Guidelines Monitoring GROUP

Private Equity Monitoring Group on Transparency and Disclosure

FIFTH REPORT – DECEMBER 2012

GUIDELINES MONITORING GROUP

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GUIDELINES MONITORING GROUP

EXECUTIVE SUMMARY

1

This is the fifth annual report of the Guidelines Monitoring Group (the "Group") and provides a summary of the private equity industry's conformity with the Guidelines for Disclosure and Transparency in Private Equity (the "Guidelines") following their introduction in November 2007.

The Group was established in March 2008 to monitor conformity with the Guidelines and make recommendations to the British Private Equity and Venture Capital Association (the "BVCA") for changes to the Guidelines if required.

The Group performs oversight for, and aims to guide, the industry in improving transparency and disclosure.

Highlights of the 2012 review

- The number of portfolio companies covered by these Guidelines increased by one to seventy-nine in 2012, with the number of private equity firms falling by three to forty-five.
- Of the sample of thirty-one portfolio companies reviewed by the Group this year, twenty-seven met the enhanced disclosure requirements.
- Whilst those portfolio companies previously covered by the Guidelines continued to demonstrate a basic or good level of compliance with the requirements, the quality of narrative disclosures for a new cohort of portfolio companies in the sample was notably lower in comparison. Fifteen portfolio companies were reviewed for the first time this year, of which eleven met the required threshold – a smaller proportion than in previous years.
- The Group is committed to working with portfolio companies to improve their disclosures and strongly encourages standards above the minimum requirements within the Guidelines. Where disclosures were not adequate, we will be writing to companies individually to explain specifically what is required to ensure compliance with the Guidelines as well as where further enhancements can be made.
- Twenty-three of the portfolio companies reviewed made the audited report and accounts available on their websites. The Group continues to reinforce the message that accounts should be readily accessible on the company's website.
- Portfolio companies maintained a good standard of disclosure for areas such as the identity of the private equity firm, details of board composition, financial position and risks.
- The quality of narrative reporting was benchmarked against trends seen in the FTSE 350. In general, portfolio companies were able to reach a similar level of compliance with the requirements; but the Group recommends that Walker companies aim for best practice, even where this exceeds the standard currently being achieved by the FTSE 350.
- The private equity firms reviewed this year all met the disclosure requirements in the Guidelines and published information including details on their investment approach, UK portfolio companies, and leadership of the firm.
- The Group continues to review the Guidelines to ensure they evolve over time with developments in financial reporting and the industry. The Group is currently reviewing the enterprise value thresholds, changes to narrative reporting being implemented in the UK by regulation and whether a Walker company and/or its sponsor firm(s) should explicitly confirm that they have complied with the Guidelines.

1.1 The Guidelines

In February 2007, the BVCA asked Sir David Walker to undertake an independent review of the adequacy of disclosure and transparency in private equity, with a view to recommending a set of guidelines for conformity by the industry on a voluntary basis. This review resulted in the publication of the Guidelines in November 2007 and these are summarised in Appendix 3.

The Guidelines require additional disclosure and communication by private equity firms and their portfolio companies where the private equity firms and portfolio companies meet the Guidelines criteria. The criteria together with details of the full requirements under the Guidelines are set out in the summary in Appendix 3.

In addition to the enhanced disclosure requirements, the Guidelines include requirements on data being provided by private equity firms and portfolio companies to the BVCA, adoption of certain valuation guidelines, reporting to limited partners and the responsibility to ensure timely and effective communication during periods of significant strategic change.

1.2 Guidelines Monitoring Group

The Group is chaired by Sir Michael Rake, Chairman of BT Group plc. He is supported by two other independent members: Alan Thomson, Chairman of Hays plc and Baroness Drake, previous President of the TUC. Representing the private equity industry are: Robert Easton, Managing Director at The Carlyle Group, and Gerry Murphy, Senior Managing Director at The Blackstone Group.

1.3 Private equity firms and portfolio companies covered by the Guidelines

Details of the private equity firms and portfolio companies that fall within the scope of the Guidelines are set out in Appendices 1 and 2.

1.3.1 Private equity firms

The number of firms covered by the Guidelines has decreased this year from forty-eight to forty-five due to movements in the underlying population of portfolio companies within scope. The table highlights the increase in "private equity-like" firms such as those operating in the distressed debt or credit opportunities space.

Table 1: Number of private equity firms covered by the Guidelines

	2012	2011	2010
Private equity firm	35	40	33
Private equity-like firm	10	8	3
Total	**45**	**48**	**35**

Within this population, Dubai International Capital and Värde Partners have not complied with the Guidelines. In prior years Dubai International Capital had voluntarily participated as if it were a private equity firm, but no longer considers itself as meeting the definition of a firm covered by these Guidelines. It therefore withdrew from the Walker reporting process in 2010. The Group continues to believe that "private equity-like" entities with investments in significant UK businesses should comply with the Guidelines, and we will continue to encourage and work with these entities. Whilst Värde Partners has failed to engage directly with the Group this year, it is a private equity-like firm investing in credit-related assets and we will continue to promote the adoption of the Guidelines.

1.3.2 Portfolio companies

A total of seventy-nine portfolio companies are covered by the Guidelines this year (2011: seventy-eight). Of this number, seventy-three are included as required companies (2011: sixty-nine), and six as voluntary (2011: nine). Further details on the portfolio companies are included in Appendix 2.

Table 2: Number of portfolio companies covered by the Guidelines

	2012	2011	2010
Required	73	69	43
Voluntary	6	9	12
Total	**79**	**78**	**55**

The increase in the number of portfolio companies covered by the Guidelines since 2009 is a consequence of transactions that met the amendment to the Guidelines thresholds in April 2010, principally the adoption of lower size threshold criteria, as well as new transactions in the year.

Of the portfolio companies covered by the Guidelines, Park Resorts, Virgin Active and WorldPay have not complied with the Guidelines in full this year. Brit Insurance did not publish a report incorporating the enhanced disclosure required. Their owners have expressed a commitment to comply with the Guidelines and intend to do so next year. Doncasters, which did not meet the enhanced disclosure requirements in previous years, was not selected for further review this year given that it is a Dubai International Capital company. SAV Credit, a new entrant reviewed for the first time this year, did not meet the enhanced disclosure requirements either.

1.4 Review of compliance

As last year, PricewaterhouseCoopers LLP ("PwC") was appointed to assist the Group in carrying out this year's review of the disclosures made by a sample of portfolio companies with year-ends up to and including 30 April 2012. This report summarises the findings of that exercise along with the Group's own review of the other requirements of the Guidelines.

1.4.1 Portfolio companies

PwC reviewed a total sample of disclosures of thirty-one portfolio companies; of these fifteen had not been reviewed in previous years. Sixteen of the companies selected had been previously reviewed and assessed as compliant. The Group aims to ensure that all portfolio companies are reviewed at least once every three years, and will continue with its policy of re-reviewing companies whose reporting is regarded as not compliant with the Guidelines. Doncasters was the only company previously assessed as non-compliant which was not selected for review again this year given its owner's viewpoint as noted in section 1.3.1 above.

Of the sample of thirty-one portfolio companies reviewed by the Group this year, twenty-seven met the enhanced disclosure requirements. The findings of this year's review identified a lower level of overall compliance with the Guidelines than in previous years, with four of the fifteen portfolio companies that were reviewed for the first time not complying with the requirements. The sixteen portfolio companies reviewed that met the thresholds in previous years have all been assessed as compliant again this year. All private equity firms, with the exception of Värde Partners, whose portfolio companies did not meet the required level of disclosure this year, have expressed their intention to comply with the Guidelines in full next year and were supportive of the Guidelines in general.

