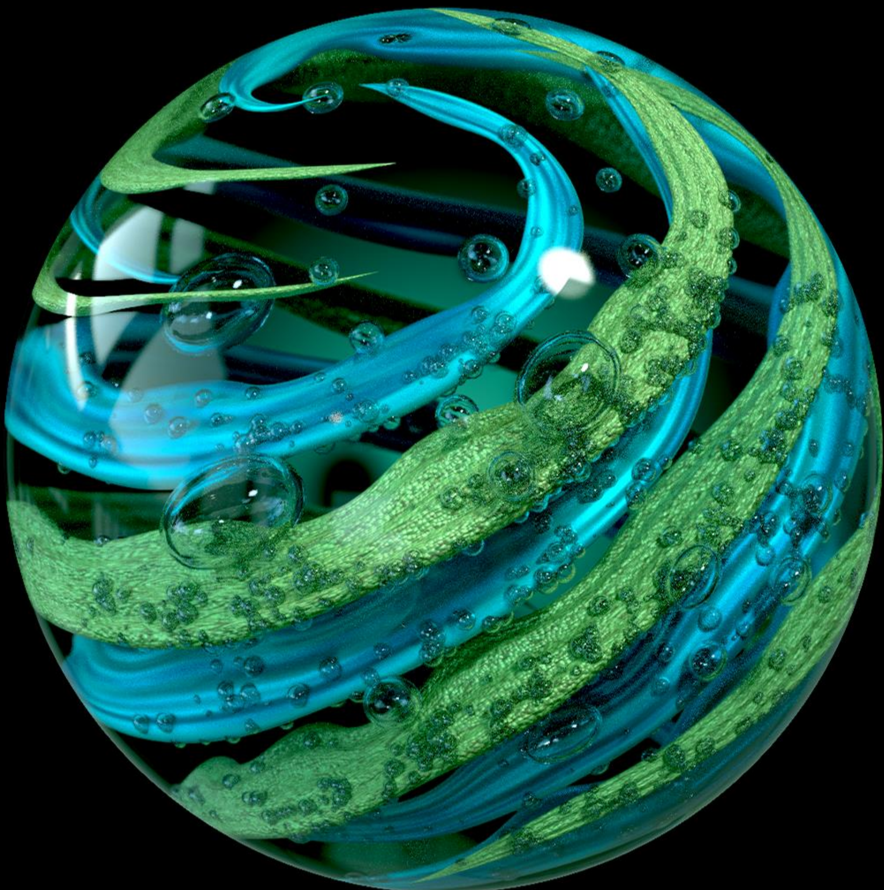
Deloitte.

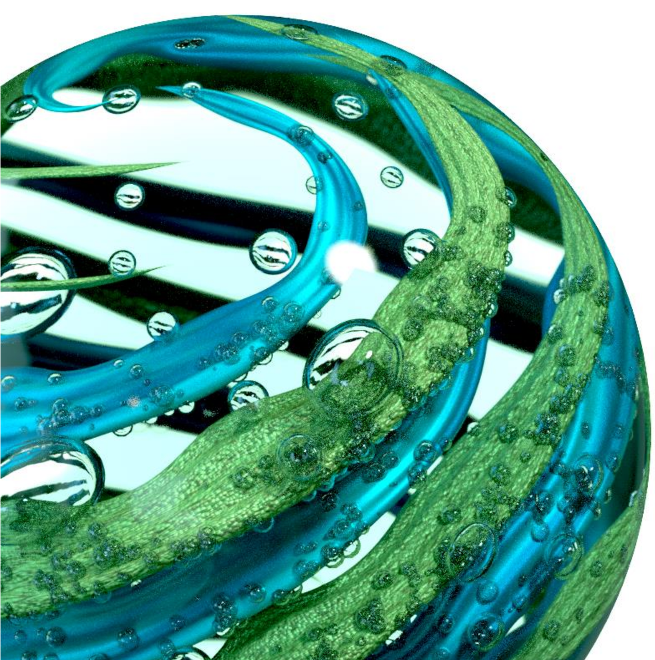


Worth It?
Delivering Sustainable Alpha in Private Equity

May, 2024

MAKING AN IMPACT THAT MATTERS since 1845

Contents



01 The past – was it true glory?

Has private equity, the burgeoning industry now managing about $2.49 Tn of "dry powder"[1], been creating "alpha" to its limited investors, truly contributing to make them comparatively wealthier?

Alongside their general partners, who have more certainly benefitted from the "2 – 20" golden rule – a strong incentive for them to outperform, but also to take higher and higher risks as well? "Flipping a coin and destroying the world, if you get tails, as long as the world improves by more than double, if it gets heads", in the words of former Crypto King and CEO of FTX Sam Bankman-Fried[2]. More importantly, is private equity positioned to generate further 'alpha' in the future, as the industry is rebounding and expected to double its Assets Under Management (AUM) between 2021 and 2026, reaching the $26 trillion watermark, as predicted by Preqin[3]? In short, have the many spectacular investments and the few disastrous ones reported in the media over the past few decades, been generating, on a weighted average basis, excess returns earned on an investment above the benchmark return, when adjusted for risk? In fact, the best "alternative" asset managers (i.e. the general managers of private equity funds, first and foremostly) have a mission to generate "alpha" by adding some diversification to their portfolios to reduce unsystematic risk. Because of that, they can rationally justify their asymmetric appropriation of 20% of the gains achieved above the hurdle rate (heads), even if they do not lose anything in case of a bad outcome (tails), and they get 2% of the AUM anyway and no matter what.

If we take the risk weighted returns generated by public, regulated stock-markets (e.g. the returns of their Indexes, such as the Standard & Poors 500 or the Euronext 100) rather than the traditional 7-8% indicated in their investment policies ("no-matter-what-the inflation-is") as their true hurdle rates to compare and see if they create alpha, the answer may not be as clear-cut as expected. This is partly due to the relative opacity of this industry – spurred on by its limited regulation and light oversight. In truth, as indicated in Exhibit 1 – Private Equity, True Glory?, academic and professional research is mixed and their results appear significantly influenced by at least a couple of reasons, and counting:

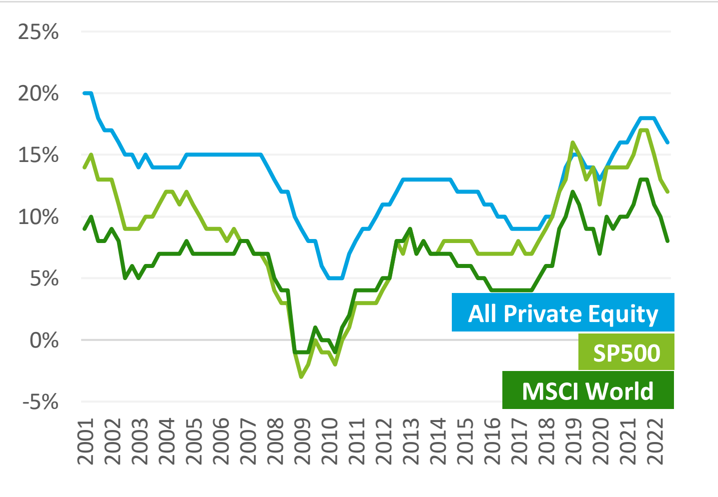
- Firstly, the returns to the limited investors must be calculated net of management fees (the 2%) and performance fees (the 20% "carried interest" on any gain realized over and above the hurdle rate), and taking into consideration the hidden opportunity cost of keeping the committed (but not yet invested) capital quickly available for the next capital call (IRR of investments are calculated based on the cash invested and divested, that are called "just in time");
- Secondly, returns – as stated in the definition of "alpha" – must be risk-weighted, e.g., using their standard deviation as a proxy for Value at Risk. It is then fortunate for the industry that the volatility of a stock-market Index is usually calculated with daily data points (and with "marked to market" values) based on highly liquid transaction markets, whereas that of Private Equity is at best calculated on a quarterly basis (and with "marked to model" NAV fair values). Finally, should Private Equity confirm its "gross alpha" creation – as its detractors argue - it should be netted against an "illiquidity discount"

[1] S&P Global - Private equity dry powder swells to record high amid sluggish dealmaking, 20 July, 2023
[2] According to Caroline Ellison testification in Court and as report by the Financial Times and other media.
[3] Financial Times – Alternative investments lose steam as fundraising slows down, 29 August 2023

that investors should consider when committing their savings for long periods (on average 7-9 years) and little chances to get them back earlier, in case of need, with a 20% plus discount and no certainty on the "if and when" of the cash-in (liquidity facilities and secondary markets are currently providing these liquidity options).

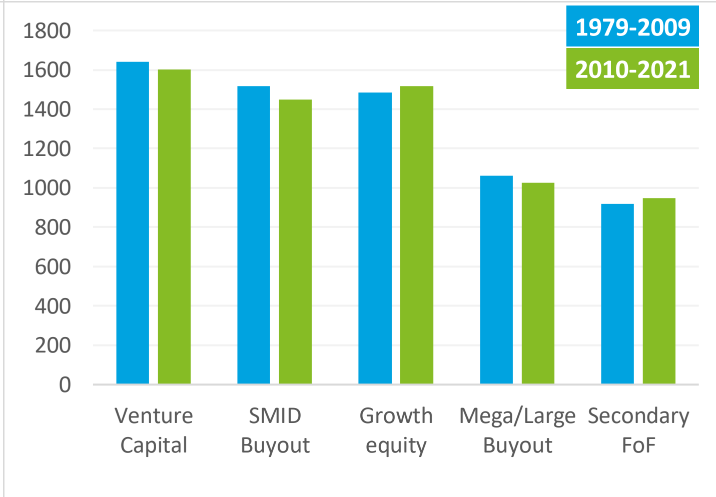
Exhibit 1: Private Equity, True Glory?

