performance indicators ("KPIs") in place, such as increasing market share of the platform company on a standalone basis.

Further the equity market finds it beneficial if add-ons bring sustainable growth, and not just temporarily adding to the group's revenue. This way of approaching growth within the value creation process is, according to Impilo, absolutely crucial in order to sell the assets at high multiples. A proven track record of a well-performed B&B strategy, indicating a probable success if continuing the strategy, is positively reflected in the exit multiple. This is because the next owner can visualize more value to be extracted in the future.

> "In the case making successful exits, is never sustainable to have acquired a bunch of assets without the aspiration to take care of them later on" – Gustav Lundgren, Investment Director at Impilo

According to Impilo, multiple arbitrage definitely is real but something that should not only be looked at mathematically. It requires that add-ons have quality of their own, that there are synergies being realized, or that a diversified portfolio, more attractive to buyers, is achieved. It is also important to factor in key employee dependence. If the previous owner (often founder) is important to operations but no longer as incentivized post-transaction, the business can suffer significantly.

Nordic Capital

Exit multiples for B&B cases depend to a large extent on the industrial logic, something that is reflected when Nordic Capital evaluates targets as well as when it itself employs B&B. In the evaluation stage, Nordic Capital always considers the organic growth of the underlying assets. If the platform has managed to grow organically and it is clear how value is created through purposeful acquisitions, higher valuation multiples are justified. Apart from organic growth, this could be proven through increased margins, successful entries to new geographies or launches of new products. On the other hand, if acquisitions have been made with no underlying strategic rationale, a higher multiple is not motivated. In such cases, Nordic Capital have often seen how the profitability in entrepreneurial-led add-ons have gone down as the less incentivized entrepreneurs "check out", having previously "taken out half a salary while working around the clock".

> "A platform is more valuable if there is a rationale - if adding companies create value" - Fredrik Näslund; Partner, CIPO and Head of Technology and Payments; Nordic Capital

Triton

Triton suggests that more integration does not necessarily mean higher multiples. It has experienced instances when limited integration rather have had positive impact on the multiples. For example, if add-ons are "local champions" in their geographies, it can seem very logical to keep them decentralized. This way of pursuing a B&B strategy can be very attractive for the add-ons as they receive support and capabilities of a larger group but are able to continue working relatively autonomously.

However, Triton stresses the importance of logic in acquisitions. It has seen extreme cases where PE firms buy companies that are very different, not creating any real value when combined. Investors today, much better than just a few years ago, see through this and will not be justifying a high multiple for the group.

> "You cannot assume to be compensated for buying and grouping together companies that do not at all belong with each other. It might have worked at the peak two years ago, but the markets do not accept that anymore" - Sara Damberg, Investment Professional at Triton

Verdane

Verdane emphasizes that if a group of companies requires significant investments to integrate or update technologies post-transaction, it will be negatively reflected in the exit consideration. This situation, termed "technical debt" by the firm, encompasses outdated technology needing recoding and complex outstanding integration of different customer interfaces, among other factors.

According to Verdane, there are two main alternatives when deciding on the packaging of assets following a B&B journey in the technology sector. The first option is to exit separate companies as a "house of brands," selling different companies together without notably integrating them. Although this may result in a discounted multiple because of lack of integration, it can be a suitable approach at times. The other option involves fully integrating technological components and the organizations. In this case, reaching new financial milestones increases investor interest, leading to higher valuation multiples.

> "If you have thoroughly done the dirty work of consolidating Europe, the exit landscape opens and you pop up on the radar for U.S. investors" - Joakim Kjemperud, Principal at Verdane

Anonymous (Nordic growth equity firm)

According to the firm, the quality of B&B is definitely reflected in the exit considerations, evident from experience of acquiring and exiting companies that have made add-on acquisitions. Buyers are nowadays smart enough not to let PE firms hide behind acquisition-driven growth or other inorganic improvements.

Key findings

- B&B quality is assessed and reflected in exit multiples more today than only a few years ago.
- B&B quality ultimately comes down to organic performance following add-on acquisitions, whereby multiples are punished in the absence of industrial logic and appropriate integration.
- Not realizing the full B&B potential ("leaving money on the table") is typically attractive to investors, motivating higher valuations.