Throughout the review process the Group has worked closely with both private equity firms and portfolio companies, particularly those within the population for the first time this year, to ensure that they meet the required standards set out in the Guidelines. The Group will continue to provide feedback to firms and portfolio companies to raise the levels of disclosure and adherence with the Guidelines, and to promote this as standard industry practice. Each private equity firm and portfolio company reviewed will receive an individual letter setting out the detailed findings of this year's review and recommendations for improvements.

The Group and the BVCA consider that further improvements must be made to demonstrate that the private equity industry is committed to transparency. The Group has continued to raise the required standard of overall disclosure to achieve compliance with the Guidelines. There was a higher level of engagement with the Group this year by portfolio companies to make compliant disclosures. We will continue to work with firms to ensure that the scope of required disclosures is clarified in advance and to address concerns about disclosing confidential information.

We also emphasise the need for private equity firms to work with their portfolio companies through the first reporting period under the Guidelines. The Group will provide advice and guidance to further improve the disclosure of those companies, as well promoting best practice. As in previous years, the Group commissioned a guide published by PwC in March 2012 entitled 'Improving Transparency and Disclosure – Good practice reporting by Portfolio Companies'. PwC will publish an update to this guide in early 2013, based on their findings this year.

Only twenty-three of the portfolio companies reviewed made the audited report and accounts available on their website. The Group continues to reinforce the message that accounts should be readily accessible on the company's website.

The Guidelines require that conformity with each of the requirements is on a 'comply or explain' basis and explanations for non-compliance should be posted on the website. Within the population reviewed, none of the portfolio companies adopted an 'explain' approach in the event of non-compliance.

In assessing conformity, the requirements under the Guidelines are separated into the three areas: guidelines specific; business review required by the Companies Act, and enhanced business review. The Group's key findings are summarised below along with comments on the quality of narrative reporting compared to trends seen across the FTSE 350.

1.4.1.1 Guidelines specific

All the portfolio companies in the sample reviewed identified the private equity fund(s) that were its owners and provided details on the private equity firms that had oversight of the company. The better disclosures set out a more comprehensive history of ownership. The requirement to detail composition of the board was met in the majority of cases with directors from the private equity firm highlighted. Best practice examples included biographies of the directors and their relevant experience.

The Guidelines require a financial review which explains the financial position and identifies financial risks facing the company and the risk management policies in place to manage these. These requirements were met in the large majority of cases, with thirty companies achieving compliance. However, the quality of disclosures varied considerably across the sample and, to improve, portfolio companies need to ensure disclosures are specific to their particular business, and information on the year end capital structure clearly ties to the financial statements.

1.4.1.2 Business Review (required by UK Companies Act)

Portfolio companies should set out a fair review of their business that covers strategy and the market environment in which they operate. This requirement was met by most of the sample although two companies failed to include any specific comment on strategy. Across the sample as a whole, the ability to clearly outline strategic priorities fell below the standard seen in FTSE 350 companies.

Principal risks and uncertainties were disclosed by nearly all the portfolio companies reviewed with only one omitting this disclosure. The better disclosures in this area also set out how the portfolio company sought to mitigate these risks.

Portfolio companies are expected to set out financial and non-financial key performance indicators ("KPIs") used by the company to assess their position and performance. Of the thirty-one reviewed, thirty companies identified their financial KPIs and twenty-eight their non-financial KPIs. An improvement is required in the disclosure of non-financial KPIs, especially with respect to the depth of the explanation and quantification.

The majority of the portfolio companies and the FTSE 350 do not clearly align strategy with their risk assessment and KPIs. This would assist in presenting a clear, credible and coherent picture of both the direction of travel and short term performance. The Group believes a significant improvement is needed in this area by both the portfolio companies and the FTSE 350, particularly in the context of the current economic environment.

1.4.1.3 Enhanced Business Review

The quality of disclosures in respect of trends and factors likely to affect future development, performance or the position of the company's business was varied. The majority of portfolio companies provided this information with only one exception. In many cases this information was historical and discussion lacked a forward-looking orientation supported by quantitative information. This was also a consistent theme for FTSE 350.

Disclosures on environmental matters were provided by twenty-nine of the portfolio companies reviewed and several noted that this was an area that they had recently started monitoring. Although still a relatively weak area for both the portfolio companies and the FTSE 350 overall, there was better alignment of reporting on sustainability with strategy in the current year.

The majority of the sample reviewed met the disclosure requirements for employees and social and community matters, with two exceptions. There was an increased level of excellent disclosures regarding employees recognising the critical importance of this key resource for most businesses. The quality of disclosures on social and community issues still needs improvement though, particularly with respect to how this area fits with the company's strategy. Consistent with prior years, compliance with the requirement to detail essential contractual or other arrangements was unsatisfactory, with three companies not disclosing sufficient information.

Promoting transparency is at the core of the Group's work and it is committed to supporting portfolio companies improve on the results above and promoting best practice. The Group will work with portfolio companies to act on the findings from our review and we will review those companies that fell short of the requirements again next year. The Group is particularly keen to ensure that Walker companies present a clear and coherent explanation of how strategy is aligned with the company's risk profile and key performance indicators, and how it is linked to trends seen in the market environment.

1.4.2 Private equity firm disclosures

The Group selected a sample of ten private equity firms covered by the Guidelines to review for conformity with each of the individual requirements. All firms selected complied with the requirement, as was the case last year.

In the coming year, the Group intends to review the entire population of private equity firms covered by the Guidelines to assess overall compliance rates.

1.5 Performance of portfolio companies

The Guidelines recommend that the BVCA should commission research into the trading performance of companies and attribution analysis in respect of exits and publish the findings.

Ernst & Young was commissioned again this year to undertake the research and it is expected that it will be completed in early 2013 and will be published on the BVCA website at www.bvca.co.uk/Research.

1.6 Future activities of the Group

When the Guidelines were introduced it was recognised that they would need to be capable of evolving over time to ensure they remain relevant. The Group is currently working on the following:

- Considering an addition to the Guidelines which would require portfolio companies and/or sponsor firm(s) to confirm adoption of the Guidelines;
- Monitoring changes in narrative reporting, such as the Department of Business, Innovation and Skills' draft regulations published in October 2012 that would introduce a separate strategic report, and the Financial Reporting Council's discussion paper on disclosures in a broader context;
- Conducting a consultation process with private equity firms about a possible amendment to the definition of a private equity firm for the purpose of the Guidelines;
- Continuing to review the enterprise value thresholds in accordance with developing European legislation and regulation; and
- Reviewing the entire population of private equity firms covered by the Guidelines to assess overall compliance rates with the communication requirements such as their history, investment approach, information on UK portfolio companies in their portfolios and a commitment to comply with the Guidelines.

Since 2007, the private equity industry has overwhelmingly adopted and embraced the Guidelines in a voluntary and self-regulatory commitment to improving transparency. The number of portfolio companies expected to provide additional information to its stakeholders has grown from fifty-four to seventy-nine, with the number of private equity firms increasing from thirty-two to forty-five. Of these companies, the participation of sixteen reflects the acceptance by the industry in 2010 of lower size thresholds recommended by the Group in light of general stakeholder demand for greater disclosure since the financial crisis. The Group looks forward to continuing its work with the private equity industry to strengthen and develop its demonstrated commitment to transparency.