ALL PRIVATE EQUITY 10-YEAR ROLLING TIME WEIGHTED RETURNS (TWRS)



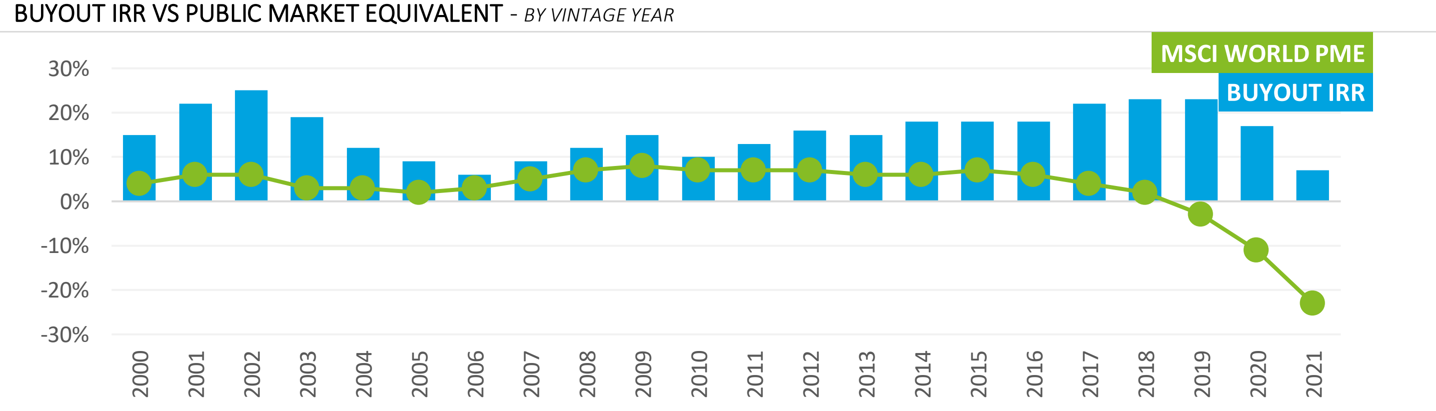
Source: Reprocessing of data from Hamilton Lane Data via Cobalt, Bloomberg (January 2023)

DISPERSION OF RETURNS BY STRATEGY (GLOBAL)
vintage year groupings ordered by l/t spread of returns



Source: Reprocessing of data from Hamilton Lane Data via Cobalt (January 2024)

BUYOUT IRR VS PUBLIC MARKET EQUIVALENT - *BY VINTAGE YEAR*



Source: Reprocessing of data from Hamilton Lane Data via Cobalt, Bloomberg (January 2023)

02 At the (efficient) frontier?

Still, according to our own research, as shown in Exhibit 2 – Portfolios' Frontier: Efficient? there is value in the risk adjusted performance of Private Equity, if we consider the past, ex-post returns in Europe realized by over 400 funds in the last decade, not to mention the diversification that they certainly add to investment portfolios that, for the average European savers (be it an institutional Pension Fund, an Insurance Company, an Endowment or an Household) are heavily skewed on Government Bonds, Real Estate (as used asset) and with some limited exposure to stock-markets. In short, according to our analysis, Private Equity appears to have overperformed strongly any other asset class and therefore created "alpha" (to be split between limited and general partners and not considering any "illiquidity discount", but also not considering any "diversification premium"). Given the low weight invested by, for example, Italian savers (less than 1% for private banking clients), would then be worth for savers to consider the Private Equity option a bit more and "flip its coin" more often – no question asked?

Exhibit 2 – Portfolios' Frontier: Efficient?

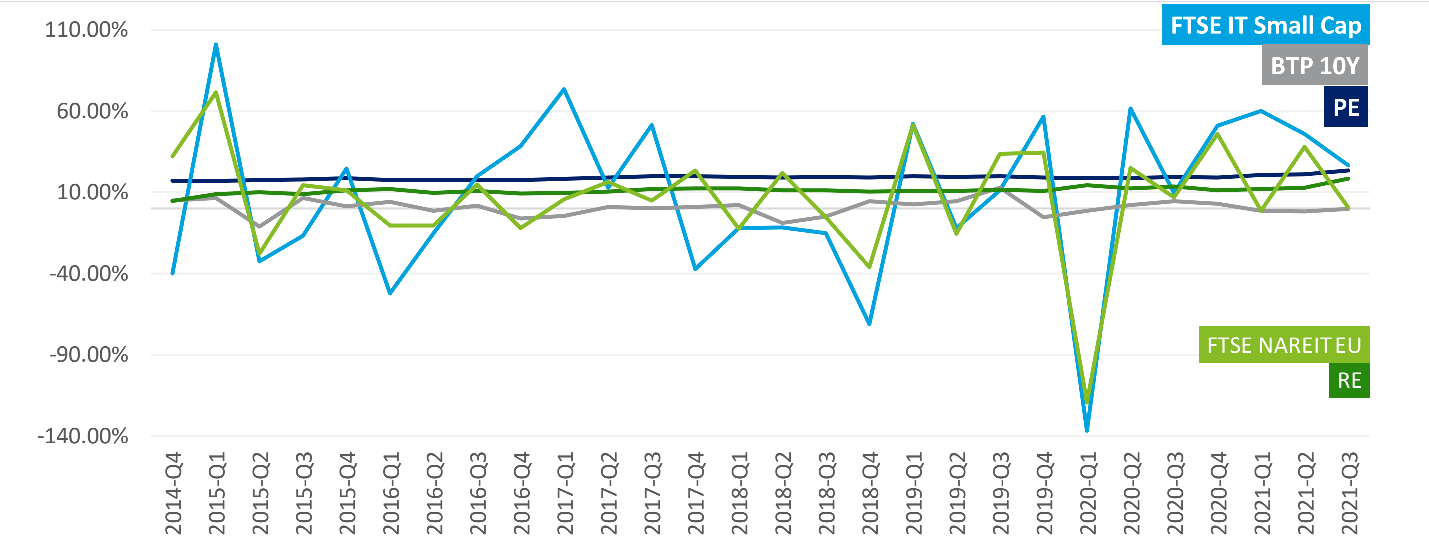
PERFORMANCE AND RISK OF PRIVATE MARKET FUNDS VS MARKET INDICES (2014 Q4 – 2021 Q3)

Private Equity Funds		Real Estate Funds	
N. of European PE Funds	400	N. of European PE Funds	111
Average Annual Return	18.9%	Average Annual Return	11.2%
Standard Deviation	20.6%	Standard Deviation	13.5%
VaR (confidence level 97.5%)	-7.1%	VaR (confidence level 97.5%)	-17.2%
FTSE Italy Small Cap Index		FTSE NAREIT Europe Index	
Average Annual Return	8.7%	Average Annual Return	8.1%
Standard Deviation	50.7%	Standard Deviation	34.9%
VaR (confidence level 97.5%)	-34.9%	VaR (confidence level 97.5%)	-35.2%

Source: "Investire bene in Italia" by Claudio Scardovi - EGEA 2023

RISK/RETURN ANALYSIS FOR EUROPEAN PRIVATE MARKETS FUNDS (2014 Q4 – 2021 Q3)

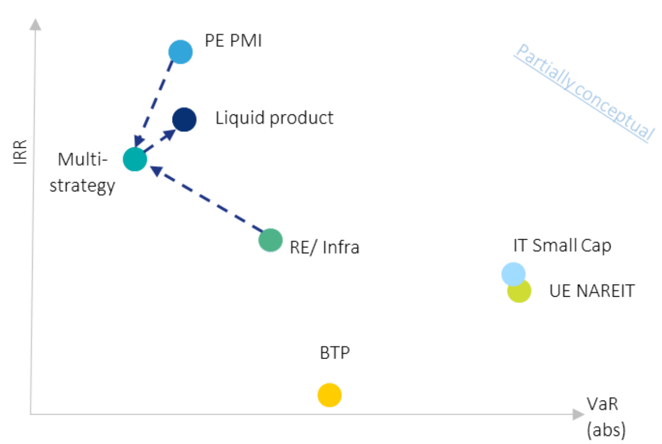
Analysis on 400 European PE Funds and 110 European RE Funds



Quarterly IRR 2014 Q4 – 2021 Q3	PE	FTSE IT Small Cap	RE	FTSE NAREIT EU	BTP10Y
IRR	19%	9%	11%	8%	2%
VAR (97.5%)	-7%	-35%	-17%	-35%	-22%
Alpha		10%		3%	

Source: "Investire bene in Italia" by Claudio Scardovi – EGEA 2023

EFFICIENT FRONTIER AND OPTIMIZATION OPPORTUNITIES CONTRIBUTED BY PRIVATE MARKETS



Source: "Investire bene in Italia" by Claudio Scardovi - EGEA 2023

MARKET MULTIPLES OF LISTED ASSET MANAGEMENT COMPANIES (APR-2024)

Investment Company	EBITDA Mult.	P/E Mult.	Revenues Mult.
3i Group	3,7x	6,6x	3,6x
Apollo	9,6x	14,8x	1,9x
BlackRock	16,3x	19,1x	8,0x
Blackstone	50,8x	26,2x	22,6X
Bridgepoint	10,6x	15,2x	26,3x
Carlyle Group	n/a	11,9x	11,9x
EQT	28,0x	25,4x	15,8x
KKR & Co.	71,0x	21,1x	9,4x