6. Discussion

This section discusses the findings of the study in light of previous research. While the case study provides an in-depth understanding of the issues in a real-world context, the relatively broader sample of PE players covered in Section 5 allows for more generalized conclusions about the Nordic PE market. The discussion is divided into four isolated sub-sections directly linked to this paper's research questions. These themes are value creation in Nordic PE, the role of B&B in Nordic PE, key elements to successfully pursue B&B, and B&B quality’s impact on exit considerations.

6.1. Value Creation in Nordic Private Equity

Value creation within Nordic PE ultimately comes down to maximizing the equity value realized from an investment. Historically, the means of optimizing equity value from a holding period has changed over time, with operational engineering increasing in importance (Biesinger, Bircan, and Ljunqvist, 2020). Previous literature (Døskeland and Strömberg, 2018) as well as our findings, points to increased competitiveness as a major factor of contribution to this development, highlighting the entrance of international competition in the early 2000s as a particularly remarkable shift. In the 2010s, PE firms were still able to realize large multiple arbitrages without any operational improvements. However, the empirical evidence in this paper points out that intensified competition in the Nordic market has put pressure on operational improvements in order to realize returns from investments. The increased number of sizable PE funds makes it both hard to acquire companies cheaply and to find unique opportunities for value creation as the market becomes more efficient. In addition, the demanding environment has led to PE firms having trouble exiting investments - tying investors’ funds up, ultimately increasing the competition for financing.

The value creation efforts made to enhance these components can, in accordance with Jensen (1989), be divided into three types of initiatives: 1) operational, 2) governance, and 3) financial engineering. While varying in importance depending on various factors, the empirical research in this paper suggests, similar to Biesinger, Bircan, and Ljungqvist (2020), that all three areas should be considered and weighed on a case-by-case basis.

To navigate in a more demanding competitive landscape, Nordic PE firms feel increased pressure to accomplish operational enhancements in their portfolio companies, in line with Hammer et al. (2017). Having skills and resources to improve operational performance is important not only for generating returns for already owned companies but also for winning deals by being a preferred buyer for the selling party. To cope with increased pressure on operational enhancements, and as suggested by Døskeland and Strömberg (2018), we find that the firms are strengthening their functional and industry resources. This is done by establishing structured in-house teams and external advisors to support with operational value. The expertise is brought at an early stage of the investment process to identify value creation levers and create execution plans on how to realize those as upcoming owners. In addition, we find that PE firms have become more targeted and specialized.

Governance engineering is often dependent on the stage and financial profile of the business at hand. Larger companies, especially if acquired in a secondary transaction, often have governance structures in place, while smaller companies usually need to be professionalized at the beginning of the holding period. Nonetheless, we find that most PE firms implement firmwide governance structures such as internal reporting processes, management incentive programs (MIP), as well as recruitment of unbiased board members. These findings are consistent with previous research made by Kaplan and Strömberg (2009) and Biesinger et al. (2020).

Financial engineering, in terms of leverage has become increasingly commoditized within Nordic PE and is nowadays not considered an advantage to other PE firms but rather an issue of risk appetite. Still, significantly increasing potential returns as established by Modigliani and Miller (1958), leverage remains a crucial element to the LBO model employed by most PE firms. This is in line with the finding of Harris et al. (2014), not least when the firms need to dig deep into their aspiration to generate value. Hence, many players use various financing solutions as well as in-house financing teams to manage leverage smoothly and favorably. Our findings suggest this to be especially important in times of high interest rates, as expected from previous research stating that financial engineering is highly dependent on capital market conditions (Axelson et al., 2013).

B&B strategies are increasingly adopted by Nordic PE firms as a means to create value. Up until lately, it has mainly been rationalized by its ability to generate multiple arbitrage, in which several cases arguably have lacked sufficient industrial logic or been executed relatively unsophisticatedly. However, empirical findings in this study suggest that multiple arbitrage standalone is no longer sufficient rationale.