2 OVERVIEW OF THE GUIDELINES

The Guidelines set out recommendations and enhanced disclosure requirements for private equity firms, their UK portfolio companies and the BVCA. These are reproduced in Appendices 3 to 5 and summarised below.

2.1 Definition of private equity firms and portfolio companies covered by the Guidelines

The Guidelines apply exclusively to private equity firms and their UK portfolio companies as defined below:

A private equity firm is a firm authorised by the FSA that is managing or advising funds that either own or control one or more UK companies or have a designated capability to engage in such investment activity in the future where the company or companies are covered by the enhanced reporting guidelines for companies.

A portfolio company is a UK company:

a) acquired by one or more private equity firms in a public to private transaction where the market capitalisation together with the premium for acquisition of control was in excess of £210 million (reduced from £300 million) and more than 50% of revenues were generated in the UK or UK employees totalled in excess of 1,000 full-time equivalents; or

b) acquired by one or more private equity firms in a secondary or other non-market transaction where enterprise value at the time of the transaction was in excess of £350 million (reduced from £500 million) and more than 50% of revenues were generated in the UK or UK employees totalled in excess of 1,000 full-time equivalents.

The above definition of a portfolio company reflects the changes made to the criteria in April 2010 and has been effective for accounting year ends of 31 December 2010 and onwards.

2.2 Summary of the content and timing of disclosure required by portfolio companies

A portfolio company should publish its annual report and accounts on its website within six months of the year-end and:

- The report should identify the private equity fund or funds that own the company and provide details of the composition of the board;
- The financial review should cover risk management objectives and policies in the light of the principal financial risks and uncertainties facing the company with links to the appropriate detail in the footnotes to the accounts; and
- The report should include a business review that substantially conforms to the provisions of Section 417 of the Companies Act 2006 including the Enhanced Business Review requirements that are ordinarily applicable only to quoted companies.

A summary of the detailed requirements for portfolio company disclosure can be found in Appendix 3.

2.3 Disclosure and communication required by private equity firms

A private equity firm should publish either in the form of an annual review or through regular updating of its website:

- A description of the way the FSA-authorised entity fits into the firm as a whole with an indication of its investment approach including investment holding periods along with an indication of the leadership of the firm and confirmation that it has appropriate arrangements to deal with conflicts of interest; and

- A commitment to conform to the Guidelines, a description of the companies in the private equity firm's portfolio and a categorisation of the limited partners in the fund or funds including a geographic categorisation and a breakdown by type of investor.

Additionally, private equity firms should, in their reporting to limited partners, follow established guidelines, such as those published by the European Private Equity and Venture Capital Association (the "EVCA"), follow established guidelines in the valuation of their assets, and should provide data to the BVCA in support of its enhanced role in data collection, processing and analysis.

Private equity firms should also commit to ensure timely and effective communication with employees, either directly or through their portfolio company, as soon as confidentiality constraints are no longer applicable.

2.4 Recommendations for initiatives to be undertaken by the BVCA

The Guidelines recommended that the BVCA should:

- Enlarge and strengthen its data gathering, analytical and reporting capabilities and should apply those capabilities to increased research activities including performance and attribution analysis for portfolio companies;
- Initiate discussions with "private equity-like" groups with the purpose of enlisting their voluntary undertaking to conform to the Guidelines; and
- Participate proactively with overseas private equity trade associations to develop a methodology for the content and presentation of fund performance information.

3 REVIEW OF CONFORMITY WITH THE GUIDELINES

3.1 Introduction

This section summarises the findings of the Group's review of conformity with the Guidelines and considers conformity in three areas:

- Disclosure by a portfolio company: the requirements to make accounts and mid-year updates available, and for the accounts to meet enhanced disclosure requirements. This covered portfolio companies with year-ends up to and including 30 April 2012;
- Communication by a private equity firm: the requirement to make information about the firm available in an annual report on, or through regular updating of, the firm's website; and
- Other requirements and recommendations: the requirements for firms and companies to provide data to the industry association, to follow established reporting and valuation guidelines and to ensure timely and effective communication as well as the recommendations for the BVCA relating to research, "private equity-like" entities and fund performance measurement.

3.2 Overview of findings

Within the sample, there were three distinct groupings:

- Portfolio companies that were reviewed in previous years demonstrated a level of reporting that is in areas, above and beyond that required by the basic requirements of the Guidelines;
- New entrants in to the population, in general, report to a level below that of those companies previously assessed and some were at a level below that which achieves at least basic compliance with the Guidelines; and
- Those portfolio companies that have been assessed as not meeting the basic requirements of the Guidelines.

The Group has retained the objective of ensuring that all companies covered by the Guidelines report to a level at least equivalent to, or in advance of, FTSE 350 companies. We note that in certain areas such as the linkage between key performance indicators and strategy, both sets of populations could enhance their disclosures.

The Group will explain where improvements can be made in feedback letters it provides to private equity firms and portfolio companies. To promote best practice, these will not only highlight areas where disclosures were not adequate, but also where disclosures could be improved beyond the basic requirements.

3.3 Private equity firms and portfolio companies covered by the Guidelines

Details of the private equity firms and portfolio companies that fall within the scope of the Guidelines are set out in Appendices 1 and 2.

The Group has established a policy that all portfolio companies within the population will be reviewed at least once within a three year cycle and will continue with its policy of re-reviewing more frequently companies whose reporting has been found to not comply with, or only just meet, the requirements

Overall, twenty-seven of the thirty-one companies reviewed by the Group this year, when assessed in overall terms have met the Guidelines' enhanced disclosure requirements. This population included sixteen companies reviewed previously and fifteen reviewed for the first time. All portfolio companies reviewed that did not comply with the Guidelines in full where those in the latter category and these were Virgin Active, Worldpay, Park Resorts and SAV Credit. This represents a failure rate of thirteen per cent for portfolio companies reviewed in 2012, which has increased from three per cent in our 2011 review and nine per cent in our 2010 review. Over time, the Group has noted trends in the group not meeting the requirements and these include the portfolio companies being smaller in size (given the reduction in enterprise value thresholds), and fewer former public companies that have been taken private.

Initially, ten of the companies reviewed, including eight companies that are new to the Walker population, were assisted by the Group to ensure that they met the requirements to a satisfactory degree. After discussion between the Group and the private equity owners of the portfolio companies concerned, six of the companies addressed the exceptions identified and met the requirements.

All of the sixteen companies reviewed for a second or third time this year, and previously assessed as compliant, had generally good or acceptable compliance. Four companies exceeded the basic requirements in overall terms. It was observed that public companies taken into private equity ownership often provide better quality disclosure.

The following were identified as being areas in which the standard of disclosure was generally good:

- Compliance with financial risk requirements to include discussion about overall risk management objectives and policies, and risk management policies in relation to the company's leverage;
- Compliance with financial position requirements to include an explanation of the year end debt and capital structure of the company and its funding requirements;
- Details of the board composition; and
- Identity of the private equity firm.

In contrast, and consistent with prior year, the following were identified as being areas in which the standard of disclosure was mixed:

- Strategy for the company including its priorities;
- Trends and factors likely to affect future performance and development of the business;
- Non-financial KPIs, for example around employee and environmental matters;
- Social and community issues affecting the business and the policies to address them;
- Market environment in which the company operates; and
- Essential contractual arrangements, such as with major suppliers and key customers.

Fourteen companies reported under International Financial Reporting Standards. Overall, accounts prepared under this basis were found to be of a higher standard than accounts prepared under UK accounting standards.

