

Real-world value creation opportunities of
Generative AI
in portfolio companies

March 2024

eXcentius services

Value creation (cost reduction & revenue uplift)

Exit preparation

Hardware and software technology advisory

Strategic technology due diligence

Delivery assurance

Deal origination

Sector strengths

Technology-enabled Managed Services.

Cybersecurity.

Healthcare.

Life Sciences.

Business services.

Satellite communications and equipment.

Telecoms.

Edtech.

Fintech.

Cross-sector strengths

Data management for cross-border compliance.

Health services technology regulatory compliance.

Medical devices regulation.

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Generative AI in a nutshell

Generative AI is a business issue, not an IT issue.

Can materially increase Enterprise Value when used to augment a business process.

Generative AI poses an existential threat to some industries and current investments.

Now a proven technology in the growth phase, and capability continues to advance at pace.

Relatively easy to adopt – it does not require transformation of existing technology systems.

Proprietary enterprise data increases the ROI.

There are risks in implementation within a portfolio company.

Generative AI is different and here to stay

Generative AI is distinct from previous technologies that promised a revolution:

- Implementation does not require radical changes to business processes, nor rewriting of existing technology systems.
- Heavy investment is not required to achieve material uplift in enterprise value.
- The technology is excellent at improving the efficiency, cost and quality of existing back-office processes.

The pace of adoption of Generative AI is unprecedented: fastest technology to hit 100m users when launched, and within 12 months of commercial availability it has become mainstream in commercial businesses. In large Silicon Valley companies use of Generative AI is now mainstream, and as of November 2023, 20% of Microsoft's global corporate customers are using Generative AI in at least one mainstream business process that drives significant revenues.

Creating proprietary Generative AI models will remain the domain of very large companies because it costs \$millions to build and train¹. Running the models is also expensive (c.100 times the cost of running a large ML model). So for most companies, using Generative AI means integrating third-party technology into business systems, with the associated dependency risks. These risks are well known and manageable, and so are unlikely to impact the appetite for adoption or valuation at exit.

1. For example, OpenAI stated that the cost of training GPT-4 was more than \$100 million.

Key differences between Generative and other types of AI

Generative AI models are designed to facilitate a 'question and answer' exchange where the question varies. This is unlike Machine Learning models, for example weather prediction algorithms, which repetitively ask the same question of changing input data.

Unlike with most AI models, it is possible to iterate and 'shape the response' of a Generative AI model by asking more narrow questions of previous responses, and by providing additional data that was not part of the original model training. This additional data can be proprietary and kept private from other model users.

Perhaps the biggest difference is the ability of Generative AI to explore and interpret 'messy' data and then to summarise.

For example, Generative AI enterprise search can be asked to summarise agreements made between any employees and staff of a specific customer over a previous month, in any communications channel used by the business such as email, WhatsApp, video meetings and Office documents. In a services company of 100,000 employees engaging with 10,000 customer staff using multiple systems globally, this request can take less than a minute and return a written summary of the explicit and implicit contracting between employees and customer personnel and highlight differences between informal and contracted agreements. As well as proving links to all the source information, it can even provide an assessment of the sentiment between each party, for each informal agreement made (an ability that will may become unlawful in the EU).

Real-world example: managed services

Application	Proprietary service delivery platform, cybersecurity managed services.
Activity	Customer reporting – on the delivery of the service.
How Generative AI is used	<ol style="list-style-type: none"> 1. Reads activity logs of service agents. 2. Translates highly technical service bullet points into prose that a non-expert can understand. 3. Calculates data points to articulate value delivered (using customer-specific data such as industry, turnover, number of employees). 4. Authors entire report giving a single, coherent narrative to a consistent depth and in a consistent style. 5. Account manager (a human) scans report to ensure accuracy/ sense. <ul style="list-style-type: none"> • Report writing is built into the company’s proprietary service delivery platform and automatically triggered when a person logs a new account activity. • Continuous improvement achieved through ‘tweaking’ the prompt settings (rather than relying on batch improvement of typical product development process).
Value to business	<ul style="list-style-type: none"> • Material EBITDA improvement through cost reduction in reoccurring process. • Increased the perceived value of the services delivered – particularly amongst the purchase decision makers (who are different from the service users). • Increased staff satisfaction – removed the need for the technical service delivery staff to author customer reports which they find difficult and frustrating to do. • Indirectly increased ability of business to attract and retain highly skilled staff (because their competitors demand that the staff write these report).