6.2. The Role of Buy-and-Build in Nordic Private Equity

It is evident that B&B is well adapted within the Nordic PE space. In fact, Ratos and the vast majority of PE firms recognize B&B within the range of being important to very central to their investment strategy. Further, the portfolio companies of the PE firms are actively pursuing an M&A agenda in most cases. This is in contrast to the study by Hammer et al. (2017) on 9,548 buyouts in 86 countries between 1997 and 2012, concluding that only 43% of PE firms perform add-on acquisitions. It is reasonable to assume that the difference is largely attributed to the time difference of the sample, as data by Pitchbook (2022) has shown the great development of add-on acquisition deal value and volume during the last decade. Only in the Nordics has the add-on share of total buyout deal value grown from 28% to 53% over the last decade. Similar development has been seen in Europe as a whole, growing from 28% to 46% over the same period (Pitchbook, 2022).

The underlying fundamentals for pursuing a B&B strategy have evolved from the 2010's, as many PE firms now need a strategic rationale beyond achieving multiple arbitrages. Although there still are investments made today solely motivated by multiple expansion, more emphasis is now put on the industrial logic of the add-on acquisitions. For several of the PE firms in the Nordics, the planned M&A agenda needs to make sense and have a clear synergistic purpose to get approved by the internal ICs.

As found by Nikoskelainen and Wright (2007), there seems to be an agreement that B&B can, in fact, be significantly value-generating. However, the actual value it creates appears to be highly case-dependent, with several rationales for the strategy often existing simultaneously. Generally, the findings of this study are consistent with earlier research on rationales for pursuing a B&B strategy (Bansraj et al., 2020; Borell & Heger, 2013; Hammer et al., 2017; Døskeland & Strömberg, 2018). First, synergies can be extracted from combining two or more companies, either through cost efficiency or revenue enhancements. Second, M&A is often seen as more resource-efficient or quicker than organic initiatives when expanding into new geographies or product verticals. There might also be certain geographies where acquisition-driven entry is preferred in order to deal with entry barriers related to well-established domestic companies and cultural difficulties. Third, there might be pure financial benefits of pursuing a B&B strategy by means of simply adding an attractive financial profile to the group or achieving multiple arbitrage. B&B is also seen as a suitable way of deploying capital to comply with underwriting criteria in terms of ticket size. The strategy is also a good tool in investments where organic operational improvements are limited. This could be the case in industries where margins are capped by competition or legislation and when high organic growth is either very hard to achieve or subject to high levels of idiosyncratic risk.

The stage in which a B&B strategy is decided upon differs between cases and PE firms. In some instances, the strategy lays the fundamental foundation for the investment thesis in line with the findings of Loos (2006). Some PE firms have a predetermined B&B runway already at the outset. They usually identify M&A targets already in the investment phase of the platform for two main reasons: having speed in execution during the finite ownership horizon and getting comfort in the B&B implementation. In some instances, add-on deal discussions are already initiated before the investment in the platform, and in other times, add-on targets are approached right after entry. Doing this ahead of time is especially important in cases where the platform investment does not reach the desired ticket size of the fund on its own. In such cases, many PE firms want to see a roadmap clearly outlined, preferably with specifically identified add-ons to acquire during the holding period of the platform. Noteworthy is that there are instances in B&B cases in Nordic PE where the runway is not predetermined and sometimes not even considered before the acquisition of the platform.

Worth noting is that PE firms do not share a consensus about optimal market conditions for B&B. However, many mention fragmentation to be suitable as it enables consolidation, as found by Bhattacharyya and Nain (2011). Some firms do have more specific preferences. Axcel, for example, also prefers large and relatively unexplored markets, with stable demand. Bridgepoint considers B&B easier to pursue in mature markets where targets are more inclined to engage in acquisition discussions, not being able to ride the structural growth. In contrast, Impilo suggests that B&B often benefits from underlying end-market growth. These markets can be approached with the B&B strategy already in mind. For several PE firms, the strategy is not as central but rather a logical enabler for a desired value creation journey. Occasionally, targets are even evaluated on a standalone basis, assuming no M&A during the holding period, but a B&B may be decided upon later to enhance the value creation.