Only a small number of companies included a specific statement of conformity with the Guidelines in the annual report and financial statements. This statement is not currently a requirement, and the Group intends to recommend for consultation the inclusion of this as a requirement in the Guidelines. This would be in line with the requirements of the UK Corporate Governance Code for listed companies. The aim would be to focus attention to the requirements of the Guidelines.

3.4 Detailed findings

The Guidelines require that the portfolio company's audited report and accounts should be readily accessible on the company website no more than six months after the company year-end and that a summary mid-year update giving a brief account of major developments in the company (but not requiring updated accounts) should be placed on the website no more than three months after mid-year.

Only twenty-three of the portfolio companies reviewed made the audited report and accounts available on the company's website. The Group continues to reinforce the message that accounts should be readily accessible on the company's website.

The requirements for portfolio company disclosures under the Guidelines can be separated into three areas:

- *Guidelines specific*: identity of the private equity firm, details on board composition and the financial review;
- *Business Review (required by UK Companies Act):* a fair review of the business, details of principal uncertainties and risks and the use of key performance indicators; and
- *Enhanced Business Review:* additional requirements comprising information on trends and factors affecting future performance, environmental matters, employees, social and community issues and details of essential contractual arrangements.

3.4.1 Walker Guideline specific disclosures

Identity of the private equity firm

> "The report should identify the private equity fund or funds that own the company and the senior executives or advisers of the private equity firm in the UK who have oversight of the company on behalf of the fund or funds."

To comply with this requirement, the identity of the private equity firm should be disclosed within the annual report.

Findings

The requirement was met by all portfolio companies within the sample. Twenty-two companies went further than the basic requirement and also disclosed the name of the managed fund in the private equity group as well as that of the private equity firm itself or the history of ownership.

Details on board composition

> "The report should give detail on the composition of the board, identifying separately executives of the company, directors who are executives or representatives of the private equity firm and directors brought in from outside to add relevant industry or other experience."

The report should go beyond the Companies Act requirements relating to directors and should include additional disclosure to highlight which of the directors were also directors of, or had been appointed by, the private equity firm.

Findings

This requirement was met by thirty companies in the sample and was achieved in a variety of ways. The best disclosures included full biographies of each director, including areas of expertise, similar to the reporting format adopted by public companies. These were good examples and went further than the requirements. Other companies provided a table of directors stating whether they were appointed by the private equity firm or not. Another method used was to include a list of directors with a footnote explaining who is from the private equity firm.

Financial review

> "The financial review should cover risk management objectives and policies in the light of the principal financial risks and uncertainties facing the company, including those relating to leverage, with links to appropriate detail in the footnotes to the balance sheet and cash flow section of the financial statements."

The report should include an explanation of the year-end debt and capital structure of the company, its funding requirements and discussion of the overall risk management objectives and policies of the company, including those in relation to the company's leverage.

Findings

The analysis of this requirement was divided into two parts; firstly the financial position of the entity at year end and secondly the identification of financial risks. Thirty companies achieved compliance with this requirement.

Financial position at year end

Not all companies defined or reconciled non accounting measures they had used in addition to the numbers included within the financial statements. The best examples included proforma information to enable meaningful comparatives to be provided, but this was not always the case.

This requirement was one of the most successfully met by the portfolio companies reviewed, with six companies having excellent disclosure in this area.

Financial risks

Discussions were often at a high level and not always company specific. The majority of companies included disclosure on the company's exposure to price risk, credit risk, liquidity risk and cash flow risk as required by the accounting standards and Companies Act. However, the level of disclosure within this area varied considerably.

Overall, this requirement was also met successfully with twenty-three companies having excellent or good examples of disclosure of financial risks. However, the remainder only met the basic level of compliance.

3.4.2 Business Review (required by UK Companies Act)

Fair review of the business

"The business review must contain a fair review of the company's business."

To comply with these requirements the annual report and accounts should include:

- A statement of company strategy setting out what the company is trying to achieve and the priorities for how it plans to achieve those objectives; and
- A description of the market in which the company operates should be given as well as how the competitive, regulatory and macro-economic forces impact on the business.

Findings

The analysis of this requirement was divided into two parts: firstly the business strategy of the entity and secondly the market environment of the entity.

Business strategy

A statement about their overall strategy was disclosed by twenty-nine of the companies in the sample sufficient to meet basic requirement, with twenty providing greater details of key strategic priorities and four doing so to an excellent standard. No discernible strategy statement was identified for two companies.

Overall, the majority of the companies reviewed included some discussion on corporate strategy. The standard of disclosures varied, with only a few companies who used the strategy to underpin their reporting and used consistent terminology throughout their annual report. The Group recommends that portfolio companies covered by the Guidelines include forward looking information to support their disclosures on strategy.

Market environment

The majority of companies provided a minimum of a good level of disclosure over their market environment, providing the user of the accounts with an understanding of the background to the company's performance based on the market in which it operates. The lower quality disclosures only reference general market conditions, namely the macro-economic environment as a whole and the impact this has had on customer spending.

Overall, all companies met this requirement, although there was some variation in the standard of disclosures. Where companies provided a comprehensive analysis, interesting graphics and diagrams were used to aid the disclosures.

Principal risks and uncertainties facing the company

"The business review must contain a description of the principal risks and uncertainties facing the company."

To comply with this requirement the annual report and accounts should include an explicit identification of the principal risks and uncertainties facing the company and avoid a long list of boiler-plate risks.

Findings

The majority of companies attempted to provide principal risks, either explicitly or implicitly. Companies that obtained good or excellent disclosure ensured the risks considered were specific to the business and demonstrated some mitigation discussion. There was one exception in the sample reviewed.

Overall, there is good disclosure of the principal risks and uncertainties in the sample and this was one of the better areas of compliance with six companies providing excellent disclosure.

Key performance indicators (KPIs)

"The review must, to the extent necessary for an understanding of the development, performance or position of the company's business, include analysis using financial key performance indicators and where appropriate, analysis using other key performance indicators, including information relating to environmental matters and employee matters. "Key performance indicators" means factors by reference to which the development, performance or position of the company's business can be measured effectively."

To comply with the requirements the annual report and accounts should include an explicit identification of the KPIs so as to avoid any misunderstanding or, at the very least, provide performance data, from which a reader might reasonably identify their KPIs. We expect most companies should have non-financial KPIs, for example around areas such as employee retention, as for most businesses these are expected to be key to the ongoing success of the business.

Findings

The analysis of this requirement was divided into a review of the financial and non financial KPIs.

Financial key performance indicators

Of the sample reviewed thirty explicitly identify their KPIs and twenty-eight companies clearly aligned their KPIs with their strategy. These companies also disclosed definitions, quantified and discussed the KPIs identified. Overall, there was a mixed response to the requirement to disclose financial KPIs although all but one company either implicitly or explicitly disclosed some financial KPIs.

Non financial key performance indicators

Overall the quality of the disclosures for non-financial KPIs was lower than the financial KPIs, being less well explained and quantified. Of the companies reviewed twenty-eight provided non-financial KPIs, either explicitly or implicitly. Two companies did not provide any evidence of non-financial KPIs. For many of the portfolio companies reviewed this was an area that could be improved. This is particularly marked for those companies who identify operational strategies and risks, but do not identify corresponding KPIs.

3.4.3 Enhanced Business Review

Trends and factors affecting future development, performance or position

> "The business review must, to the extent necessary for an understanding of the development, performance or position of the company's business, include the main trends and factors likely to affect the future development, performance and position of the company's business."