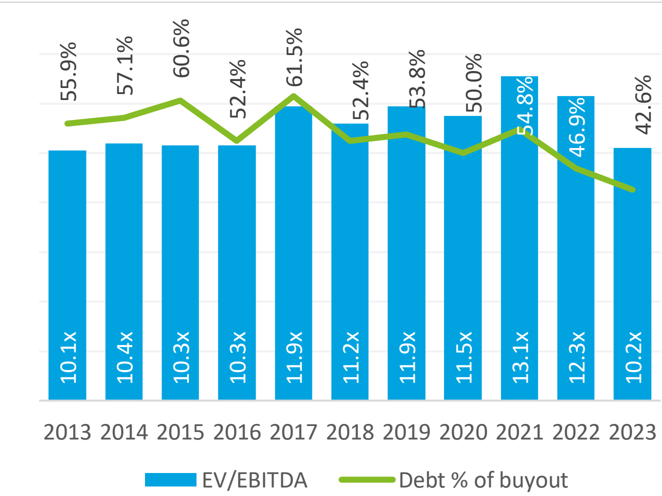
Source: Refinitiv (Apr. 2024)

Assuming Private Equity has indeed overperformed in the past, it is important to analyze the type of "alpha" it generated, and the methods used. The absolute size of this "alpha" can vary significantly, and the ways it has been achieved may not always reflect sustainable value creation. Academic and professional research on "relative alpha" attribution, using simple regression analysis, indicates that this outperformance was primarily driven by a few key factors:

- Adding leverage, using the company as collateral. This can create market value either because targets were underleveraged, or – more likely - because they were already so, with the further leverage added migrating de facto value from bank lenders to equity limited investors.
- Achieving financial synergies by M&A (a larger company has a better chance to be invested and at higher multiples. This is partly due to the hyper-scaled size effects of the replicating portfolios invested by passive funds that tend to buy whatever falls into the market Index).
- Addressing cost synergies, cost reductions in areas such as procurement and HR, along with decreased amortization from new capital expenditures, can temporarily boost EBITDA. However, this approach can lead to a rebound effect in the mid-to-long term.
- Pursuing distinctive competitive advantages, consolidating players across the value chain can lead to quasi-dominant positions, allowing for the renegotiation of contractual obligations with stakeholders. This can extract additional value but may also raise concerns about fair competition.

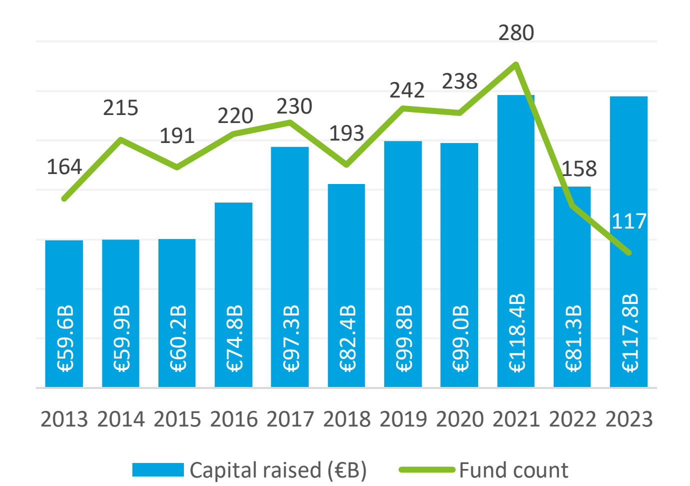
Exhibit 3 – EU Private Equity - Investment activities

MEDIAN PE BUYOUT EV/EBITDA MULTIPLE AND AVERAGE SHARE OF DEBT IN BUYOUTS

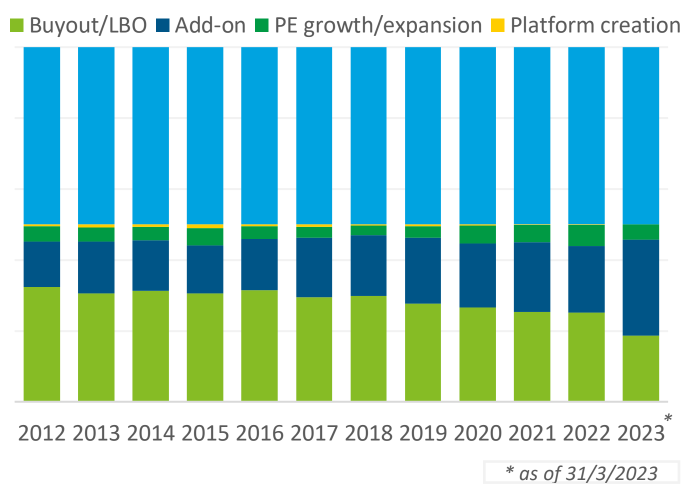
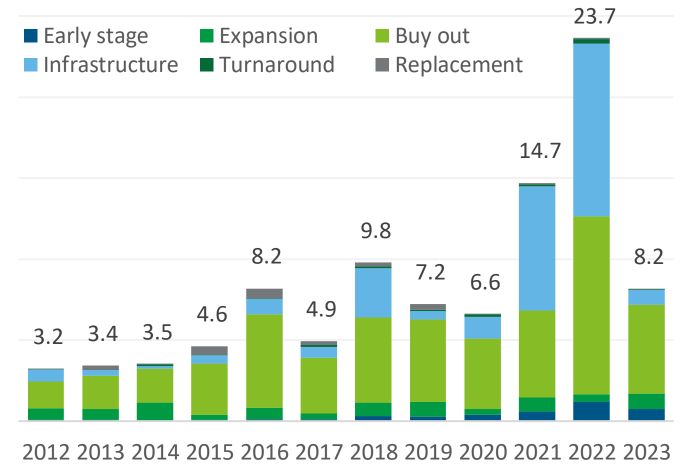


Source: PitchBook Data, Inc.

PRIVATE EQUITY FUNDRAISING ACTIVITY



Source: PitchBook Data, Inc.

EUROPE PE DEAL VALUE (€BN) BY TYPE	ITALY PE DEAL VALUE (€ BN) BY TYPE
	
Source: PitchBook Data, Inc. - The 2023 Q1 European PE Breakdown– data as of March, 2023	Source: Reprocessing of data from AIFI - Il mercato italiano del Private Equity e del Venture Capital - 2023, 2018, 2016

03 The future: are there reasons to worry?

In any case, as often remarked by academic research and by regulatory documents (such as the hardly-ever-read-by-anybody KID – Key Information Document), "future, positive performances are not warranted by past ones". Not only the longest streak of "heads" does not increase the future probability of getting another one. But also, a number of exogenous factors may be suggesting that the "golden age" of Private Equity's "super-returns" (SuperReturn being the name of one of the most famous jamboree events of the industry) is coming to an end? In fact, several reasons suggest this:

- As the amount of "dry powder" keeps growing, with countless new Private Equity funds popping out, and the big American ones such as Blackstone, Apollo, KKR, Carlyle (but also the big European as EQT and CVC) becoming bigger and bigger, a first question relates to the competition in the industry. Is now "too much capital chasing too few assets?". And is the industry ripe for a consolidation and polarization with few big, generalist winners and a few remaining super-niche specialists? In fact, based on the following Exhibit – Reasons to worry? Or optimism to gain? even assuming double digit growth in private markets (including private equity but also real estate, infrastructure and natural capital), the investable universe appears quite large, suggesting a long run ahead for this asset class. A well-structured consolidation among main players could then strengthen the overall industry and benefit investors as well.
- Is then the industry sheer size becoming too powerful and noticeable enough to suggest a heavier regulation with consequential supervisory burdens? Is it now too big to deliver "alpha" (by mathematical definition, a larger and larger asset class approaches the impossibility of delivering "alpha" as it becomes an essential part of the market "beta" – i.e. its relative contribution to the weighted average of all investable assets classes grows so much that whatever "super return" is able to achieve in absolute terms it becomes "beta" in relative ones. Also, as Private Equity bets rise in size they become more difficult to be deployed as simple, financial arbitrage opportunities. In fact, some deeper regulation and wider supervision could help the industry in improving its transparency and fairness to the limited investors, opening the door to its much awaited "democratization" (i.e. the opportunity for retail investors to access this, so far, exclusive asset class). Finally, with its still quite low weight relative to the investable funds and assets (Exhibit), it appears to be ample room to deliver "alpha" to end investors.
- As the macroeconomic environment has been changing radically (with less debt available at a much higher cost) and the geopolitical context becomes more uncertain and therefore risky (from deglobalization and decoupling trends, to regional wars potentially expanding as global ones, to the threats posed by climate change), are there enough good opportunities to make up for the increase opportunity cost of capital? Would then the largely untested, never fully proved, Private Equity value proposition of "delivering alpha in good and bad times" be convincing enough to keep attracting new capital and best talents, which stand as the high-octane energy required for the industry to grow? In fact, the lack and higher cost of debt has become the latest at-scale opportunity for Private Equity, that extended and diversified their product sets into direct credit. And it appears that Private Equity do deliver better "alpha" during testing times, when public markets tend to malfunction and overreact to negative news.
- Ultimately, assuming some "alpha" was indeed created in the past by Private Equity, which kind of value was that and how much sustainable? How much of this was then "value creation" or else just "migration" - from lenders to super-wealthy equity investors, given the typical over-

leverage of the industry and its asymmetric pay off; and from workers to super-rich managers and investors, given the typical over-reliance of the industry on cost cutting aimed at boosting the exit EBITDA – as exit transaction prices are often based on an EBITDA multiple calculation? Even assuming the economic value created was sustainable, has Private Equity strategy also being pursuing other values, i.e., social and environmental - aimed at delivering psycho-physical wellbeing to a large number of people – and not just stash of cash to the usual privileged 1%? And was ESG lived just an annoying fashion, already the subject of backlash and to get away with asap? In fact, whilst future worries are not necessarily implying undemanding "alpha" performances, a significant opportunity for Private Equity to pursue sustainable economic values creation and other sustainability goals is long overdue and could be fast approaching.