£1m annual EBITDA uplift (cost reduction)

Reduced the cost of client reporting from £400.00 to £0.39 per report, in a business process delivering 50 reports per week.

Cost to implement: £15k.

Time to implement: 3 weeks.

Real-world example: luxury goods quality control

Application	Checking for manufacturing defects in luxury handbags (high cost per item, low volume production of each handbag style, large total volume of production of all styles).
Activity	<p>Creation of synthetic data to train Vision AI models.</p> <p>The Vision AI models are used in the company's European offices to assess photographs taken of each handbag as they are manufactured by the Asian supplier – rejected handbags are not shipped or paid for.</p>
How Generative AI is used	<ul style="list-style-type: none"> To improve accuracy, the vision AI models require a large number of training images that cover all possible scenarios, such as bags at different angles, dark lighting conditions and variations in incorrect stitching. Because of the the small volume of production of each style of handbag, these images are difficult to acquire. The Generative AI model is given the small number of actual handbag images that are available, and then tasked to create a large number of variations of these sample images – for example, varying the ambient light and varying the placement of the brand logo. Critically, the Generative AI model also generates the image meta data required by the Vision AI models. The Vision AI models are then retrained using the new synthetic images and meta data.
Value to business	<ul style="list-style-type: none"> EBITDA uplift through reduction in the cost of accepting (and subsequently rejecting) defective handbags that were not identified before they were shipped by the manufacturer. Removed the need for senior, experienced staff to spend time identifying defective products – junior staff can run the (now more accurate) Vision AI models without the need for experienced human vetting. Removed the career pressure placed on the vetting staff – failure to spot a defective handbag before accepting a shipment is an expensive mistake.

\$4.5m annual EBITDA uplift (cost reduction)

Reduced the costs of returning defective handbags to manufacturer and recovering the manufacturing monies paid.

Avoids the irrecoverable cost of shipping and the cost of replacing defective handbags sold to customers.

Cost to implement: \$37k.

Time to implement: 8 weeks.

Real-world example: product reviews (consumer retailing)

Application	Creation of verified consumer product reviews, which are sold to the manufacturer/ brand.
Activity	Obtaining a review of a product from a verified purchaser.
How Generative AI is used	<ul style="list-style-type: none"> • The purchaser is presented with a small number of key words that might describe the product quality and the purchase experience. • Generative AI instantly writes a full text (prose) review based on the user's keyword selection. • The user is asked to confirm the review (and has the opportunity to edit it). • Contextual data about the product, purchaser and retailer is provided to the Generative AI model to improve the quality of the written review. • The language of the generated review is changed to match the geography of purchase. • Generative AI is used to translate the review into other languages.
Value to business	<ul style="list-style-type: none"> • Increase in revenues due to a very large increase in the number of reviews obtained from purchasers: In the previous process, a purchaser was asked to write a review (free text entry). The uptake was low due to the perceived effort required. The review was then sent to a staff member for editing. After editing, the purchaser was emailed the revised review and asked to confirm/ accept it. The response rate was very low because of the lapsed time (the purchaser 'had moved on'). Revenue depended upon the purchaser accepting the edited review. As the new Generative AI process is easier for the purchasers (no free text entry) and near instantaneous, the percentage of purchasers submitting a verified review has increased by c.750% and thus revenues have increased significantly. • Cost reduction – the cadre of review editors was reduced by 50%. • Cost reduction – the cost of acquiring new customers (brands) has fallen because the company can demonstrate better performance compared to their competitors. • Increased customer satisfaction and retention – customers (brands) are now receiving significantly more reviews at a lower unit cost.

23.5% increase in revenues

12.7% reduction in net operating costs

Increased the volume of sellable products (customer reviews) by c.750%.