To meet this requirement the business review should have a high level, forward-looking orientation explaining the trends and factors likely to influence the business including market trends, future strategic priorities or investment in research and development. This can be throughout the annual report or in a specifically headed section.

Findings

Overall portfolio companies complied with this requirement, but the response was mixed. The content of the annual reports reviewed was historical in focus providing a review of the current year and performance and lacking a discussion of future performance. This largely reflects the perceived commercial sensitivity of providing a forward-looking orientation and the judgemental, rather than the factual, nature of compliance.

Examples of poor approaches to compliance include the use of high level generic information with little relevance to the company overall. Some companies provided aspects of a forward-looking orientation but scattered throughout the report. Few companies provided quantitative information to support their discussion.

Twenty companies provided a minimum of good disclosures. There was one company which failed to meet the basic disclosure requirement. Given the current economic environment, the Group expects to see an increase in the discussion of current market trends as management try to provide a sense of the quality and sustainability of corporate performance, for example issues relating to raising finance.

Environmental matters

> "The business review must, to the extent necessary for an understanding of the development, performance or position of the company's business, include information about environmental matters (including the impact of the company's business on the environment), including information about any policies of the company in relation to those matters and the effectiveness of those policies."

The section should include a discussion of the environmental matters affecting the business, the policies in place to address them, and the impact of these policies. The type of disclosure required is dependent on the nature of the business.

Findings

Twenty-nine companies of the sample reviewed provided some disclosure of their environmental matters. However the response of companies varied in quality with some companies including a high level overview of environmental matters, and others including a detailed discussion of environmental matters and performance. Some companies provided a cross reference to a separate Corporate and Social Responsibility report if there was one, or additional environmental information on their website. Several other companies noted that this is an area they have recently started monitoring.

Overall there appeared to be broad compliance with this requirement, although the responses varied quite considerably between high level statements and more detailed disclosure. There were two companies that did not provide any disclosures in this area.

Employees

> "The business review must, to the extent necessary for an understanding of the development, performance or position of the company's business, include information about the company's employees including information about any policies of the company in relation to those matters and the effectiveness of those policies."

Employee disclosures should go beyond those previously required by the Companies Act and to the extent employees are a critical resource of the business, there should be a discussion of the management and development of employees including recruitment, training and development, and retention practices.

Findings

The overall compliance in this area was generally good, with an increased level of excellent disclosures recognising that employees are an essential resource for most businesses. There were two companies where disclosures will need to be improved next year.

Social and community issues

> "The business review must, to the extent necessary for an understanding of the development, performance or position of the company's business, include information about social and community issues, including information about any policies of the company in relation to those matters and the effectiveness of those policies."

Details should be provided at a high level of the social and community issues affecting the business and policies to address them. The level of disclosure needs to go beyond details of political and charitable donations.

Findings

There was mixed quality of disclosures on social and community issues with only a small number of excellent examples in this area and seven companies that had only basic disclosures. For example, few of the samples provided any discussion around local employment policies.

Overall there were two companies that did not comply with this requirement. There were few examples of company-specific discussion or information that was relevant to the strategy.

Essential contractual or other arrangements

> "The business review must, to the extent necessary for an understanding of the development, performance or position of the company's business, include, subject to subsection (11) [disclosure seriously prejudicial in opinion of the directors], information about persons with whom the company has contractual or other arrangements which are essential to the business of the company."

Details of essential contractual arrangements should identify the parties and arrangements involved and not just provide details of supplier payment policies and creditor days. Where companies do not have any contractual or other arrangements that are essential to the business, this should be clearly stated.

Findings

Often the existence of contractual or other arrangements was scattered throughout the report and there were few examples of companies who provided the information under a specific heading. This is not inconsistent with what we have observed among listed companies.

This remains a developing area and we consider that most of the portfolio companies reviewed could improve significantly with more explicit references of key contracts and resources and the impact on the business. There were three companies that did not provide sufficient disclosure in this area to achieve a basic standard.

3.5 Review of disclosure by private equity firms

> "A private equity firm should publish an annual review accessible on its website or ensure regular updating of its website to communicate information about itself, its portfolio companies and its investors along with a commitment to the guidelines."

The requirement allows firms either to prepare a separate annual report or include the information generally within the firm's website.

Findings

All ten private equity firms in the sample selected met the requirements. Better examples included case studies of realised investments, details of corporate and social responsibility matters and detail about the structure and governance of the firm. Some firms included an annual review on their website, and others chose to include a mixture of regular updates to the website and a document covering the Walker Guidelines specifically.

3.6 Other requirements and recommendations

The Guidelines include additional requirements for private equity firms and portfolio companies regarding the provision of data to the industry association, the adoption of established valuation and reporting guidelines and timely and effective communication at a time of significant strategic change. They also include recommendations for the industry association regarding research capabilities and activities, engagement with "private equity-like" entities and fund performance measurement.

Findings

- In general, most private equity firms owning portfolio companies that meet the criteria are cooperating with the BVCA in collating the detailed information required to prepare the 'BVCA Annual Report on the Performance of Portfolio Companies' commissioned by the BVCA from Ernst & Young. However, this year there are six owners of seven portfolio companies that have not yet provided the information requested;
- The private equity firms apply guidelines published by the International Private Equity and Venture Capital Board or by the Private Equity Industry Guidelines Group or, in the case of public companies, applicable accounting standards; and
- Where portfolio companies have undergone significant strategic change, the private equity firms ensured timely and effective communication with employees, as soon as confidentiality constraints ceased to be applicable. The Group did not identify any instance where a private equity firm had not ensured timely and effective communication of a significant strategic change in a portfolio company.

3.6.1 Performance of portfolio companies

The annual review of the performance of portfolio companies, undertaken by the BVCA and Ernst and Young will be finalised in early 2013. The report will be published on the BVCA website at www.bvca.co.uk/Research.

3.6.2 Engagement with "private equity-like" entities

The Group and the BVCA are continuing to hold discussions with other potential private equity or "private equity-like" firms, including sovereign wealth funds, with the purpose of enlisting their voluntary conformity with the Guidelines.

3.6.3 Fund performance measurement

The Guidelines recommended that the BVCA should participate proactively with private equity trade associations beyond the UK and with the limited partner community to develop a consistent methodology for the content and presentation of fund performance information. The BVCA is continuing to hold discussions with other European private equity trade associations covering a number of areas including fund performance measurement.

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APPENDIX 1: PRIVATE EQUITY FIRMS COVERED BY THE GUIDELINES

The following private equity firms are required to comply with the Guidelines:

- 3i Group plc
- Advent International plc
- Alinda Capital[1, #]
- Apax Partners
- Apollo Global Management LLC
- Arcapita[1]
- Arle Capital Partners
- Bain Capital
- BC Partners
- Bridgepoint
- CCMP Capital Advisors (UK) LLP[1]
- Cerebus Capital Management[1, #]
- Charterhouse Capital Partners LLP
- Cinven
- Clayton Dubilier & Rice LLC
- CBPE Capital
- CVC Capital Partners Ltd
- Doughty Hanson & Co Ltd
- Dubai International Capital[1, #]
- Global Infrastructure Partners[#]
- GI Capital Partners[1]
- GS Capital Partners[1]
- Henderson
- KKR & Co Ltd
- Lion Capital
- Lyceum Capital
- Macquarie
- Marathon Capital[1, 2, #]
- Montagu Private Equity LLP
- Oaktree Capital Management[1, 2, #]
- Onex Partners[1]
- Ontario Teachers' Private Capital[1, #]
- PAI Partners
- Palamon Capital Partners
- Park Square Capital[1, #]
- Permira Advisers LLP
- Terra Firma Capital Partners Limited
- TDR Capital
- The Blackstone Group International Partners LLP
- The Carlyle Group
- TPG Capital LLP
- Värde Partners[1, 2, #]
- Vision Capital Ltd
- Warburg Pincus
- York Capital Management[1, #]

[1] Not a member of the BVCA
[2] Addition this year
[#] Private equity-like entity

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APPENDIX 2: PORTFOLIO COMPANIES COVERED BY THE GUIDELINES

The following portfolio companies either met the criteria set out in the Guidelines, or have committed to conform to the Guidelines on a voluntary basis.

