

Would I Lie to You? On Private Equity Intermediary Performance Reports

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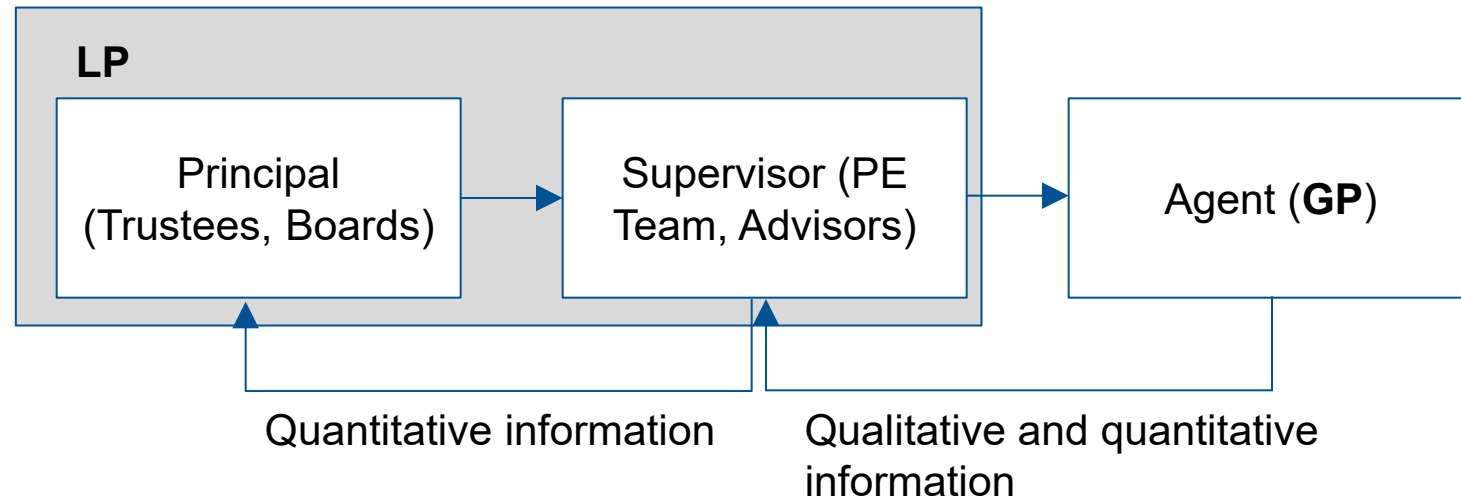
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Motivation & Puzzle

- **Private equity/VC:** \$13 trillion globally, but massive opacity + scale → monitoring challenge
- **Investors receive quarterly reports on fund performance:**
 - **Quantitative information:** fund performance, portfolio companies' financial performance and valuation, **NAV** being THE number for oversight (for aggregation & benchmarking)
 - **Qualitative information:** there are narrative updates on each portfolio company (~11 sentences per firm and report)
- **The Puzzle:**
 - GPs obviously have price-relevant information about their investments and should incorporate it into the NAVs they report
 - BUT they also write detailed textual narratives
 - **Do narratives contain forward-looking information NOT reflected in NAVs?** (Our main research question, measuring report tone)
 - If yes, why would GPs allocate information strategically across these channels?

Double Agency Framework (Morris & Phalippou, 2012)



The Friction: Costly to transmit soft information upward (scale problem) (Stein, 2002)

- **Quantitative** (NAVs): Principals demand aggregable, auditable metrics (Crawford & Sobel, 1982) → GPs face litigation/regulatory risk if over-marked
- **Qualitative** (narratives): Supervisors need signals for reinvestment decisions → GPs need LP re-commitments for future funds
- **Strategic solution:** Keep NAVs conservative (satisfies oversight), convey forward-looking signals in narratives (helps informed monitors make decisions)

GP Portfolio Company Reports

What GP Reports Contain:

- Non-standardized PDFs, ~80 pages
- Quarterly, audited only once a year
- Fund-level performance summary
- Portfolio company updates:
 - Detailed financials (sales, EBITDA, margins, multiples)
 - Fair Value / NAV ← THE number for oversight
 - Textual narrative