30% reduction in total FTE.

Time to implement: 21 weeks.

Where Generative AI can deliver the most investor value

Generative AI has a greater impact and provides better ROI when it is used to support a human-led creative activity, particularly one that involves synthesis of information and making of data-driven decisions.

	Third-party technology (e.g. Office 365, ERP)	Proprietary SaaS	Service delivery platform (proprietary software or integration of third-party products using proprietary middleware)
Service infrastructure	<ul style="list-style-type: none"> Enterprise-wide data discovery and intelligent knowledge mining. <p>Requires the vendor to implement Gen AI within their own code.</p>	<ul style="list-style-type: none"> Content creation. Synthetic data for training of other AI models/ capabilities. Conversion: guide potential customers through complex purchase journeys. Augment product features involving user decision making. 	<ul style="list-style-type: none"> Content creation. Data analysis. Regulatory reporting (risk reduction through increased clarity and coverage). Customer reporting (reduce cost, increase quality and transparency, articulate value of services delivered).
Product development	<ul style="list-style-type: none"> Software code development. Software code review (testing, quality control, code enhancement). 	<ul style="list-style-type: none"> Synthetic data for testing. 	<ul style="list-style-type: none"> Hardware design & hardware design review. Synthetic data for ML model development.
Marketing / Sales	<ul style="list-style-type: none"> SEO. Content development. Strategy development. 		
Service/product design	<ul style="list-style-type: none"> Ideation. Validation of value proposition. Validation of product/ service uniqueness. Data analysis. 		
Customer support	<ul style="list-style-type: none"> Query analysis (identifying the core issue). Mitigation matching (finding the best solution). Legal contracting (for complex service delivery). 	<ul style="list-style-type: none"> Behavioural analysis (of customer and company) to optimise processes. 	<ul style="list-style-type: none"> Content development. Automated communications.

There are also opportunities to augment Management Information Systems, particularly in the gathering of information that is scattered across the business in systems and places that are traditionally difficult to discover. This functionality is being rolled out by large vendors, such as Microsoft's Copilot. The benefits are clear – increased transparency, discoverability and speed of reporting – but the direct impact of these productivity gains on investor value is less evident.

How Generative AI can impact ROI

In order of number of implementations, the table below illustrates how portfolio companies are achieving investor returns with Generative AI.

Investment impact	Dominant driver of impact
EBITDA uplift	<ul style="list-style-type: none"> • Direct cost reduction through reduction in the number of FTEs required to deliver a process – stronger ROI obtained in middle management and creative processes (i.e., processes involving more expensive staff). • Indirect cost reduction of staff base, achieved by freeing up available staff hours to be deployed in other activities, thus reducing the longer-term headcount requirements.
Revenue protection	<ul style="list-style-type: none"> • Reduction in customer churn due to increased quality of service / quality of products – quality uplift obtained through greater consistency in service delivery/ manufacturing process and/or improving the value of the service/ product components. • Reduction in customer churn due to improved customer services – achieved through improved communications during complaints processes and improved problem/solution matching.
Revenue growth	<ul style="list-style-type: none"> • Increased customer conversion rates in complex sales (particularly relationship-based sales). • Increased revenue from cross-selling – mostly through the provision of more targeted information to staff involved in the sales process. • Reduced time to market of services/ products that require large data – achieved through the rapid creation of synthetic data.

Achieving positive ROI

The value of using Generative AI appears to be independent of scale or industry sector but is better when deployed in knowledge-based processes.

The value derived for the same use case varies from business to business.

We have not seen strong use cases for Generative AI in physical processes, such as in-store product retailing.

Whilst difficult to measure the investor impact, there is anecdotal evidence of:

- Reduced staff turnover and ‘easier’ recruitment when used to remove the burden of repetitive tasks from knowledge-based processes.
- General increase in productivity of staff involved in middle management and creative processes – achieved when using Generative AI tools embedded in office infrastructure such as Office365, which find and collate company knowledge.