Exhibit 4 – Reasons to worry? Or optimism to gain?

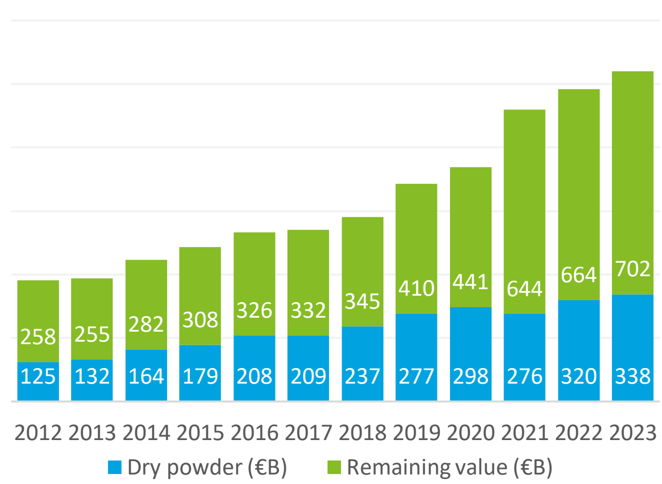
AUM AND MARKET CAPITALIZATION

Investment Company	AUM	Market Cap
BlackRock	10 009	119
Blackstone	1 040	159
Apollo Global Management	651	65
KKR & Co.	553*	89
Carlyle Group	426	17
EQT	141	40
Bridgepoint	52	3
3i Group	8	35

Source: Refinitiv, data as of April 8th, 2024

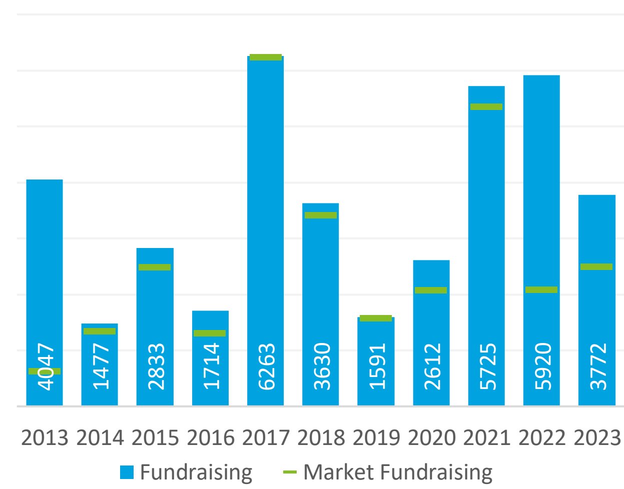
* KKR AUM as of end of 2023 (from KKR Investor Day, April 2024)

EUROPEAN PE AUM (€B)



Source: PitchBook Data, Inc.

FUNDRAISING EVOLUTION IN ITALY (€ MLN)



Source: Reprocessing of data from AIFI – Il mercato Italiano del private equity e venture capital – 2017, 2018 and 2023

In short, for the Private Equity industry, whilst past performances were not always unquestionable glory, and the future looks full of sensible worries, there are plenty of reasons to believe in it as a strong, secular turbine that can ignite growth, innovation, wealth, and wellbeing.

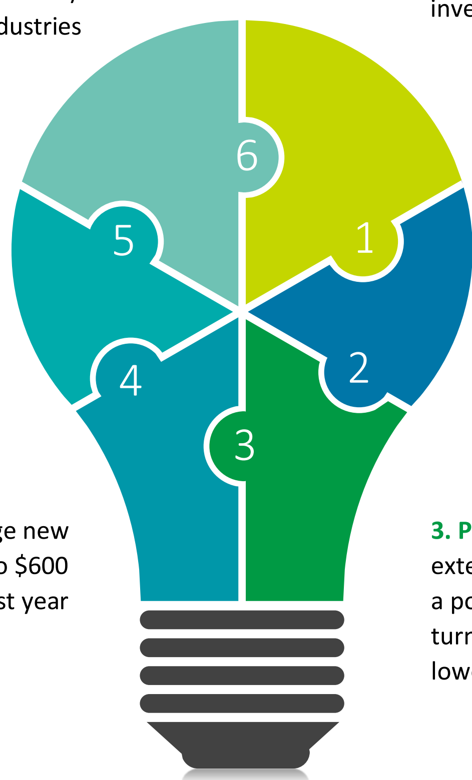
Certainly, new structural factors are posing new questions and require new solutions, for the players that want to qualify as winners and deliver true "alpha" along with sustainable values creation.

In short, to paraphrase Gustave Flaubert, the past may be constraining us, and our future is worrying – that's why, to keep Private Equity becoming more and more successful, and a real force for good, we need to live its present and act now, transforming the industry to avoid the otherwise unavoidable levelling of its performances, and with a required degree of optimism. Eventually, as the saying goes "pessimist may look smarter, but optimists make money, in the long run". There has never been a better moment to be so in Private Equity.

LONG TERM RATIONALE AND SOLUTIONS

6. STRANDED ASSETS AND RENEWABLES: still huge financing gap to cover, with equity needed to fund mid-long-term transformation of entire asset classes/ industries

1. STRONG SECULAR FUNDAMENTALS: over €230 Tn of investable financial resources versus current €13 Tn (ideal allocation of wealth invested of 20%-40% - large gap to cover)



5. TRANSPARENCY AND INTEGRITY-RELATED: updates from SEC regulations: strengthen the protection of retail investors and make the overall industry more resilient

2. DEMOCRATIZATION THROUGH RETAILIZATION: involvement of private and retail investors and in partnership with financial Institutions

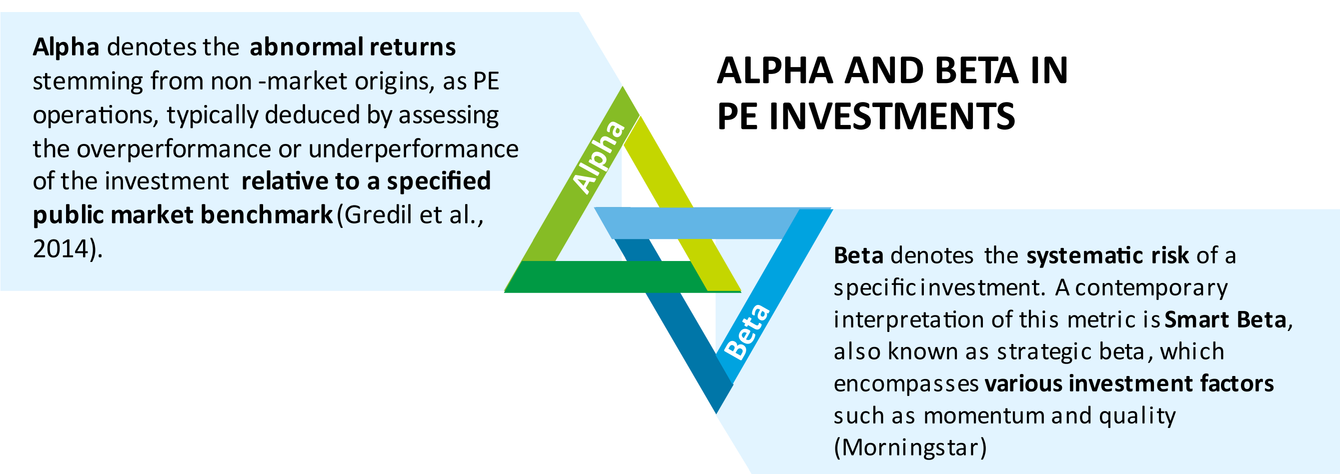
4. CONSOLIDATION: average new closing stage fund size equal to $600 million, up $200 million from last year

3. POSITIVE START OF A NEW CYCLE: externalities on the markets resulting from a potential long wave of restructurings and turnarounds (new investment cycle with lower price point)

04 Designing a “smart Beta” strategy in Private Equity

Based on our analysis, Private Equity has indeed generated “alpha” in the past. However, this performance has not been unanimous and has often relied on strategies such as leveraging information asymmetry, traditional financial techniques, and operating in relatively undeveloped markets with limited competition Consequently, much of the “alpha” embedded in its current business model may face erosion due to evolving macroeconomic and geopolitical conditions, which introduce unprecedented challenges and headwinds. The base case for Private Equity in the next decade is therefore one of a “great levelling trap” - with the “alpha” Holy Grail harder and harder to get. A “betization” meta trend could characterize the world of asset management, as passive investments become more and more dominant and driven by Indexed – hence, with largest companies included in them getting bigger, as they are invested almost by default; and the SME remaining out of the big money flows and sub-scale, almost as a consequence. The investment selection of best SME, and their active management once invested, is in fact a crucial function performed by Private Equity, as it ensures that a Darwinian “survival of the fittest” contributes to a market-based mechanism of optimal allocation of any kind of scarce resource – capital included and to a Schumpeterian “destructive innovation” that follows, readjusting dynamically the composition of the Indexes. As this applies to companies, as well as sectors and Countries, we argue that a significant opportunity to overperform in the future will come from “smart beta” strategic asset allocation, based on emerging “competitive invariances” coming out of meta (and not meme) investment themes.