Our Sample:

- Novel, proprietary data set
- ~20,000 reports (semi-annual data)
- 1,769 portfolio companies
- Europe (71%), North America (29%)
- Fund vintages 2000-2015
- Data through June 2024 (most investments exited by then)
- ~ 240,000 sentences analyze

Key Innovation:

- First study with investment-level **time-series** of NAVs + financials + full text
- Semi-annual frequency (quarterly changes often immaterial)
- 83% of investments fully realized → we observe actual exit outcomes

How We Measure Report Tone

- **FinBERT** (Huang, Wang & Yang, 2023), a transformer model on financial texts: corporate filings, analyst reports, earnings calls
- **Sentence-level classification:** Negative (-1) | Neutral (0) | Positive (+1)
- **Report Tone** = Average across all sentences in portfolio company update

Example:

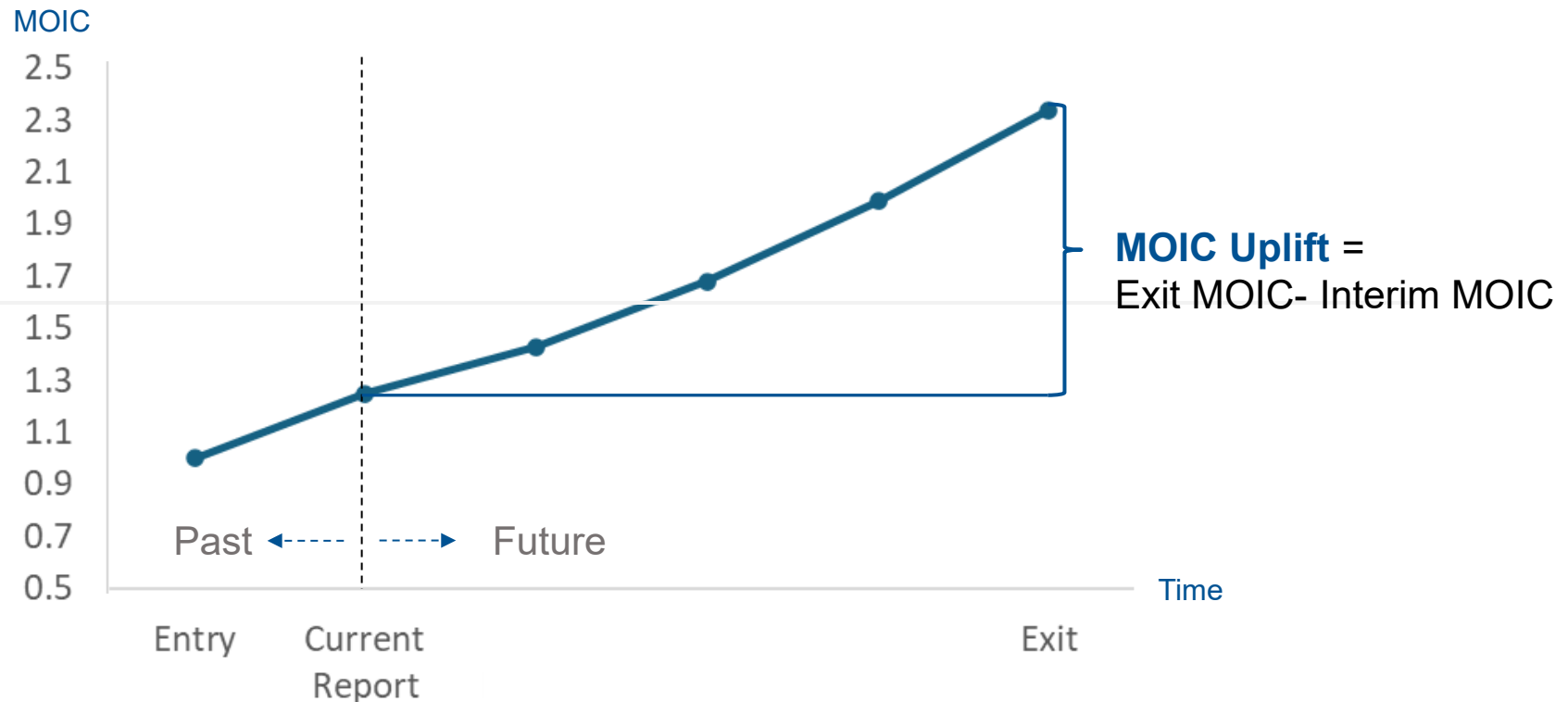
- "Revenue growth accelerated to 15%" → +1
- "The company operates in healthcare" → 0
- "Margin pressure from input costs" → -1
- Report Tone = $(1 - 1 + 0) / 3 = 0.0$