Existential threat to obtainable revenues in some industries

There are two types of business models that will see rapid erosion of investor value due to the adoption of Generative AI. There are business models that:

- Charge a premium for human creative activities when delivering a service – e.g. paralegal, business process outsourcing, software development.
- Create and charge for insights drawn from large volumes of data.

Across these business models we expect to see significant reductions in obtainable revenue due to two patterns of market behaviour:

- **A collapse in market pricing** (not volume of sales) in competitive markets
As competitors deploy Generative AI to reduce their service delivery cost base, they will lower their pricing to be more competitive in the short term. This will lead to both a market ‘price war’ and a downwards shift in the perceived value of these services, and hence a fall in total revenues. Even market consolidation will not protect pricing because of the shift in customer’s expectations.
- **A collapse in demand**
The demand for some services will simply disappear as customers conduct the activity themselves through the in-house adoption of Generative AI, or as software vendors replicate the service capability into their own products using Generative AI.

There are many service industries that use these business models in part or in whole. Where these business models drive entire industries, we expect to see either complete loss of an industry or extreme market consolidation resulting in only a handful of high-volume, low-cost providers.

PDF conversion – a \$10bn industry under existential threat

The conversion of PDF documents to editable Microsoft Office format, without Generative AI, requires expensive proprietary technology plus a manual creative intervention to identify and correct errors in programmatic document conversions.

In 2022 this was a c.\$10bn industry and conversion costs averaged \$5-\$10 per document (and \$100+ for specialist documents such as legal contracts). The investor value of the industry is based on investing in proprietary conversion technology and recruiting low-cost labour.

Generative AI can now convert documents on-demand, at a fraction of the cost. And ChatGPT is now providing this capability almost for free as part of its paid-for service which anyone can access without specialist technology.

Threats to returns on current investments

Generative AI is already posing a threat to the expected returns of some current investments.

Obtainable multiples at exit

In competitive markets, we are seeing downwards pressure on multiples at exit where portfolio companies have not implemented Generative AI to reduce their operational cost base whilst their competitors have – the more advanced competitors are seen as a more attractive investment proposition, regardless of changes in revenue or market pricing of the exiting company.

And where whole industries are facing a fall in long term unit pricing (actual or expected), multiples paid by acquirers are surely likely to fall from their historical values that were used in the original investment thesis.

Achievable EBITDA

Many industries will adopt Generative AI to reduce the net cost of back-office business operations. In competitive markets we believe this will lead on to a fall in pricing that erodes revenues faster than the cost savings are realised, thus reducing total EBITDA. We expect to see this EBITDA dynamic start to play out in late 2024 in several industries, thus impacting any portfolio investments due to exit in 2025 or beyond.

* Sources:

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Software services companies – current investor returns under threat

In the next 12-24 months we expect to see significant reductions in the valuation of IT services companies coming up for exit, particularly those providing code development and testing as a service.

Generative AI is materially better at coding, testing and finding bugs than even the best programmers, and operating Generative AI to do these activities requires less experienced, lower cost developers. Peer-reviewed research published by Harvard Business School (November 2023)* shows that services companies are achieving typical productivity gains of:

- 20-40% less time on product management writing tasks.
- 40% increase in quality of code writing .
- 15% faster AI development.
- 50% faster coding (software).
- 14% increase in productivity of customer support staff.

As companies roll out Generative AI and reduce their cost base, some will undercut competitors' pricing in this highly price sensitive market. In response, portfolio companies will need to lower their prices to survive, faster than they can cut their costs, resulting in lower relative and net EBITDA at exit, and thus lower multiples. In addition, multiples will be further lowered as investors adjust to the new industry normal of lower revenues at similar cost of sales.

The landscape of investor opportunities in the services industries will change significantly

We expect Generative AI to be widely adopted in services industries where human-led creativity can be automated (at lower cost and to a higher quality and consistency). Total market revenues will continue to grow over the next 5 – 10 years, but the distribution of revenues will change.