Required portfolio companies

PORTFOLIO COMPANY	OWNERS
Acromas (AA / Saga)	Charterhouse, CVC, Permira
Airwave Solutions[1]	Macquarie
Alliance Boots[1]	KKR
Annington Homes	Terra Firma
Associated British Ports	GS Capital Partners
Biffa	Montagu Private Equity
Birds Eye Iglo[1]	Permira
Brakes Group	Bain Capital
Brit Insurance[2]	CVC, Apollo
British Car Auction	Clayton Dubiler & Rice
Camelot	Ontario Teachers' Private Capital
Card Factory	Charterhouse
Care UK	Bridgepoint
Center Parcs[1]	Blackstone
Civicia[1]	3i
DFS[1]	Advent
Domestic and General Group	Advent
Doncasters	Dubai International Capital
DX Group	Candover/Arle Capital Partners
Edwards Group	CCMP Capital Advisors (UK)
Enterprise	3i
Enserve	Cinven
Environmental Scientifics Group[1]	3i
Equiniti	Advent
Eversholt Rail	3i
Exova[1]	Clayton Dubiler & Rice
Expro	GS Capital Partners
Fat Face	Bridgepoint
Findus Group	Lion Capital
Fitness First	Oaktree, Marathon
Gatwick Airport	Global Infrastructure Partners
Gala Coral	Apollo, Cerebus, Park Square & York Capital
Gondola Holdings	Cinven
Integrated Dental Holdings[1, 2]	Carlyle, Palamon Capital Partners
John Laing	Henderson
Just Retirement	Permira
Kellen Group (Phoenix Natural Gas)	Terra Firma

London City Airport	Global Infrastructure Partners
Merlin Entertainments Group[1]	Blackstone, Dubai International, CVC, KIRKBI
Moto	Macquarie
National Car Parks	Macquarie
New Look[1]	Permira, Apax
Northgate Information Solutions	KKR
Odeon & UCI Cinemas	Terra Firma
Osprey (AWG)	3i
Park Resorts[1]	GI Partners
Partnerships in Care[1]	Cinven
Pets at Home	KKR
Phones4U	BC Partners
PHS[1]	Charterhouse
Pret a Manger[1, 2]	Bridgepoint
Priory Group[1, 2]	Advent
QMH[1]	GS Capital Partners
RAC[1, 2]	Carlyle
SAV Credit[1, 2]	Värde Partners
South Staffordshire Water	Alinda Capital
Spire Healthcare	Cinven
Stonegate Pub Company[1]	TDR Capital
Thames Water	Macquarie
The Vita Group	TPG
Tomkins	Onex Partners
Top Right Group (includes EMAP)[1]	Apax
Trader Media[1]	Apax
Travelex	Apax
Travelodge	Dubai International Capital
TSL[1]	Charterhouse
United Biscuits[1]	Blackstone, PAI
Virgin Active[1, 2]	CVC
Viridian Group[1]	Arcapita
Vue Cinemas[1, 2]	CVC
Wales & West Utilities	Macquarie
Weetabix	Lion Capital
WorldPay[1, 2]	Advent, Bain Capital

Voluntary portfolio companies

PORTFOLIO COMPANY	OWNERS
AWAS	Terra Firma
Deutsche Annington Immobilien1	Terra Firma
HIT Entertainment	Apax
Infinis Ltd1	Terra Firma
Talaris	Carlyle
Tragus1	Blackstone

[1] Accounts reviewed this year
[2] Addition this year

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APPENDIX 3: GUIDELINES FOR ENHANCED DISCLOSURE BY PORTFOLIO COMPANIES AND PRIVATE EQUITY FIRMS

1. **Conformity with each of the Guidelines** should be on a **comply or explain** basis.

Where an explanation is given for "non-compliance", this should be posted alongside other related relevant disclosures called for under these Guidelines on the website of the private equity firm or portfolio company.

2. Definition of a **private equity firm** for the purpose of the Guidelines:

A firm authorised by the FSA that is managing or advising funds that either own or control one or more UK companies or have a designated capability to engage in such investment activity in the future where the company or companies are covered by the enhanced reporting guidelines for portfolio companies.

3. Definition of a **portfolio company** to be covered by enhanced reporting guidelines (as amended by the Group in April 2010):

A UK company

a) acquired by one or more private equity firms in a public to private transaction where the market capitalisation together with the premium for acquisition of control was in excess of £210 million and more than 50% of revenues were generated in the UK or UK employees totalled in excess of 1,000 full-time equivalents.

b) acquired by one or more private equity firms in a secondary or other non-market transaction where enterprise value at the time of the transaction is in excess of £350 million and more than 50% of revenues were generated in the UK or UK employees totalled in excess of 1,000 full-time equivalents.

4. Content of enhanced disclosure by a portfolio company

A portfolio company should include as part of its audited annual report and accounts the following enhanced disclosures, none of which call for disclosures beyond those specified for quoted companies in the Companies Act 2006 or other disclosure requirements applicable to quoted companies. Such reporting should throughout focus on substance rather than form and on the economic reality of a company or group rather than its legal structure.

a) The report should identify the private equity fund or funds that own the company and the senior executives or advisers of the private equity firm in the UK who have oversight of the company on behalf of the fund or funds.

b) The report should give detail on the composition of the board, identifying separately executives of the company, directors who are executives or representatives of the private equity firm and directors brought in from outside to add relevant industry or other experience.

c) The report should include a business review that substantially conforms to the provisions of Section 417 of the Companies Act 2006 including sub-section 5 (which is ordinarily applicable only to quoted companies). Section 417 is reproduced at Annex D below, sub-section 5 provides:

"(5) In the case of a quoted company the business review must, to the extent necessary for an understanding of the development, performance or position of the company's business, include -

a) the main trends and factors likely to affect the future development, performance and position of the company's business; and

b) information about—

   (i) environmental matters (including the impact of the company's business on the environment),
   (ii) the company's employees, and
   (iii) social and community issues,

including information about any policies of the company in relation to those matters and the effectiveness of those policies; and

c) subject to subsection (11), information about persons with whom the company has contractual or other arrangements which are essential to the business of the company.

   If the review does not contain information of each kind mentioned in paragraphs (b)(i), (ii) and (iii) and (c), it must state which of those kinds of information it does not contain."

d) The financial review should cover risk management objectives and policies in the light of the principal financial risks and uncertainties facing the company, including those relating to leverage, with links to appropriate detail in the footnotes to the balance sheet and cash flow section of the accounts.

e) To the extent that the guidelines at (b) and (c) above are met by existing market disclosures in respect of debt or equity issuance on public markets, this should be explained with the relevant material made accessible on the company's website; and where compliance with these guidelines, in particular in respect of any forward-looking statement, might involve conflict with other regulatory obligations, the reason for non-compliance should similarly be explained on the company website.