When pursuing a B&B journey via a platform company, the PE firms may take an active or passive role. The empirics of the study disclose that the level of involvement depends on the M&A maturity of the platform at entry. If the company has experience in making acquisitions and established integration processes in place, the PE firms feel more comfortable taking a passive role. If not, the firms are typically more active in supporting with structure and execution. Another factor determining PE firm involvement is the size of the add-ons. Smaller acquisitions are, to a higher degree than larger acquisitions, handled by the management team within the platform company. For larger acquisitions, especially if being transformational to the platform, the PE firms usually get more involved. Later, in such scenarios, management teams can be brought in to facilitate advanced discussions regarding, e.g., product details, cross-selling abilities, or level of appropriate integration. Most PE firms in the Nordics are involved in acquisitions in some way, often assisting with valuation and general advisory.

Against the above background, we find in line with Rehm et al. (2012) that the B&B approach differs between cases. For example, the study confirms B&B strategies are run differently depending on the desired outcome. One important aspect in this regard is the level of integration, which is seen to differ across platform companies as well as add-ons within a platform. For example, a B&B journey may encompass a few horizontal acquisitions with marginal integration (e.g., merging headquarters and certain support functions) and a number of smaller acquisitions that are fully submerged into the platform company. Hence, it can be perfectly logical to keep some add-ons separated while integrating others.

6.3. Key Elements in a Successful Buy-and-Build Strategy

Similar to Ratos' approach of having stability and profitability in the platform before pursuing growth opportunities, the PE players interviewed especially highlight the importance of being prepared before employing a B&B strategy and, above all having a strong rationale for the M&A agenda, not only building upon potential multiple arbitrage. The latter is highlighted by HL Display's M&A framework that is well-anchored in the underlying company strategy and demands hard synergies. Furthermore, platform companies need to be well-positioned in the market, which not only includes being strong relative to peers but also having a good reputation in the industry. With the number of potential targets often being limited, it is vital to understand the market dynamics and the platforms' ability to succeed with acquisitions.

If having a strong B&B case, the empirics in this paper present other key considerations for a successful execution of the B&B strategy. First, the platform needs to have a capable management team that can handle the M&A agenda and integration alongside organic activities. The team does not necessarily require previous experience or hard skills related to M&A but rather competencies in establishing personal relations and connections, which the bilateral processes of B&B often are centered around. While the involvement of PE firms can differ from case by case, the empirics are aligned in the view that processes primarily should be handled by the platform company. However, while, for example Triton always makes sure to have a Head of M&A, Ratos suggests that the acquisition process should be driven by the management teams, pointing to the risk of discrepancy between the processes of acquiring and integrating companies. Second, the strategy and processes need to be well-anchored at all levels in the platform company, including the establishment of an M&A playbook. Clear processes with a sensible organizational structure will not only enhance the M&A agenda but also facilitate integration, as showcased by HL Display's successful integrations. Third, there must be an attractive value proposition for the targets to be acquired. Beyond the possibility of enhancing the company's performance, it can be about providing key personnel of the add-on target with incentive programs or new career opportunities.

For Ratos and the PE firms interviewed in this study, the success of the strategy is often highly reliant on the integration of add-ons, confirming conclusions by Steigenberger (2017), Birkinshaw et al. (2000), and Schweiger (2002), among others. While not integrating can be seen as limiting the hypothetical benefit of an acquisition, integration requires lots of work and can be value-destructive if not done properly. What level of integration is most suitable in a specific case depends on several variables. One of these is the customers; for some add-on companies with strong local relationships with customers, it may make sense to cultivate the relationships by maintaining its customer-facing brand. Another is culture and organizational structure; as there will be a lot of focus on people management when integrating companies, they will need to be able to work together. This is in consensus with Sudarsanam (2010). For example, it is favorable if the key personnel are optimistic about the organizational structure that would be in place in case of full integration. Finally, the level of synergy potential also determines how and to what degree the add-ons should be integrated. In some instances, full integration is the enabler for extracting the synergies. In other cases, smaller efforts are needed, which implies that full integration is not necessarily needed. When deciding on integrating the add-ons, there needs to be a clear integration plan in place. Beyond a structured integration plan, the PE firms stress the importance of delivering on the value propositions promised to the target, and respecting the people involved in the process, aligning with Ratos' value: *It's all about the people*.