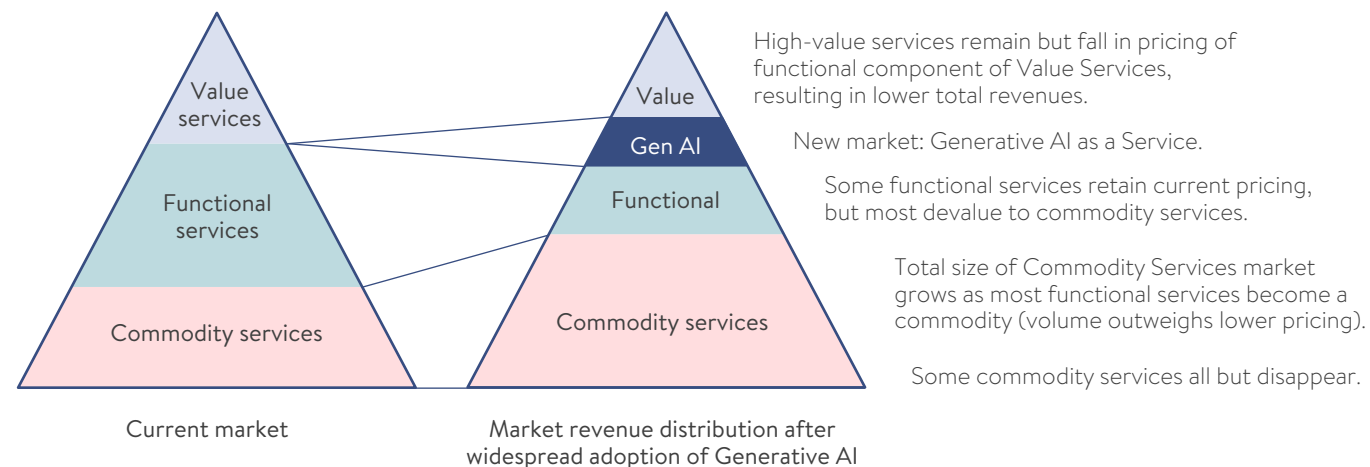
Revenues in Value services that are relationship driven, such as legal advisory, innovation consulting and medical consulting, will see little change. But pricing will fall for the functional component of those services.

The biggest impact will occur in Functional services, such as systems integration, software development, basic digital health services and simple legal services. These services will become commodities as new entrants use Generative AI to establish lower price points that incumbents have to follow.

Some commodity service industries will disappear altogether as the services are either replicated in-house or are integrated into Generative AI services by the model owners and model service providers.

The Generative AI as a Service market will continue to grow, to account for a sizable share of total market revenues.

Probable shift in share of revenues across services categories



Probable services market impact of Generative AI adoption

Category	Example service markets	Likely operating impact	Investment impact	Possible investor strategy
Value services	<ul style="list-style-type: none"> Legal advisory. Change management. Business consulting. 	<ul style="list-style-type: none"> Marginal increase in operating margins through cost reduction in back-office processes. Slight fall in pricing of low-value (functional) services. 	Little or no change in EBITDA.	<ul style="list-style-type: none"> Adjust service bundling to protect margins of functional services.
Functional services	<ul style="list-style-type: none"> Software architecting. Systems integration. Digital health services (basic) Simple legal services. Simple financial services. Business process outsourcing. 	<ul style="list-style-type: none"> Material drop in margins due to price fall outpacing cost reduction. 	Material fall in EBITDA.	<ul style="list-style-type: none"> Merger to maintain total revenues. Shift service mix towards high value services.
Commodity services	<ul style="list-style-type: none"> Customer support. Basic software code development. Marketing SEO. Paralegal services 	<ul style="list-style-type: none"> Growth in volume of revenues. Some operating margin improvement. 	Growth in EBITDA.	<ul style="list-style-type: none"> Growth through market expansion.

Key investor risks

1. Not implementing Generative AI

Whilst the least tangible, probably the biggest risk is that of not implementing Generative AI when your competitors are. We are already seeing signals that investors are lowering their valuation of target companies that have not implemented Generative AI in competitive markets (and thus do not capability to increase or protect enterprise value using the technology).