5. Form and timing of public reporting by a portfolio company

a) The audited report and accounts should be readily accessible on the company website;

b) The report and accounts should be made available no more than 6 months after the company year-end; and

c) A summary mid-year update giving a brief account of major developments in the company (but not requiring updated accounts) to be placed on the website no more than 3 months after mid-year.

6. Data input by a portfolio company to the industry association

As input for the enhanced role in data collection, processing and analysis to be undertaken on an industry-wide basis by the BVCA, portfolio companies should provide to the BVCA (or to a professional firm acting on its behalf) data for the previous calendar or company accounting year on:

- trading performance, including revenue and operating earnings.
- employment.
- capital structure.
- investment in working and fixed capital and expenditure on research and development.
- such other data as may be requested by the BVCA after due consultation and where this can be made available without imposing material further cost on the company.

7. Communication by a private equity firm

A private equity firm should publish an annual review accessible on its website or ensure regular updating of its website to communicate:

- a description of the way in which the FSA-authorised entity fits into the firm of which it is a part with an indication of the firm's history and investment approach, including investment holding periods, where possible illustrated with case studies.
- a commitment to conform to the guidelines on a comply or explain basis and to promote conformity on the part of the portfolio companies owned by its fund or funds.

- an indication of the leadership of the UK element of the firm, identifying the most senior members of the management or advisory team and confirmation that arrangements are in place to deal appropriately with conflicts of interest, in particular where it has a corporate advisory capability alongside its fiduciary responsibility for management of the fund or funds.
- a description of UK portfolio companies in the private equity firm's portfolio.
- a categorisation of the limited partners in the funds or funds that invest or have a designated capability to invest in companies that would be UK portfolio companies for the purpose of these guidelines, indicating separately a geographic breakdown between UK and overseas sources and a breakdown by type of investor, typically including pension funds, insurance companies, corporate investors, funds of funds, banks, government agencies, endowments of academic and other institutions, private individuals, and others.

8. Reporting to limited partners

In reporting to their limited partners on their interests in existing funds and for incorporation in partnership agreements for new funds, private equity firms should:

a) follow established guidelines such as those published by EVCA (or otherwise provide the coverage set out in such guidelines) for the reporting on and monitoring of existing investments in their funds, as to the frequency and form of reports covering fund reporting, a summary of each investment by the fund, detail of the limited partner's interest in the fund and details of management and other fees attributable to the general partner (a summary of the EVCA guidelines is at Annex E).

b) value investments in their funds using either valuation guidelines published by the International Private Equity and Venture Capital Board (IPEV) or those published by the Private Equity Industry Guidelines Group (PEIGG) or such other standardised guidelines as may be developed in future.

9. Data input by private equity firms to the industry association

Data to be provided on a confidential basis to an accounting firm (or other independent third party) appointed by the BVCA to cover:

a) In respect of the previous calendar year:

   - the amounts raised in funds with a designated capability to invest in UK portfolio companies.
   - acquisitions and disposals of portfolio companies and other UK companies by transaction value.
   - estimates of aggregate fee payments to other financial institutions and for legal, accounting, audit and other advisory services associated with the establishment and management of their funds.
   - such other data as the BVCA may require for the purpose of assessment of performance on an industry-wide basis, for example to capture any material change over time in the terms of trade between general partners and limited partners in their funds.

b) In respect of exits from UK portfolio companies over at least the previous calendar year to support the preparation on an aggregate industry-wide basis of an attribution analysis designed to indicate the major sources of the returns generated by private equity. In broad terms, these are the ingredients in the total return attributable respectively to leverage and financial structuring, to growth in market multiples and market earnings in the relevant industry sector, and to strategic direction and operational management of the business. The relevant data, which will unavoidably involve important subjective assessment, will involve content and format at the outset as in Annex F to the guidelines, to be reviewed and refined as appropriate in the light of initial experience and discussion between the BVCA, with the third-party professional firm engaged for this and related analysis, and the relevant private equity firms.

10. Responsibility at a time of significant strategic change

A private equity firm should commit to ensure timely and effective communication with employees, either directly or through its portfolio company, in particular at the time of a strategic initiative or a transaction involving a portfolio company as soon as confidentiality constraints cease to be applicable. In the event that a portfolio company encounters difficulties that leave the equity with little or no value, the private equity firm should be attentive not only to full discharge of its fiduciary obligation to the limited partners but also to facilitating the process of transition as far as it is practicable to do so.

APPENDIX 4: GUIDANCE ON THE DEFINITION OF A PRIVATE EQUITY FIRM FOR THE PURPOSE OF THE GUIDELINES

A4

The guidance that follows is for the purpose of private equity firms when considering the definition of 'control' which forms part of the definition of a 'private equity firm' in the Guidelines.

New Walker companies

A portfolio company of a private equity firm or firms becomes a Walker company, subject to meeting the other criteria as laid out in the Guidelines, when any one of the following criteria is met:

1. It is evident the private equity firm holds a majority stake (>50% of the ordinary shares) in the underlying business; or

2. If a private equity firm, in its own accounts, discloses that it maintains control of the portfolio company; or

3. A private equity firm has the ability to direct the financial and operating policies of a portfolio company with a view to gaining economic benefits from its activities. Consideration shall include, but not be limited to: management control; board seats; directors indicative of significant influence.

Where more than one private equity firm invests in a portfolio company, those firms will be jointly responsible for ensuring that the portfolio company applies the Guidelines.

Walker company exits

A portfolio company of a private equity firm is eligible for removal from the mandatory Walker population when any one of the following criteria is met:

1. A private equity firm exits via an Initial Public Offering, even if the private equity firm retains a majority stake. The newly listed vehicle will be bound by the reporting requirements mandatory for listed companies; or

2. An event occurs, such as a restructuring, whereby a private equity firm is no longer able to control the financial and operating policies of a portfolio company.

To ensure that the guidelines consider instances where there has been a dilution of ownership post initial acquisition, a private equity firm that holds 20 percent or more of the voting rights following such dilution will be presumed to exercise significant influence over that portfolio company, and will continue to be a Walker company, unless the contrary is shown. This test will not be applied at initial acquisition by a private equity firm, and will only be applied where there is a dilution of ownership post initial acquisition.

The BVCA, with the assistance of Ernst & Young, the firm commissioned to conduct research into the performance of portfolio companies, will discuss specific cases with private equity firms and provide feedback on its findings to the Guidelines Monitoring Group for its consideration.

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APPENDIX 5: RECOMMENDATIONS FOR INITIATIVE BY THE INDUSTRY ASSOCIATION

These recommendations for initiative by the BVCA cover:

- the BVCA's industry-wide reporting and intelligence function;
- the establishment of a guidelines review and monitoring capability;
- for engagement with major investors and their associated entities or affiliates which, though "private equity-like", do not require authorisation by the FSA; and
- and for engagement in discussion with relevant private equity groupings outside the UK in the development of common standards, in particular in respect of fund performance.

A. Reporting and intelligence

1. The BVCA should boost significantly its capability for the collection, processing and analysis of data submitted by private equity firms and portfolio companies. While the main focus of this report is, as indicated and defined at the outset, on the activities of large buyout firms and their portfolio companies, the BVCA's reporting and intelligence function covers the whole of the private equity industry, including venture and development capital. The recommendation here is that this overall capability should be boosted so that the BVCA becomes the recognised authoritative source of intelligence and analysis both of larger-scale and of venture and development capital private equity business based in the UK and a centre of excellence for the whole industry. It is recommended that, alongside the strengthening of the executive that is already in train, the BVCA should retain the services on a fee-paying basis of one or more professional firms to assist in this task as a means of quality input and assurance, as also for the assurance of confidentiality in respect of data that is provided exclusively for incorporation in an aggregation process.