Robustness: FinRoBERTa, Loughran-McDonald dictionary

	(1)	(2)
(1) FinBERT		
(2) FinRoBERTa	0.82 ^a	
(3) Dictionary (LM 2011)	0.57 ^a	0.53 ^a

^c, ^b, and ^a denote statistical significance at the 10%, 5%, and 1% level, respectively

How We Measure Future Performance (MOIC Uplift)

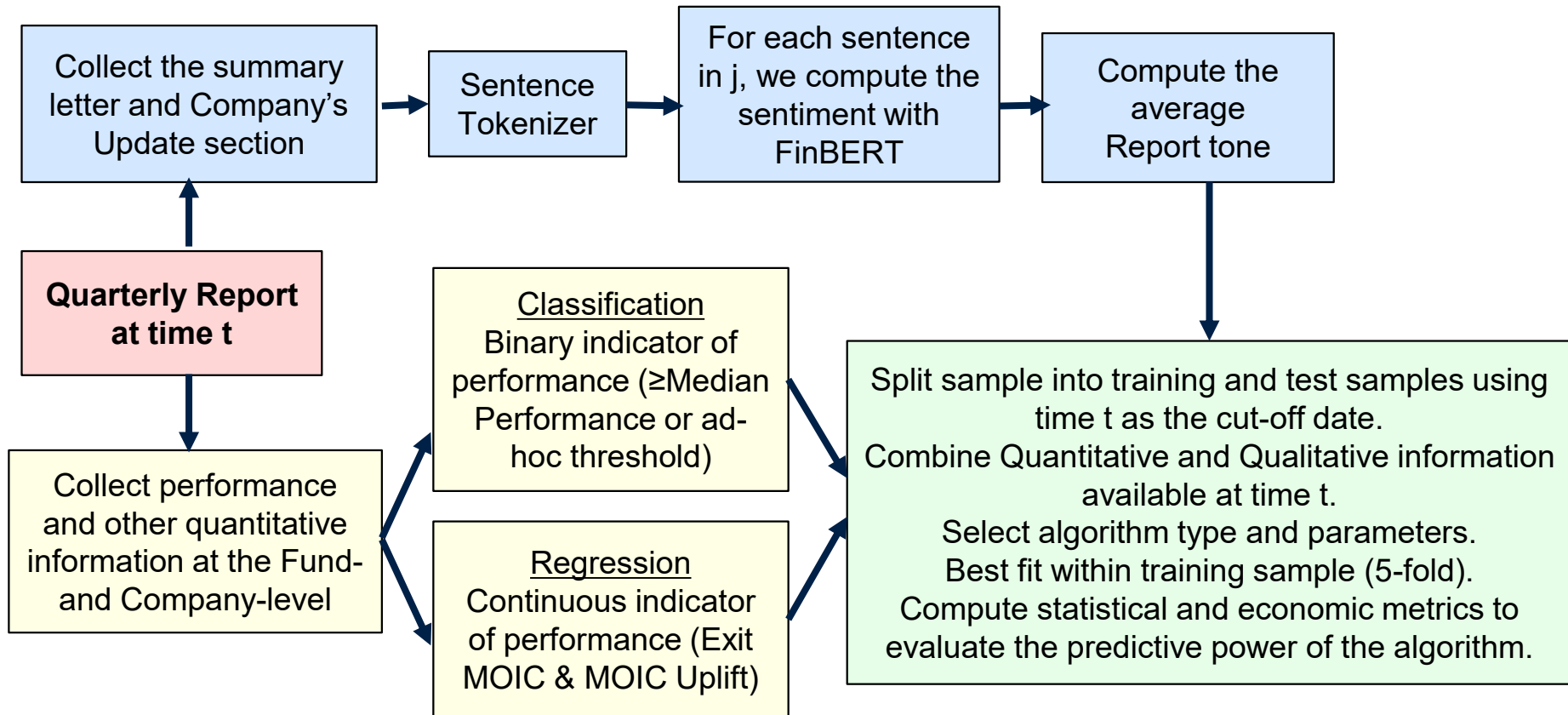


Example:

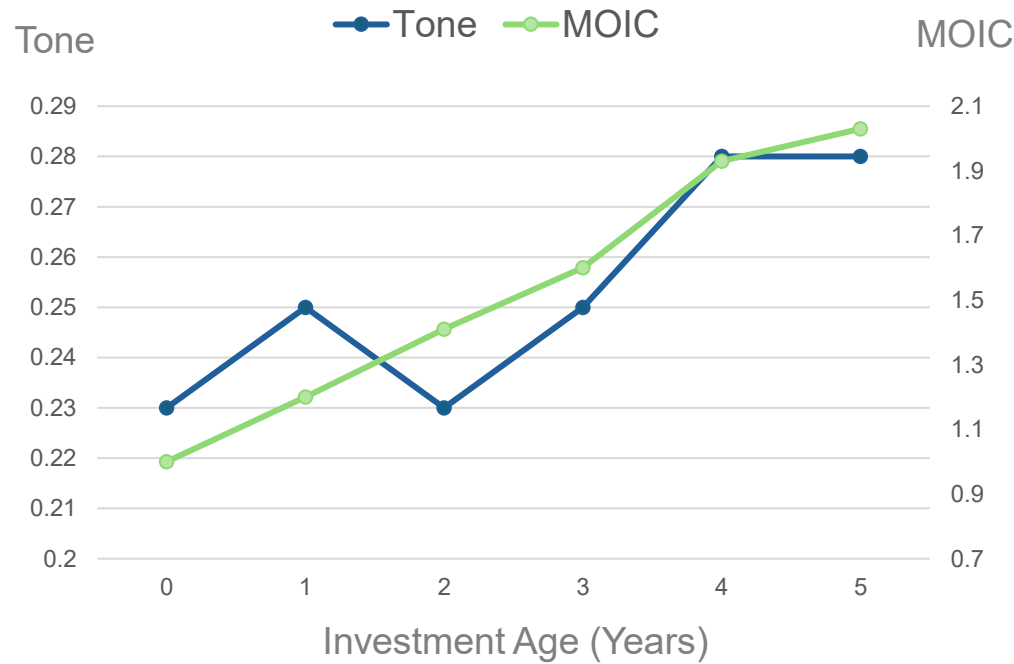
- Entry: NAV = \$100m, MOIC = 1.0x
- Interim/Current: NAV = \$120m, MOIC = 1.2x
- Final/Exit: NAV = \$230m, MOIC = 2.3x

Uplift = 1.1x

ML: How We Treat Qualitative and Quantitative Data



Tone and Performance Throughout Deal Life



- **Mean (Median) tone** = 0.25 across all reports, with substantial cross-sectional variation (SD = 0.32)
- **Geographic differences:** US GPs' tone (0.34) is more positive than European GPs (0.24), but effect of tone on performance is robust across regions
- **Lifecycle pattern:** Tone relatively stable; interim MOIC rises gradually

MOIC Uplift: Descriptive Results

	Total	Report Tone			Pos. minus Neg.
		Positive	Neutral	Negative	
Panel A: Full sample					
	0.75 (19,156)	0.86 (13,899)	0.64 (2,198)	0.34 (3,059)	0.52 ^a
Panel B: By Interim MOIC Quartiles¹					
High	0.89 (3,898)	0.97 (3,107)	0.72 (432)	0.44 (359)	0.53 ^a
Low	0.36 (3,923)	0.42 (2,320)	0.40 (473)	0.23 (1,130)	0.20 ^a

¹Omitting second and third quartiles for illustration purposes.