Exhibit 5 - Meta (Not Meme) Investment Themes to Fight the Betization of the Industry



MEME

Refers to an **investment strategy** that follows what concepts **spread rapidly among industry professionals.** It may encapsulate shared insights, humor, or cultural references within the **peers of private equity community.**

META

Refers to an **investment strategy** that follows **overarching trends** that influence the industry as a whole. These meta themes may include broader economic factors, technological advancements, shifts in consumer behavior, or global market dynamics **that impact the overall landscape of private equity.**

META THEMES

01 **TECHNOLOGICAL DISRUPTION:** Innovative technologies coming to maturity and leading to breakthroughs in value creation across industries and sectors

02 **CONSUMER TRENDS AND PREFERENCES:** Structural changes in demand and supply acting as catalysts for new competition dynamics across value chains

03 **CULTURAL AND DEMOGRAPHIC SHIFTS:** Other structural changes in the fabric of society (e.g. demographics, urbanization, social behaviors)

04 **MACROECONOMIC DISLOCATIONS:** and other exogenous risk factors leading to market dislocations and value migrations

05 **REGULATORY CHANGES:** Geopolitical and industrial policies changes impacting on global and local market structures and trade/ finance corridors

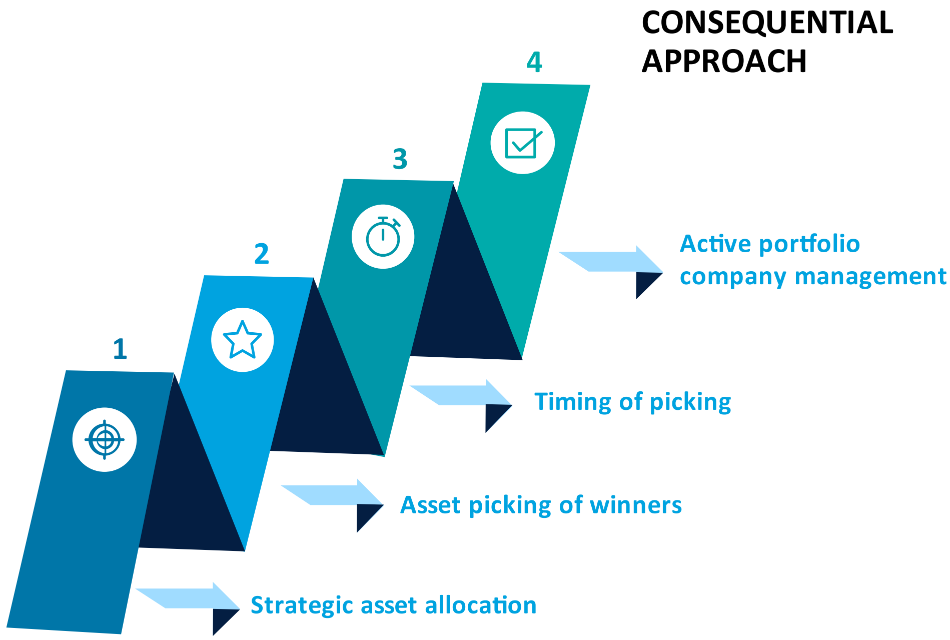
06 **LONG-TERM ECONOMIC RESILIENCE:** Existential challenges ahead linked to sustainability and their impact on short-mid-long term economic value creation

07 **CYBERSECURITY AND DATA PRIVACY:** Recognize the increasing importance of cybersecurity and data privacy in an increasingly digital world

08 **EDUCATION AND LIFELONG LEARNING:** Explore opportunities in the education sector, including online learning platforms, vocational training and lifelong learning initiatives

09 **DIVERSITY AND INCLUSION:** fostering innovation and resilience within industries, enhancing corporate governance, and driving sustainable economic growth

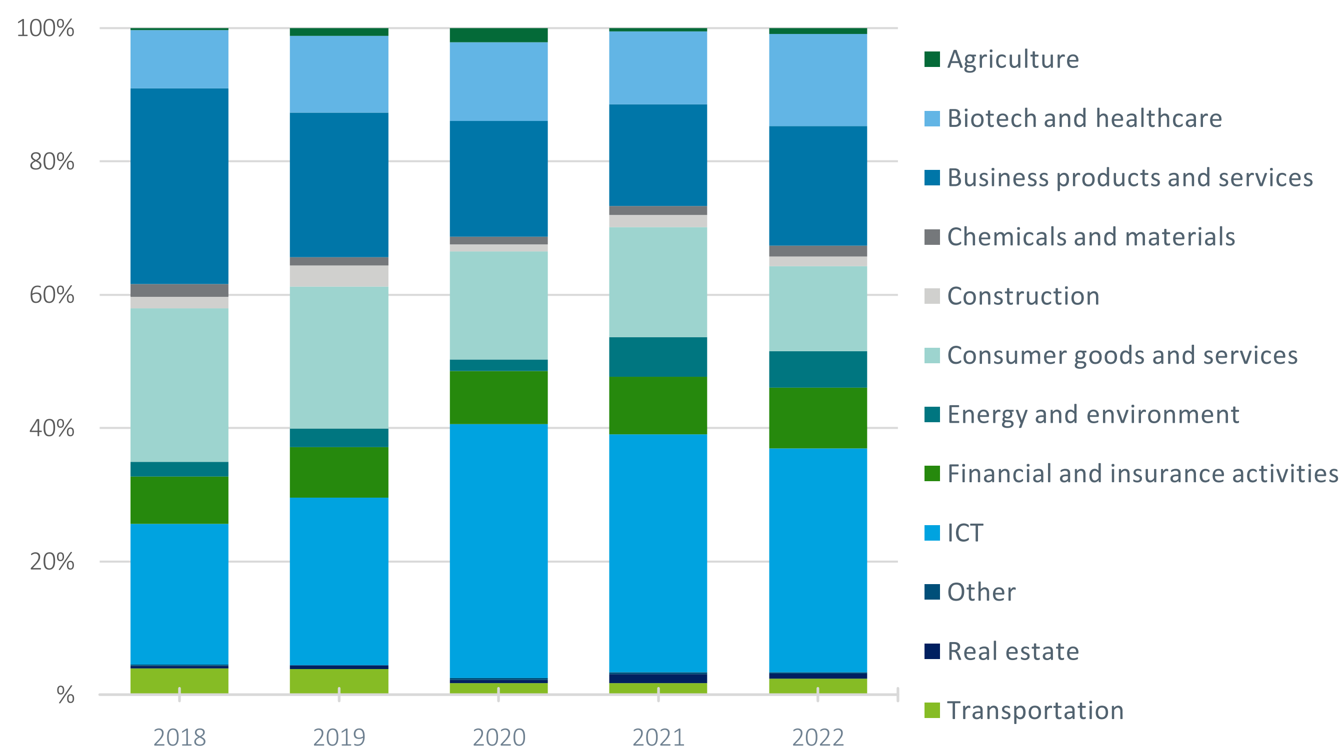
10 **HEALTH & WELLNESS:** consider the growing focus on health and wellness, including trends in preventive healthcare, personalized medicine, and wellness tourism



That is, for generalist Private Equity players, rightly positioning on the meta trends and investment thesis that, on average, will create more value in the future (and regardless of the dispersion between winners and losers) will become a more significant, and better appreciated, competitive advantage. Positioning into "electric-batteries vehicles" and out of "combustion-engine vehicles", within the car manufacturing sector, could be a good example of a "smart beta" positioning that could have been done in the past, as "alpha" creation was not assured anyway (many producer of the former went bust, and a few of the latter are still doing fine and progressively reconverting), but it could made easier to get successfully through the successive asset and time pickings, leading to an performing investment. A greater focus on strategic asset allocation and on the selection of long-term meta investment themes – today almost absent in mid-market Private Equity – not only could drive "smart beta" positioning, making sure the Index is beaten, albeit just by a bit, but almost certainly; but could also decrease the opportunity cost of capital, spurring the chances to create value. We can then define "smart beta" as the strategic, selective positioning targeted by design by "alpha" platforms as they try to anticipate economic cycles and value migrations that are going to happen across sectors, sub-sectors, phases of the value chain, technologies, and geographies.

As beta aims to maximize diversification (and can be easily invested through Indexes by passive funds, but only including companies already traded in stock-markets), "smart beta" can offer further diversification coming from private SME and with a twist – repositioning the asset allocation in advance of new value creation or migration waves. By lowering its overall risk profile, a "smart beta" approach could also make Private Equity more easily investable by retail savers and hence more democratic and inclusive. It could also be used as a counterargument to its "illiquidity discount", as a more diversified and better planned Private Equity "smart Beta" investment portfolio could be more easily invested by secondary funds, building their own, larger "smart beta" portfolio (as sum of shares of many, independent funds), or even floated on the stock-market.

MID-MARKET FUND INVESTMENTS IN EUROPE



Source: Invest Europe, Mid-Market Private Equity - Europe's Engine for Growth (October, 2023)

05 Developing an “alpha platform” in Private Equity

In the last few years, almost everything has been changing, with several factors potentially impacting Private Equity’s future performances and competitive positioning. Increased macroeconomic volatility has first led to inflation, and then to less (and more expensive) debt available, followed by geopolitical decoupling, supply-chain ruptures, regional war escalations and climate change risks – all of this has been eroding most of the “alpha” traditionally supported by leverage. Also, an inherent trade-off between the increased calls to adopt an ESG playbook, and the backlash promoted by its detractors has just been making more difficult the life of private investors, with ESG conscious investors asking for more sustainability goals, but at the same time not being ready to give away any expected extra return. Not only cost cutting – another traditional “alpha” booster – becoming more difficult to execute as less socially acceptable, but also ESG frameworks have become more expensive to manage. If all this was not enough, significant delays (if not roadblocks) in the exit of the invested portfolio companies (circa 28K at the end of 2023) have hampered the traditional capital “raise-to deploy-to distribute-to raise again” cycle. Forced longer holding periods are then leading to higher “illiquidity discounts”, reduced IRR (because of the higher time-value-of-money discount effect) and hence lower “alpha” (if at all).