2. Investing in an undeliverable investment thesis

Over the next 24 months in certain industry sectors, we expect to see a pace of Generative AI adoption that will change investor fundamentals in a timeframe that is a lot shorter than a typical investment period. As highlighted previously, there are business models that will rapidly become commercially less valuable due to Generative AI, the investment dynamics of many service industries will probably shift, and the commercial markets of some industries will disappear altogether.

3. Negative ROI – inadequate business case

Whilst setting up Generative AI within a company can be relatively inexpensive, it can go on to become costly when used repetitively as part of an ongoing business process. If the business case of using the technology is not well thought through, it is quite possible to increase the net cost to the business¹.

It can be difficult to accurately predict the costs of using a

Generative AI model in a business process, partly because of a lack of transparency in the pricing of model service providers, and partly because of hidden data management costs in the prompting process, such as high data transfer charges levied by Amazon AWS when moving documents.

4. Suboptimal ROI – poor implementation

Poor implementation will most likely lead to suboptimal ROI, even for a solid business case. This is because, like all models, the quality of Generative AI output is a function of the input. Where the initial set up is poor, the utility of the Generative AI is poor and so its adoption is low. Further, it is difficult to fine tune the prompting so business process owners will become increasingly disengaged.

The most important factors of ensuring good implementation are ownership by the business (not IT) and bottom-up development of use cases (by people who interact with the target business process ever

5. Unable to operate due to change in regulation

Generative AI can do many things that Governments do not like, but at present have not legislated for. We expect to see national and regional regulation curbing some currently permissible use cases. The probable shape of this regulation has already been defined by the European Union. It is very likely that the EU will be first to legislate and that most of the rest of the world will adopt.

1. In a commercially successful business, we have seen a \$7.5m investment in Generative AI yield a projected annual cost savings of only \$750k. This implementation was owned by the IT group, not the business process owner, and financial ROI was not used as a metric of success.

The need for enterprise data

There are two sets of data required to use Generative AI models effectively: the training data and the prompt data.

Generative AI models are Language Models trained on very large bodies of information¹, often obtained from a multitude of sources in multiple human and machine languages. As a result, the models have embedded knowledge that is far beyond the horizon of any company or employee. This enables the models to be excellent at finding similarities and summarising across large volumes of data. However, it also means that they give generic responses by default, which tends to be of little commercial value.

To increase the focus of the model's response, and thus the commercial value and ROI of deploying Generative AI, it is necessary to give the model contextual information when prompting. This additional 'prompt data' is not part of the model and can be varied with every request made to the model².

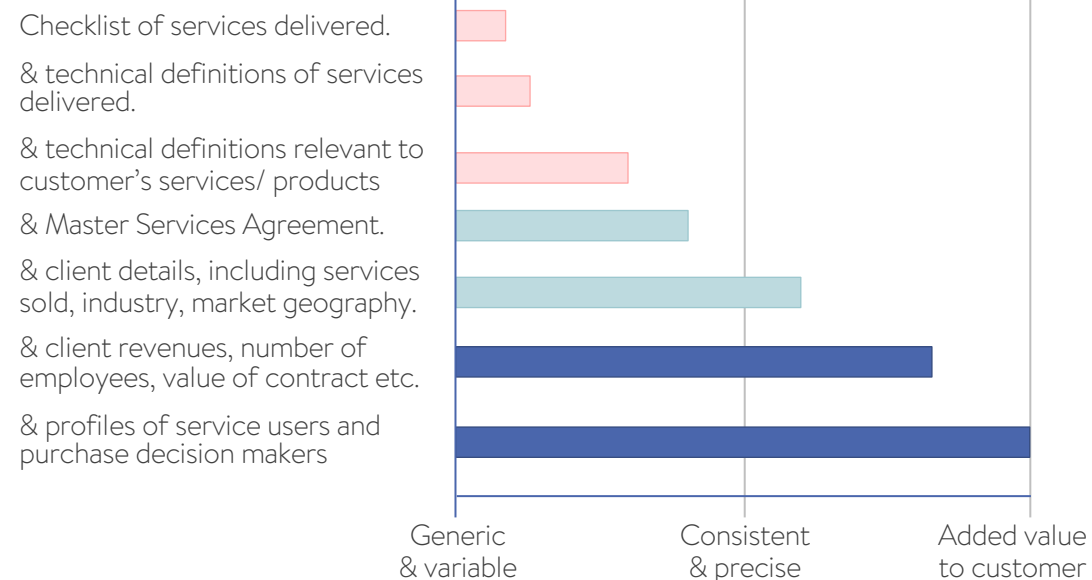
For commercial operations, the best prompt data tends to be the company's proprietary data that is spread across the entire enterprise (in all disciplines from sales to operations, in all formats including documents, chat messages and video calls) – it is a company's enterprise data that creates the commercial value³.