6.4. Buy-and-build Quality's Impact on Exit Considerations

Naturally, PE firms evaluate targets that have pursued B&B similarly to how they internally consider B&B cases during the holding period and at the time of exit. An important aspect regularly present in the analysis of how the asset should be valued is the concept of multiple arbitrage. It is evident that the concept is in fact real, meaning that platform companies can acquire add-ons valued at lower multiples and, by incorporating them into the platform group, justify a higher multiple in a fair valuation. However, multiple arbitrage is not simply a mathematical question. As identified by the empirical data of this study, B&B implementation can be performed in different ways and seems to be evaluated by the investor universe on its level of quality. How a B&B case is executed will, therefore, be reflected in the exit multiple. To be remembered, however, as highlighted by Ratos and the Nordic PE firms, valuation is not an exact science and will always be subject to negotiation and other factors present in selling processes.

Heisig et al. (2022) find that the different sources [e.g., organic and inorganic] of EBITDA growth are not differentiated by potential buyers. This arguably implies that the organic and inorganic performance is not differentiated in exit considerations. Contrastingly, we find that PE firms can no longer compensate for poor organic performance by acquisitions-driven growth. Industrial logic between companies in the group following a B&B journey is demanded by investors today, more than only a few years ago. It is, hence, no longer enough to group separate entities together to justify a higher multiple for the group. Evidence of industrial logic could be proven through realized synergies. Also, looking at the add-on companies on a standalone basis, investors want to see demonstrated organic growth post-acquisition. Another important aspect is how well entities have been integrated. If there are components remaining in the integration plan, new owners will be required to make further investments to sort out those issues, which will be negatively reflected in the exit considerations. In cases where decentralized structures make sense, a failed attempt to fully integrate could rather be value-destructive.

In addition to the soundness and industry fit between the companies, achieving a multiple arbitrage in B&B also depends on human factors. These are seen as relatively complicated, especially in times of acquisitions, yet heavily dependent on the level of integration of the add-on companies. In a full-scale integration, key personnel from the platform and the add-ons will need to fit under the same organizational structure. This implies roles may cease to exist, people move to new roles, and existing roles may be filled with new people. The complexities arising from this are boosted by differing company cultures that are not always fully compatible. One common issue related to human capital in B&B is reduced incentives of previous owners of add-ons. If, for example, founders of add-ons are not keen to provide as much effort as before, the phenomenon is referred to as “entrepreneurs checking out”. Another issue is overall employee churn – whereby employees on add-ons decide to leave post-transaction. Hence, it is important to showcase that the new organizational structure is efficient and has appropriate spans of control. Investors’ assessment of this significantly impacts the exit considerations.

In some scenarios, not realizing the full potential of a B&B journey may be strategic from the perspective of achieving a high exit multiple. The empirics from the interviews with the Nordic PE firms confirm previous studies (Hammer et at., 2017; Hochberg et al., 2014), implying that money sometimes is, in fact, “left on the table”. If having shown industrial logic and track record of successful B&B implementation, it is rational for investors to assume an effective future trajectory if they continue pursuing the strategy. This is attractive for buyers as they want to see upside potential from value creation opportunities and is thereby reflected positively in the exit multiple.

7. Conclusion

The study aims to shed light on B&B strategies in the Nordics via a case study on Ratos' B&B strategy implementation in HL Display and interviews with Nordic PE firms, providing answers to our three research questions:

1. What role does buy-and-build play in value creation?
2. What are key elements in a successful buy-and-build strategy?
3. How is the quality of buy-and-build reflected in exit considerations?

Increased competition in the Nordic PE industry in recent decades, intensified by the entrance of international firms in the early 2000's, has led to higher requirements to create value. Evident is the increased emphasis on being operationally involved in portfolio companies with operational activities today being the most central source in creating value. In acknowledgment of this, PE firms have been seen to strengthen their own functional and industrial expertise by employing in-house operational teams and leveraging external industry advisors. We find that B&B is one way to create value and has taken a significantly larger presence in the Nordic PE space. Although still partly driven by its ability to achieve multiple arbitrage, investors today require higher degrees of industrial logic of the add-on acquisitions. Acquisition-driven value creation is well incorporated in the investment strategies of Nordic PE firms – at times laying the foundation for an investment thesis while sometimes being a natural enabler of a desired value creation journey. Value created in a platform from pursuing B&B may arise from, e.g., synergy extraction, resource-efficient product or market expansion, favorable financial attribution, or multiple arbitrage. In addition, Nordic PE firms use B&B to reach desired ticket sizes of investments. Investment firms pursue B&B in different ways from several perspectives depending on case-dependent suitability: level of participation in M&A processes, extent of predetermined add-ons, and exhaustiveness of add-on integration.