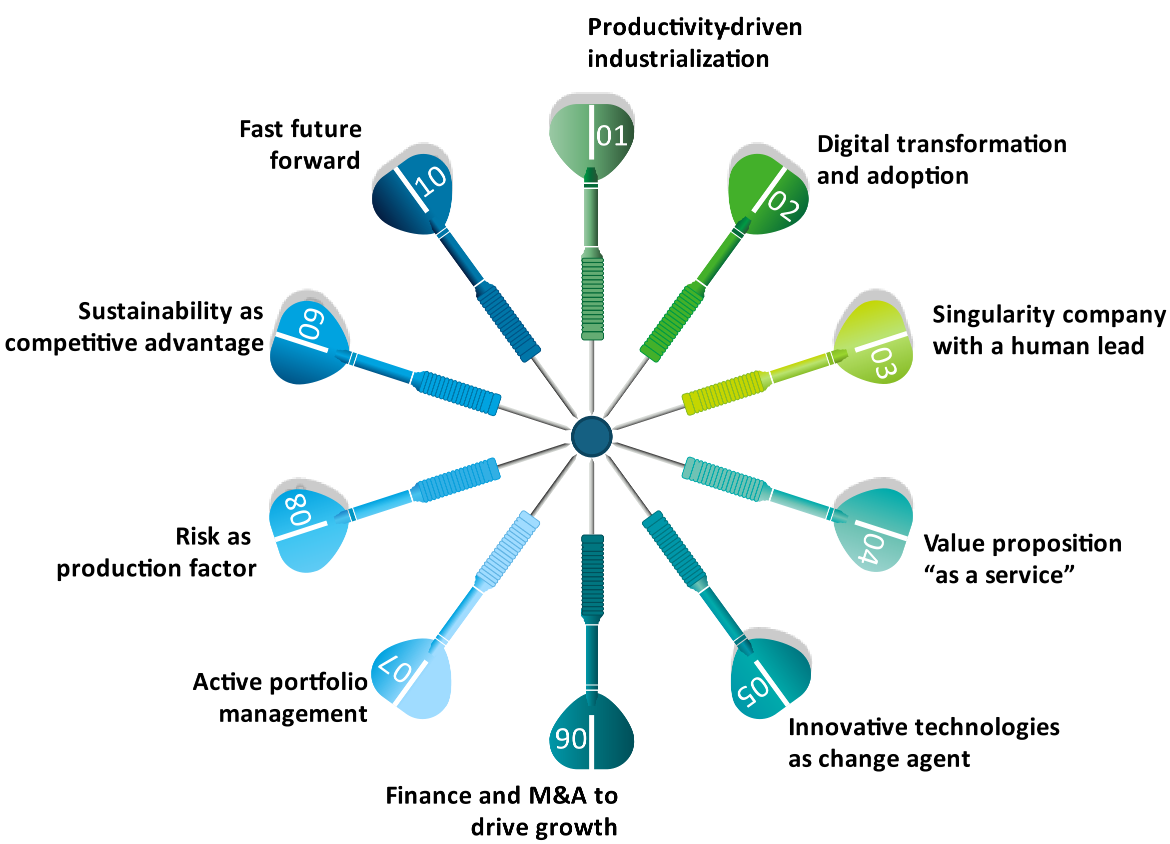
On the capital raise, the reduced funds available for reinvestment have been feeding fewer and fewer players, with institutional investors concentrating their bets on the “big names” of the Street. Whilst greater amounts of capital managed by fewer players make more difficult for them to maximize IRR (as a percentage) and therefore “alpha”, for their general managers there is a huge incentive to push for larger and larger deals, as their carried interest is driven by IRR (as a percentage, over and above its “hurdle rate”) multiplied by the capital employed (as volume). How easier for them is then to increase volume and make up for the percentage lost and get the same carried interest in Euro! In fact, the implicit incentive to do bigger and bigger deals, often involving companies that were already public, could just further erode the true “alpha” delivered by the industry and limit its contribution to the “survival of the fittest” SME and its related “creative destruction”. Asymmetric pay offs can also lead to an incentive to increase risks, as little correlation links the Risk Adjusted Returns track record of the alternative asset manager and its ability to raise further capital (that is raised just by the “big names”).

How could then Private Equity, as an industry and as a business model, be transformed to regain its competitive allure and its ability to deliver true and sustainable “alpha” - to its limited investors and (more at large) to its stakeholders? Certainly, greater transparency on fees and governance, a cunning strategic asset allocation focused on “smart beta” and a better aligned incentive model for general managers to focus on sustainable “alpha” could all help. However, the proof of concept of the “alpha” creation capabilities of Private Equity should come from its active management of portfolio companies. If a Private Equity is proving to be their better owner and manager, truly accretive value should naturally follow along the holding period. Even in case of forced longer periods of “holding”, that would just mean a greater opportunity to create an even higher “alpha”. In fact, companies’ active management can create “relative alpha” across multiple dimensions, and not just by adding debt and cutting costs. The track record relevance of the operating partners (the “portfolio companies’ shadow managers”) should then be equal to the one of the investment partners (the “deal makers – buying and selling”). They could include a well-balanced mix of professional experiences, technical skills, and vertical sectorial depth. As Private Equity can demonstrate its replicable prowess in “alpha” creation by managing companies better, it should also be able to attract more patient capital and with a lower opportunity cost. As the “alpha” gets embedded in the “alpha platform” processes and managerial approaches, it should also be able to better attract entrepreneurs as potential sellers and partners, as they would see a financial partner but with deep industrial understanding and potentially better suited to run their company over their next growth cycle. An “alpha platform” active on its portfolio companies’ management would then focus on accelerating growth, increasing its margins, and augmenting its innovation - almost in parallel. A greater “platformization” of most critical services provided would then lead to their faster and more extensive adoption, with a long-term goal of delivering “Private Equity as a service” – with active management as a winner and financial capital (a mere commodity) as a qualifier. Ultimately, should this pursuit include other non-economical values as well, the Private Equity “alpha platform-as-a service” could help even more its invested portfolio companies in developing into best sustainable companies.

06 A "decalogue" to drive sustainable values creation

Whilst it is fundamental for Private Equity to get right "smart beta" meta trends and their related investment thesis, groundbreaking, true sustainable values creation, including but not limited to financial and economic targets, must be defined, and addressed and the portfolio company's level. In fact, the acid test of any "alpha platform" ultimately relates to its ability to deliver "alpha", no matter what the sector or economic cycle it's in. Being a strong asset and time pickers is certainly a qualifying trait in Private Equity, but whilst this is a dominant characteristic of successful investors in stock-markets, for financial sponsors (the industry parlance for Private Equity players) their winning attribute is the ability to better govern and manage the invested company – demonstrating they are its best owner for the upcoming holding period.

Exhibit – MASA: Make Alpha Sustainable Again



In fact, no matter what the many technicalities differentiating private and public markets, the most unique and special proposition of Private Equity is its ability to command (in case of majority investments) or strongly influence (in case of minorities) and stir the company's transformation that is required for this to innovate, develop, and grow profitably.

To reach these strategic targets, "old tricks" (load the debt, cut the costs, inflate the EBITDA on the final "sprint") are good enough no more. And the main value creation strategy should not rest on the hypothesis of being able to "buy low and sell high" (always a good starting point, assuming a world of stupid people). If the economic value that will be delivered is sustainable in its pattern and also striving for other socially and environmentally sensible goals, Private Equity will have become not just an almost unstoppable industry, but a force for good as well.

With this ambition in mind, we focus now on the description of a partial, ever-changing, subject-to-constraints, decalogue of drivers to actively manage portfolio companies and evolve them in better and stronger ones, hopefully along with their ecosystems:

1. **Productivity-driven industrialization.** Cost outs on HR, purchasing and other expenses and as reduced amortization on new investments have been one of the most fashionable strategies pursued by Private Equity to achieve short term EBITDA improvements (or "sprints", executed when the fund is just about to exit its investments). As such, they have often backlashed, with unhappy employees and uncommitted suppliers leading to cost structures' "bungee jumping", and with reduced investments (including in ADV and marketing) leading to lower growth and eroded margins. A new emphasis on "industrialization" should instead target real productivity enhancement, doing more with less, and taking care of all non-renewable resources used. An optimal industrialization should start with the design of the target operating model and reconsider all required capabilities and processes as front-to-back and starting from customers.

2. **Digital transformation and adoption.** For all the mind-numbing talk on digital transformation, its required investments and hyper scaled expected ROI, not much has yet been done by SME. When pursued, large IT investments have often been implemented inconsequentially, leading to (at best) more efficient/ effective ways of doing the usual things. Cloud-based solutions adoption can instead lead to the overhaul of large technology stacks and the decommissioning of legacy applications. It can also allow SME to pursue large scale changes that were once an exclusive preserve of large corporates with huge IT budgets. In fact, agility and the flexible adoption of new digital apps and technologies, as they come to market and mature, are becoming a source of competitive advantage, especially when leading to new ways of doing things, to deliver innovative value propositions and changing the business model in the process.