Prompt contextual information & model response

Example prompt: Write a summary of the technical service delivered to client

Contextual information provided in prompt

Response profile



1. Whilst there is no set definition, small Language Models tend to have about 10m parameters, large models have 1bn+ parameters, and very large models, such as OpenAI's ChatGPT version 4, have in excess of 1tn parameters. In contrast, AI models used for medical diagnosis, even in the most complex fields, typically have less than 1m parameters.
2. Some commercial services, including ChatGPT, retain prompt data within a session so that it can be built upon when asking a set of iterative questions.
3. Check the terms and conditions of the model service being used! Some services allow the model owner to use proprietary prompt data for subsequent retraining of the model and for fine tuning responses to other people's prompts – i.e., your proprietary data can become public information.

eXcentius case studies

Case study | Value creation & investment preparation

Portfolio company

US based provider of military and civilian satcoms equipment, including hardware and software for ground station hubs and modems for ships, planes and fixed sites.

Global revenue USD\$0.5bn.

Value created

- Product portfolio strategy and roadmap that reversed \$261m of declining revenues and increased total market share.
- Market research, customer research and product analysis to secure \$100m investment raise for product portfolio transformation.
- Design of the technical architecture of next generation hardware & software products to increase long-term ARR.
- Map of operational transformations to transition Product Management and Engineering functions and reduce cost base.
- Identification and recruitment of off-shoring specialist technology partner.

Critical insights

Our forensic examination of the market technology assumptions in the 5-year P&L forecast showed that 61% of projected revenues were not achievable with the company's current technology strategy.



Case study | Value creation

Portfolio company

A global telecoms operator providing mobile voice and data services for civilian and defence, with a complex product and services portfolio due to little customer migration to newer products over a long trading history.

Global revenue USD\$1.4bn.

Value created

- +9% EBITBA.
- 30% reduction in cost of Customer Support.
- Reduced complexity in Sales, Product and Engineering management.
- 37% reduction in technical debt.

Key deliverables

Rationalisation of the portfolio from 140 to 40 products, with ring-fenced critical products (military, blue-light etc).

Product retirement plans and product feature migration plans.

Frameworks to renegotiate contractual terms with suppliers and customers.

Architecture for customer outreach plans.



Case study | Technology due diligence of telemedicine service

Target company

UK-based remote dermatology services in secondary healthcare, with majority of revenues from health insurers.

Clinical diagnosis of skin conditions using a patient app and 'out of hours' assessment by physicians.

Proprietary technology of mobile app, case management software and image analysis AI.

Key findings

- 37% of investment period revenues unlikely to be achieved.
- Systematic reduction in Enterprise Value due to transfer of Intellectual Property

It would not be possible to deploy the required AI within the investment timeframe due to the unforeseen need for regulatory certification, and the product roadmap would not deliver the additional revenue-generating services on time.

The shareholding and licensing agreements, plus the technical requirements of scaling the proprietary AI, would lead to transfer of IP to the value of a loss in 3x multiple.

Additional deliverables

- Design of a realistic technology platform to deliver the investment thesis.
- Identification of an alternative investment.

We designed a technology platform that could deliver the investment objectives, articulating the technical architecture, costs, skills and schedule to implement, and the associated product roadmap.

And with the investor's consent, we conducted a global search for an alternative target and identified a more mature company with better technology and a better fit for the investor's existing portfolio businesses. We provided introductions to the board, a view of the quality of the technology, and an assessment of potential fit within the investor's portfolio.



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