Key considerations to succeed with a B&B strategy are favorable market conditions, platform characteristics, and other implementation-related factors. The description of market conditions compatible with a B&B strategy is not homogenous, as it is highly case-dependent, and it rather works to guide the way the strategy should be deployed. On the one hand, fragmented markets are good for consolidation with small and frequent acquisitions. On the other hand, concentrated markets may suit B&B strategies, focusing on market expansion by acquiring market leaders in different geographies. We find that a platform optimally should be well positioned in its market, both in terms of performance compared to peers and reputation among its stakeholders. Further, it should have a management team that is willing to and capable of pursuing an active M&A agenda alongside daily operations. In particular, they should utilize personal relations and be skilled in discussions as part of bilateral processes. Often, previous M&A experience of the platform makes this process smoother. There should be stability within the platform company in order optimize the chances of succeeding with a B&B strategy. Otherwise, issues arising from integration risk getting amplified. Integration, KPI monitoring, and other essential processes of a B&B strategy should be well-anchored in the platform company's management. In addition, the platform company should have an attractive value proposition for the key personnel in the add-on companies, such as incentive programs, career opportunities, or being part of something purposeful. Finally, the integration plan needs to be tailored for each individual add-on company in a B&B journey. It should, by other things, cover integration of IT and other central divisions. Most importantly, it should include a detailed outline of human capital management.

The quality of B&B is today, more than before, reflected in exit considerations. Although multiple arbitrage is well accepted as a real phenomenon, it is not simply a question of mathematics. First, buyers nowadays demand the presence of industrial logic in a B&B for a higher multiple than the assets standalone to be justified. Signs of such logic could be realized synergies within the group. Companies cannot hide behind acquisition-driven performance as investors incorporate organic improvements in their evaluations. Second, the healthiness and completeness of add-on integrations are reflected in exit considerations. With complexities arising from combining companies, the exit price will be subject to the dynamics within the new organizational structure. Such dynamics have partly to do with the compatibility of different cultures. For example, factors related to employee churn and motivation of key people from changed incentives post-transaction will be considered in exit considerations as they are foundational for the future of the group. Also, if it requires significant investment to sort out incomplete integration, the price of the group will be negatively impacted. Worth noting is that although full integration has significant advantages, it sometimes makes sense to keep a group decentralized. Third, it could be favorable not to realize full potential of a B&B strategy as the ability to continue the value creation journey may be attractive for buyers. As the future B&B potential is reflected in the exit price, it is therefore sometimes reasonable to "leave money on the table". In order to do so, however, it is crucial to have established a successful track record in implementing the strategy.