3. **Singularity company with a human lead.** AI (and Gen-AI specifically) has been generating lots of hype, often obscuring the incredible scientific progress achieved in the field and the few, practical (but also very interesting and potentially high rewarding) applications that could be made already available for SME. To make it real, and bring this to fruition, a limited numbers of use cases can be identified and promoted by the financial sponsor for initial testing and later, when successful, for full scale adoption. With humans in the lead, almost any capability could be augmented, from planning, to risk management, to production and marketing. Whilst a "singularity moment" dominated by an Artificial General Intelligence (AGI) is still some way off, singularity-minded companies could already benefit from a better general (artificial and human) intelligence of doing things better, to deliver the best value to their best customers.

4. **Value proposition "as a service".** Decades-long discussions have focused on the secular shifts from farming and agriculture to industrial manufacturing and then to services, with this structural shift supposedly leading to greater wealth for the most cunning Nations. A new trend is now making these broad sectors more and more codependent and with intertwined destinies. As farming, cars and even real estate become mostly about data, software and the

related services that can be provided by specialized third parties, so service companies need natural resources, hardware products and a built environment to fully deliver on their promises. For SME operating in any of these, their strategic option is to focus on their core competitive advantage and let other strategic parties operate synergically the remains, to then focus jointly on the ultimate and resulting value proposition delivered "as a service" to the final customers.

5. Innovative technologies as change agent. Innovative technologies are not the preserve of digital software and not limited to AI or quantum computing. In fact, a vast array is now maturing and ready for large scale adoption, coming from disparate fields such as biotech and life sciences, genetics and longevity, precision materials, food and agriculture, renewable energy, communication-transportation, and space economy, to name a few. Whilst large R&D investments have likely already been made by State-backed institutions or large corporates, a "fast and furious" adoption by SME could lead to transformative value generation and the development of some competitive hedge on the selected "application verticals". Therefore, innovative technologies, even if not created and developed in-house, can lead to discontinuities in the company's business model and even in its end purpose, truly acting as change agents.

6. Finance and M&A to drive growth. Strategy should be informed by the company's mission and vision of the future it wants to achieve, with finance (and M&A) as tools to support its execution. Still, finance and M&A can play a critical role in identifying and executing organic (e.g. with capital investments required) and inorganic (e.g. involving M&A) options to drive sustained growth. A financial sponsor led growth strategy could then consider an optimal mix of the two, adding more of an industrial focus to the typical "buy and build" M&A and leveraging more on the post-merger integration to truly create an augmented, newly combined resulting entity. As "small is (not anymore) beautiful" and likely less efficient and effective, for SME great value can accrue from growth strategies that are ignited by the capital and M&A promoted by the financial sponsor – but they need a strategic rationale and industrial vision to make them work.

7. Active portfolio management. Active portfolio management can add value, on a risk-adjusted basis, to a private equity at fund and company level. At fund level, the CFO of the financial sponsor can strategically allocate its investments, diversifying their long-term bets and creating synergies among the value creation levers used across multiple portfolio companies (e.g., on the overall cost of funding, or the pooled third parties' procurement). At company level, the CFO can steer the optimal allocation of scarce resources within the internal marketplace of potential users (e.g., business units, service and product lines, distribution channels), thus leading to its optimal value creation. For a CFO to act as warden of the capital invested by the financial sponsor and as arbiter of the competitive marketplace using scarce and non-renewable resources, she needs a fully integrated, standardized cockpit of relevant financial information.

8. Risk as production factor. Any entrepreneurial activity entails uncertainty. Therefore, risks are the unavoidable and required "production factor" of any SME. Risks can eventually lead to superior returns - above the financial sponsor cost of capital and higher than the stock-market Index ones (hence, producing economic value added and "alpha"). Or they can potentially lead to losses in value – of the equity invested by the shareholders, the debt provided by lenders, the professional commitment paid by employees and business partners and the natural resources supplied by the overall ecosystem (e.g. including clean air and water, fertile soil, nice environment, stable climate). A holistic understanding of risks and their pragmatic, proactive management can lead to the optimization of the wealth created by the company for its financial sponsors and wellbeing for other stakeholders – and is required for sustainable values creation.

9. Sustainability as competitive advantage. A most common interpretation of sustainability by Private Equity is one of "constraint". It is something it needs to have to raise capital and fulfill regulations, and a cost that can hinder efficiency. It is also a set of

further limits (often conflicting) that can delay or derail its IRR maximization strategy or set a cap on the fund Capital on Capital multiplication. In fact, there can be ways and instances where the SME pursuit of sustainability can support the creation of a more unique and compelling competitive positioning, leading “consequently” (and not “notwithstanding”) to higher economic performance and “alpha”. For example, SME can bet on a structural shift driven by green transformation (e.g., solid state energy batteries), or change in sustainability-minded customers’ behavior (e.g., controlled environment, regenerative agriculture produced food) and win big.

10. Fast future forward. No matter what the never exhaustive and always changing “decalogue list” of drivers to support value creation and “alpha” generation, Private Equity can act as catalyst and accelerator of the SME that are willing to consider this as an option, rising to the challenge of change, to build their future and move fast forward. Financial sponsors can do this by evolving the governance of the invested company, professionalizing its organizational structure and investing to develop on multiple fronts, from education to R&D, from technology to M&A. More importantly, they can bring and embed new and higher ambitions, aligning the incentives of multiple stakeholders towards a few, shared common goals. They can instill energy and inspire a passion to perform, bringing best practices and talents with them. In short, a final “alpha” driver entails the time contraction of SME quickly projected towards higher futures.

07 Primary Research: Creating "Alpha" in Mid-Market Private Equity in Italy

Deloitte conducted a survey among multiple Private Equity professionals, specifically focusing on the Italian Mid-Market, to gather insights into the sector's ability to generate "alpha" through investments. Thirty-six professionals from thirty-two Private Equity houses participated in the survey.

Overall, respondents expressed confidence that the Private Equity industry has historically and will continue to outperform public markets in delivering "alpha." To uphold its advantageous position, the industry must not rely on blind optimism but rather stay attuned to emerging trends and influences. This awareness and adept response to both internal and external factors are paramount for maintaining expectations of the future "alpha" generation.

External factors such as international conflicts, geopolitical decoupling, and de-globalization, coupled with internal drivers within industries like intensified competition and a growing pool of uninvested capital -"dry powder" - not effectively allocated to high-quality assets, have emerged as the key challenges facing the industry. Moreover, it was noted that in the context of the Italian landscape, the complexity of the current legislative framework may pose an underestimated challenge for investors assessing legal system risks, potentially influencing their preference for investment opportunities in other European countries.

On the flip side, other exogenous, such as heightened consideration of Private Equity as an option, or the implementation of AI and Gen-AI, and endogenous drivers, such as consolidation to establish a scalable platform through bolt-on M&A, can serve instead as levers to sustain value creation. Among the comments that emerged in the survey, it was noted that the primary challenge in the Italian mid-cap market is the 'dwarfism' of companies. Limited revenue restricts cash flow available for investments. Therefore, the foremost driver to enhance company growth is scaling it to a level where it can invest, attract top-tier human capital, and compete internationally. Consequently, private capital infusion can fuel growth and yield exceptional returns.

Most respondents consider strategic allocation, both at the sector and investment thesis levels, as a key requirement to deliver 'alpha' in the coming years. As argued by one of the interviewees, professionals investing in the Private Capital space accrue expertise over the years, leading to the understanding that focus is not only crucial as a thesis but also to mitigate investment risk.

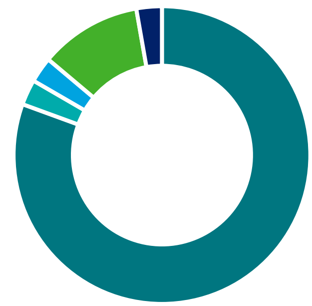
Two other critical factors mentioned are the leadership's capacity to manage the organization while adapting to ongoing changes, and the sector's current trajectory. Successful investments frequently coincide with companies experiencing significant sector disruption, showcasing their ability to identify and capitalize on these changes effectively.

In conclusion, harnessing the substantial emerging competitive advantages underscored in the survey, including the digitization of businesses, strategic leveraging of M&A, and the industrialization of operational models, should be complemented by a forward-looking approach to sector-specific trends. This comprehensive strategy is essential for enhancing 'alpha' generation. While underscoring the excellence of Italian manufacturing as a magnet for capital and value creation, insights from the experts involved in the survey point towards emerging trends. These trends indicate a pivot towards more innovative sectors such as Digital Transformation, Technology, Green Technology, Healthcare innovation, and the Food Industry.

Hereinafter the detailed results from the survey.