2. This recommended enlargement and strengthening in the BVCA's data gathering, analytical and reporting capability will call for materially increased data input from portfolio companies covered by the enhanced reporting guidelines and from the private equity firms investing in those companies. Responsibility for the sourcing of specific data flows respectively as between private equity firms and portfolio companies should be determined by the BVCA on the basis of prior consultation, to include for the previous calendar year or portfolio company reporting period:
   - amounts raised in funds with designated scope to invest in portfolio companies in the UK.
   - categorisation of limited partners by geography and by type.
   - scale of acquisitions of UK portfolio companies by transaction size at the time of acquisition.
   - trading performance of portfolio companies in terms of revenues and operating earnings.
   - estimates of levels and changes in employment, new capital investment and research and development expenditure by portfolio companies.
   - aggregate fee payments by private equity firms and portfolio companies to other financial institutions and for legal, accounting and other advisory services.
   - such other data collection and analysis as may be required in support of a comprehensive evidence-based assessment capability on the performance and economic impact of private equity in the UK, with particular reference to employment, productivity, investment and innovation.

3. Data should be collected from private equity firms to support attribution analysis in respect of exits in at least the previous calendar year to provide on an industry wide basis annually an assessment of percentages of total return over the holding period attributable to:
    - leverage and financial structuring.
    - growth in market multiples and market earnings in the relevant industry sector.
    - strategic direction and operational management of the business.
4. It is recommended that the BVCA should publish an enlarged version of its economic impact and associated surveys to cover both the industry overall and giving separate data and analyses for
    - larger-scale private equity business to present an authoritative evidence based account of the performance of the industry in the UK over the holding periods of portfolio companies and of the subsequent performance of former portfolio companies where exit by the fund or funds is to the public market by means of an IPO process.
    - venture and development capital, which will call for an increase in the sample sizes for data collection.

B. Guidelines review and monitoring

For the purpose of ensuring that the guidelines for disclosure by portfolio companies and private equity firms remain appropriate in the light of changing conditions and to monitor conformity with the guidelines, the BVCA should establish a Guidelines Review and Monitoring Group (the "Group") with the following elements:

1. Terms of reference of the Group:
    a) to keep the guidelines under review and to make recommendations for changes when necessary to be implemented by the BVCA after due consultation to ensure that the Guidelines remain appropriate in changing market and industry circumstances.
    b) to review the extent of conformity with the guidelines, through compliance or explanation, on an ongoing basis.
    c) to publish a brief annual report on the work of the Group.
2. Composition of the Group:
    a) a Chairman with substantial experience but independent of private equity.
    b) total size of 5 to include 2 executives of GPs or advisers to funds investing in portfolio companies covered by the Guidelines.
    c) 2 independent members additionally to the Chairman with substantial professional or business experience.
    d) thus a majority of independents.
3. Appointment of the Group:
    a) to be appointed by the Chairman and Council of the BVCA on the advice of a Nominations Committee of the Council.
    b) the Chairman of the Group to have a term of 3 years with provision for appropriate rotation of other members to ensure continuity.
    c) the Chairman and members to be paid an appropriate fee.

4. Operations of the Group:

The guidelines review and monitoring processes under paragraph 1 (a) and (b) above to be supported by an accounting firm appointed by and under the direction of the Group:

a) undertaking data processing and assessment on the basis of initial self assessment on conformity by private equity firms and portfolio companies.

b) appropriate spot-check sampling.

c) funded under budget provisions agreed between the Group and the Chairman and Council of the BVCA.

5. Conformity with the Guidelines:

On the basis that BVCA member firms commit to conform to the guidelines as a condition of membership, the Group would discuss in confidence with a private equity firm or portfolio company any case of non-conformity which it considered to be material. In the absence of commitment to early remedial action, the matter would be for discussion and determination of appropriate action between the Chairman of the Group and the Chairman of the BVCA and might, after due process, involve public disclosure and termination of membership of the BVCA.

C. Engagement with "private equity-like" entities

1. The BVCA should identify entities whose business, though not requiring authorisation by the FSA, is similar to that of the private equity firms covered by these guidelines, to include in particular the UK affiliates of sovereign wealth funds and other major principal or proprietary investors whose funding is not dependent on limited partners.

2. The BVCA should initiate discussion with such groups (where appropriate, in the case of sovereign wealth funds, after consultation with government) with the purpose of enlisting their voluntary undertaking to conform to the Guidelines, on the basis that this will be in their own interest as a manifest of their commitment to established good practice as to disclosure and transparency in such business conducted in the UK.

3. The BVCA is recommended to create an appropriate category of membership to enable such entities to be associated appropriately with the activities of the association.

D. Fund performance measurement.

The BVCA should participate proactively with private equity trade associations beyond the UK and with representatives of the domestic and international limited partner community to develop a methodology for the content and presentation of fund performance information with particular relevance for prospective future limited partners as well as those in existing funds. The Global Investment Performance Standards ("GIPS") prepared under the auspices of the CFA Institute represent a possible approach on which the BVCA should engage during the impending five year review of GIPS. Any standard to emerge from this process should be incorporated in the guidelines in due course.

APPENDIX 6: EXTRACT FROM COMPANIES ACT, 2006

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Section 417 Contents of directors' report: business review

1. Unless the company is subject to the small companies' regime, the directors' report must contain a business review.
2. The purpose of the business review is to inform members of the company and help them assess how the directors have performed their duty under section 172 to promote the success of the company.
3. The business review must contain:
   a) a fair review of the company's business, and
   b) a description of the principal risks and uncertainties facing the company.
4. The review required is a balanced and comprehensive analysis of:
   a) the development and performance of the company's business during the financial year, and
   b) the position of the company's business at the end of that year, consistent with the size and complexity of the business.
5. In the case of a quoted company the business review must, to the extent necessary for an understanding of the development, performance or position of the company's business, include:
   a) the main trends and factors likely to affect the future development, performance and position of the company's business; and
   b) information about:
      i) environmental matters,
      ii) the company's employees, and
      iii) social and community issues, including information about any policies of the company in relation to those matters and the effectiveness of those policies; and
   c) subject to subsection 11), information about persons with whom the company has contractual or other arrangements which are essential to the business of the company.

   If the review does not contain information of each kind mentioned in paragraphs b)i), ii) and iii) and c), it must state which of those kinds of information it does not contain.
6. The review must, to the extent necessary for an understanding of the development, performance or position of the company's business, include:
   a) analysis using financial key performance indicators, and
   b) where appropriate, analysis using other key performance indicators, including information relating to environmental matters and employee matters.

   "Key performance indicators" means factors by reference to which the development, performance or position of the company's business can be measured effectively.
7. Where a company qualifies as medium-sized in relation to a financial year see sections 465 to 467), the directors' report for the year need not comply with the requirements of subsection 6) so far as they relate to non-financial information.
8. The review must, where appropriate, include references to, and additional explanations of, amounts included in the company's annual accounts.
9. In relation to a group directors' report this section has effect as if the references to the company were references to the undertakings included in the consolidation.
10. Nothing in this section requires the disclosure of information about impending developments or matters in the course of negotiation if the disclosure would, in the opinion of the directors, be seriously prejudicial to the interests of the company.
11. Nothing in subsection 5) c) requires the disclosure of information about a person if the disclosure would, in the opinion of the directors, be seriously prejudicial to that person and contrary to the public interest.

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