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9. Appendices

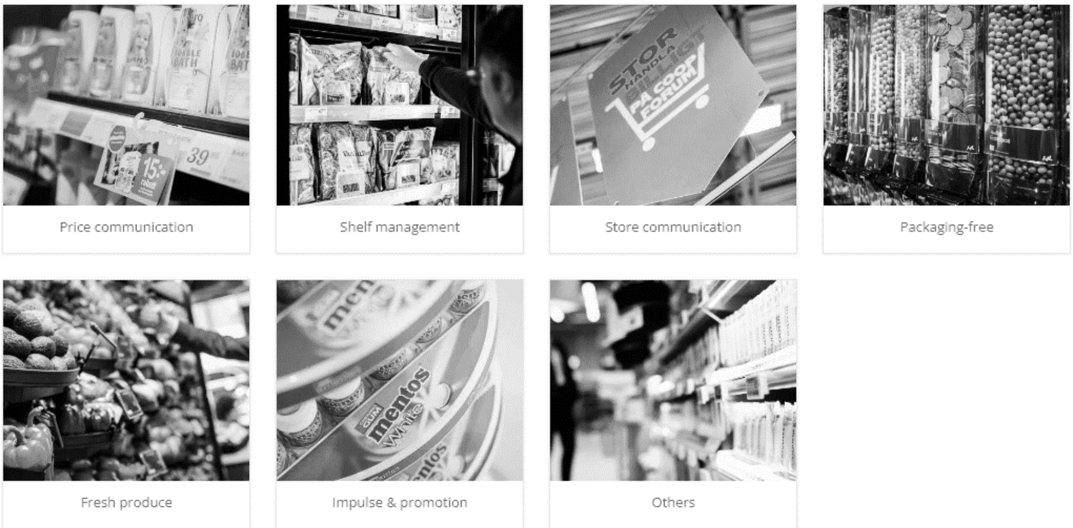
9.1. Overview of Interviewees

Date(s)	Firm	Interviewee	Role(s)
2-Oct-23	Ratos	Jonatan Gustafsson	Senior Associate
6-Oct-23	Ratos	Jonatan Gustafsson	Senior Associate
6-Oct-23	Aira (ex-Ratos)	Joakim Twetman	Chief Strategy Officer, Former President Business Area Industry at Ratos
25-Oct-23	Nordic Capital	Fredrik Näslund	Partner, Chief Investment Process Officer, Head of Technology & Payment
26-Oct-23	Bridgepoint	Oliver Krogh Hallin	Associate
31-Oct-23	Impilo	Gustav Jungdalen Lundgren	Investment Director
2-Nov-23	Triton	Sara Damberg	Investment Professional
3-Nov-23	Axcel	John Kleven Falck	Investment Manager
6-Nov-23	HL Display	Björn Borgman	Chief Executive Officer
9-Nov-23	Verdane	Joakim Kjemperud	Principal
9-Nov-23	Ratos	Jonas Wiström	Chief Executive Officer
16-Nov-23	Verdane	Victor Dahl	Associate
23-Nov-23	Anonymous	-	Investment Manager
27-Nov-23	Altor	Karl Svenningsson	Director

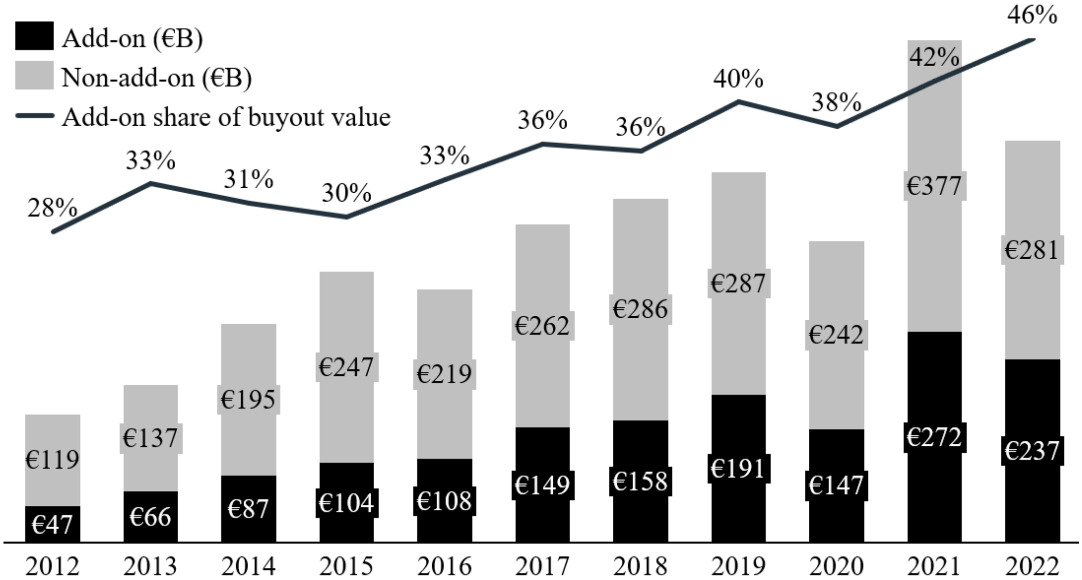
9.2. Ratos' Profit Improvement Building Blocks

Source: Ratos Capital Markets Day 2022

9.3. Overview of HL Display's Product Offering



9.4. Add-on Buyout Activity over Time in Europe



Source: PitchBook as of December 31, 2022