1. Do you believe Private Equity, as an industry, has created "alpha" in the last decade?

It has overperformed stock markets and through the cycle	81%
It has overperformed stock markets but just in growth phases	3%
It has overperformed stock markets but just in recession phases	3%
It has overperformed stock markets but not counting any "illiquidity premium"	11%
It has not overperformed stock markets therefore has not created "alpha"	3%



2. Which industry have you been targeting mostly to support "alpha" in the last decade?

Energy, infra-related and transportation	6%
Technology, media and telecommunication	22%
Consumer (incl. Fashion, Food, Furniture etc.)	22%
Manufacturing - across sub sectors	36%
Services (incl. Education, Health, Financial services)	14%

3. Which strategy have you been targeting mostly to support "alpha" in the last decade?

Consolidation to create at-scale platform via bolt-on M&A	64%
Cost cutting at procurement and HR level	0%
Digital and/or green transformation	3%
Organic volume growth (incl. Internationalization, New Products/Client segments)	33%
Organic margin improvement (incl. Marketing, Targeting, Pricing optimization)	0%

4. Do you believe Private Equity, as an industry, will create "alpha" in the next decade?

It will create strong "alpha" and through the cycle	75%
It will create "alpha" but just in growth phases	6%
It will create "alpha" but just in recession phases	0%
It will overperform stockmarkets but not counting any "illiquidity premium"	19%
It will not overperform stockmarkets and therefore will not create "alpha"	0%

5. Which exogenous factors could mostly hamper the ability of private equity to deliver "alpha"?

New interest rate environment and less favorable availability/cost of debt	17%
Geopolitical decoupling, de-globalization and ruptures in the supply chain	31%
Change in demographics and in related consumers' buying patterns	6%
Escalation of regional and global wars and their impacts on markets and societies	44%
Change in climate and related impacts on markets and societies	3%

6. Which endogenous factor could hamper the ability of private equity to deliver "alpha"?

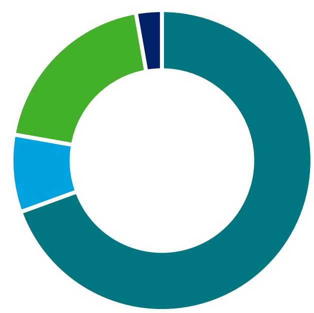
Increased competition in the industry (greater number of competitors)	33%
Increased consolidation in the industry (fewer players but much bigger)	11%
Increased difficulty in raising equity capital (reduced/reversed AUM growth)	8%
Increased regulatory and other ESG/reputation related constraints	3%
Greater and greater "dry powder" chasing fewer and fewer good assets	44%

7. Which exogenous driver could sustain the ability of Private Equity to deliver "alpha"?

Widespread adoption of AI and Gen-AI specifically to support deal making	8%
Widespread adoption of innovative technologies to support assets' productivity	28%
State-led interventions (e.g. NextGen EU/IRA) to support green transformation	3%
Democratization/retailization of capital raise in private equity	6%
Increased openness on the sell-side to consider private equity as an option	56%

8. Which endogenous drivers could sustain the ability of private equity to deliver "alpha"?

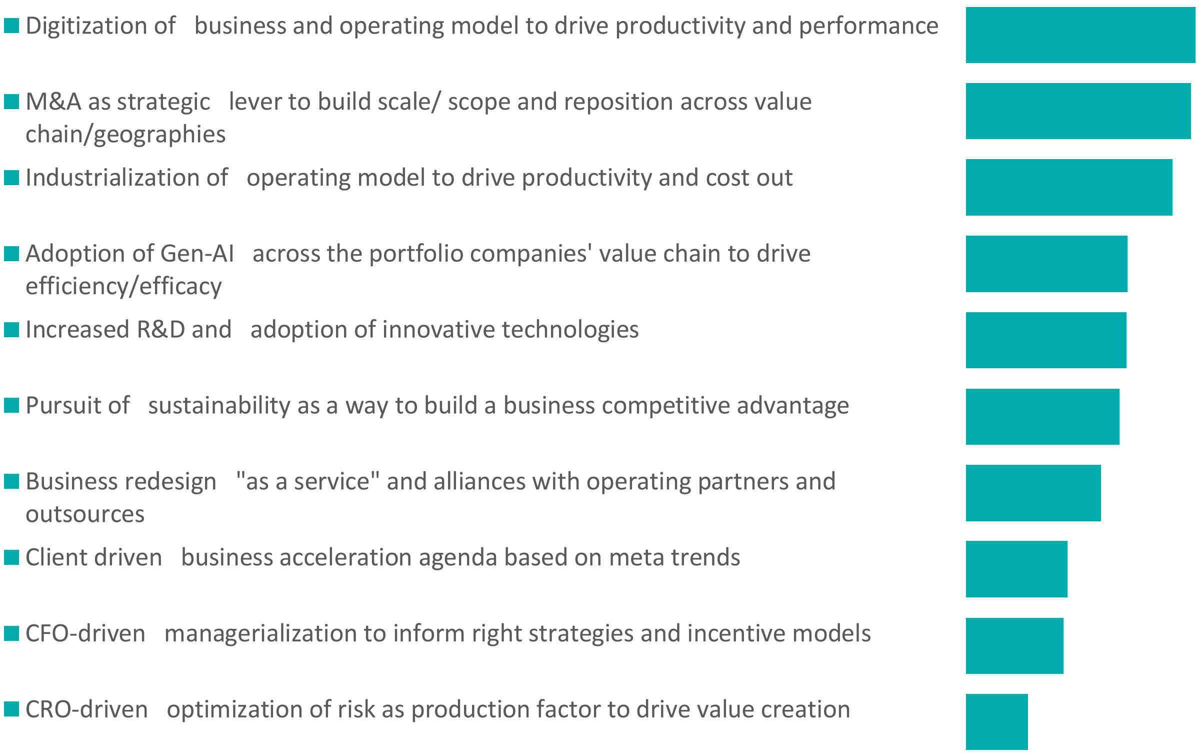
Consolidation to create at-scale platform via bolt-on M&A	69%
Cost cutting at procurement and HR level	0%
Digital and/or green transformation	8%
Organic volume growth (incl. Internationalization, New products/Client segments)	19%
Organic margin improvement (incl. Marketing, Targeting, Pricing optimization)	3%



9. Will a greater focus on strategic allocation by sector/ investment thesis be required to deliver "alpha"?

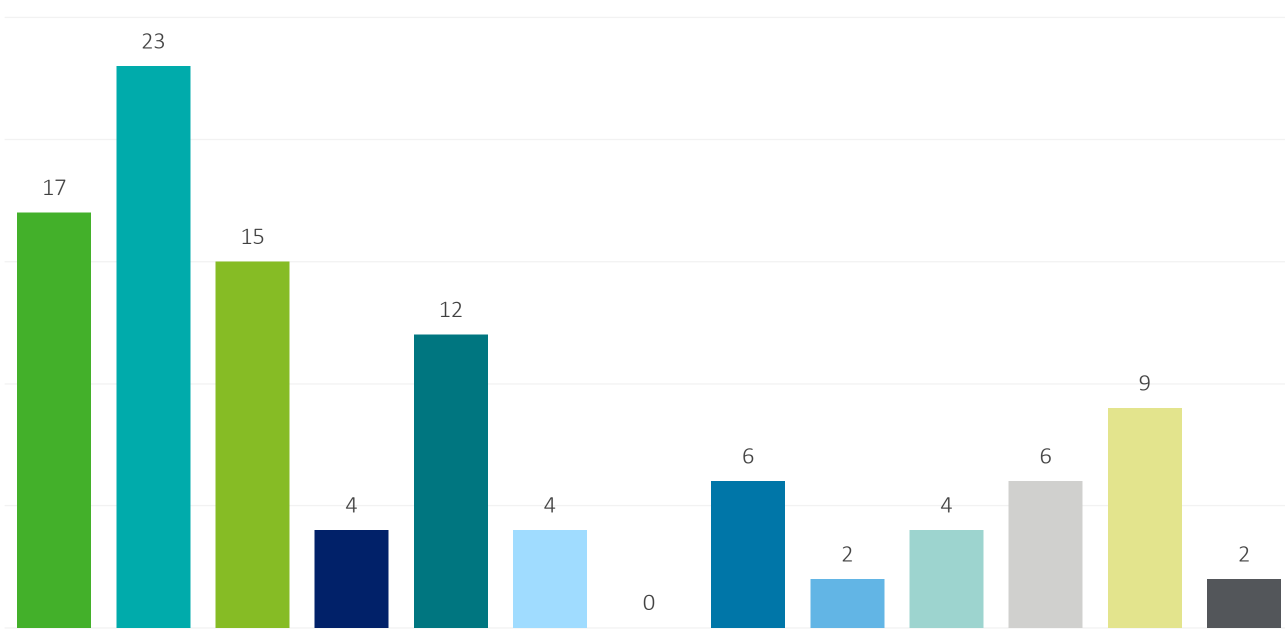
Strongly agree, both at sector/sub-sector and investment thesis level	47%
Strongly agree, but just at sector/sub-sector level	6%
Strongly agree, but just at investment thesis level	11%
Broadly agree but still with investment flexibility and tactical opportunity counting a lot	28%
I disagree, as the flexibility of the generalist approach and tactical opportunities drive deal making.	8%

10. How would you rank these 10 suggested emerging competitive advantages (from most to least)



11. Which trends are you planning to target to support "alpha" in the next decade?

●	Green Technology (Renewable Energy, Battery Storage and Energy Solutions)	17
●	Digital Transformation and Technology (AI and Machine Learning, Cybersecurity, Blockchain)	23
●	Healthcare Innovation (Biotechnology, Telehealth, Healthcare IT)	15
●	Natural Capital (agriculture, timberland)	4
●	Food industry, particularly plant-based and alternative proteins	12
●	Mobility and Transportation (e.g., Electric Vehicles, Urban Mobility Solutions)	4
●	Space Economy (Satellite Communications, Space Exploration and Tourism)	0
●	EdTech and Online Learning (Digital Education Platforms, Virtual and Augmented Reality in Education)	6
●	FinTech (e.g., Payment Processing and Digital Wallets, InsurTech)	2
●	Climate Adaptation and Resilience (e.g., Infrastructure, Water Management)	4
●	Silver Economy	6
●	Servitization (combining products with services, e.g., printers and managed print services)	9
●	Others	2



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