- **Positive tone** → **2.5x higher future performance** than negative tone (0.86x vs. 0.34x)
- **Effect persists within NAV quartiles:** Even among top-performing investments, positive tone predicts +0.53x additional uplift
- **Implication:** Narratives contain forward-looking information not reflected in current valuations

MOIC Uplift: Regression Results

Variable	Coeff.	SE	Effect Size
Panel A: All realized investments (N= 12,835)			
Report Tone	0.726***	0.050	+0.18x
Interim MOIC	0.063***	0.015	+0.07x
Panel B: Fund Generation ≤ 3 (N=3,379)			
Report Tone	0.613***	0.110	+0.15x
Interim MOIC	0.105***	0.035	+0.11x
Panel C: Fund Generation > 3 (N=9,452)			
Report Tone	0.734***	0.074	+0.18x
Interim MOIC	0.042***	0.015	+0.05x

- **Effect Size:** $\beta * SD$
- **Controls included:** Financial growth, fund size, generation, age, fundraising status, auditor type, investment size, realization share, report length
- **Fixed Effects:** Investment age, Semester, Industry (GICS), Region

MOIC Uplift: Regression Results by Investment age

	Year 1	Year 2	Year 3	Year 4	Year 5
Variable	Coeff. (SE)				
Report Tone	1.070*** (0.135)	0.652*** (0.129)	1.006*** (0.123)	0.541*** (0.128)	0.627*** (0.131)
Interim MOIC	0.125* (0.069)	0.247*** (0.044)	0.073* (0.037)	0.055 (0.034)	0.024 (0.033)
N Obs	2,729	2,524	2,175	1,742	1,320

- **Report tone** remains positively associated with subsequent performance at all stages of the lifecycle, with the strongest effects observed in the early years following investment.
- **Interim performance** is only positively associated with subsequent performance in the first three years and becomes economically and statistically insignificant thereafter
- **Controls included:** Financial growth, fund size, generation, age, fundraising status, auditor type, investment size, realization share, report length
- **Fixed Effects:** Investment age, Semester, Industry (GICS), Region

MOIC Uplift: Regression Results. Fundraising

	All	Fund Gen. ≤ 3	Fund Gen. > 3
Variable	Coeff. (SE)		
Report Tone	0.685*** (0.055)	0.681*** (0.077)	0.664*** (0.080)
Report Tone*Fundraising	0.214* (0.123)	0.053 (0.176)	0.416** (0.172)
Interim MOIC	0.063*** (0.016)	0.149*** (0.023)	-0.029 (0.023)
Interim MOIC*Fundraising	0.000 (0.038)	0.137** (0.056)	-0.069 (0.051)
Fundraising	-0.070 (0.071)	-0.303*** (0.105)	0.040 (0.096)
N Obs	12,834	6,556	6,275

- **Effect experience:** younger managers rely more on quantitative performance signals during fundraising, while established managers place greater weight on qualitative disclosures.
- **Controls included:** Financial growth, fund size, generation, age, fundraising status, auditor type, investment size, realization share, report length
- **Fixed Effects:** Investment age, Semester, Industry (GICS), Region

MOIC Uplift: Regression Results. Europe vs US

	All	Europe	US
Variable	Coeff. (SE)		
Report Tone	0.606*** (0.047)	0.645*** (0.058)	0.603*** (0.082)
Interim MOIC	-0.013 (0.015)	0.039** (0.019)	-0.121*** (0.027)
Staleness (%)	0.101* (0.052)	0.243*** (0.062)	-0.317*** (0.095)
Markdown (%)	-0.674*** (0.065)	-0.616*** (0.077)	-0.715*** (0.122)
N Obs	12,826	9,103	3,723

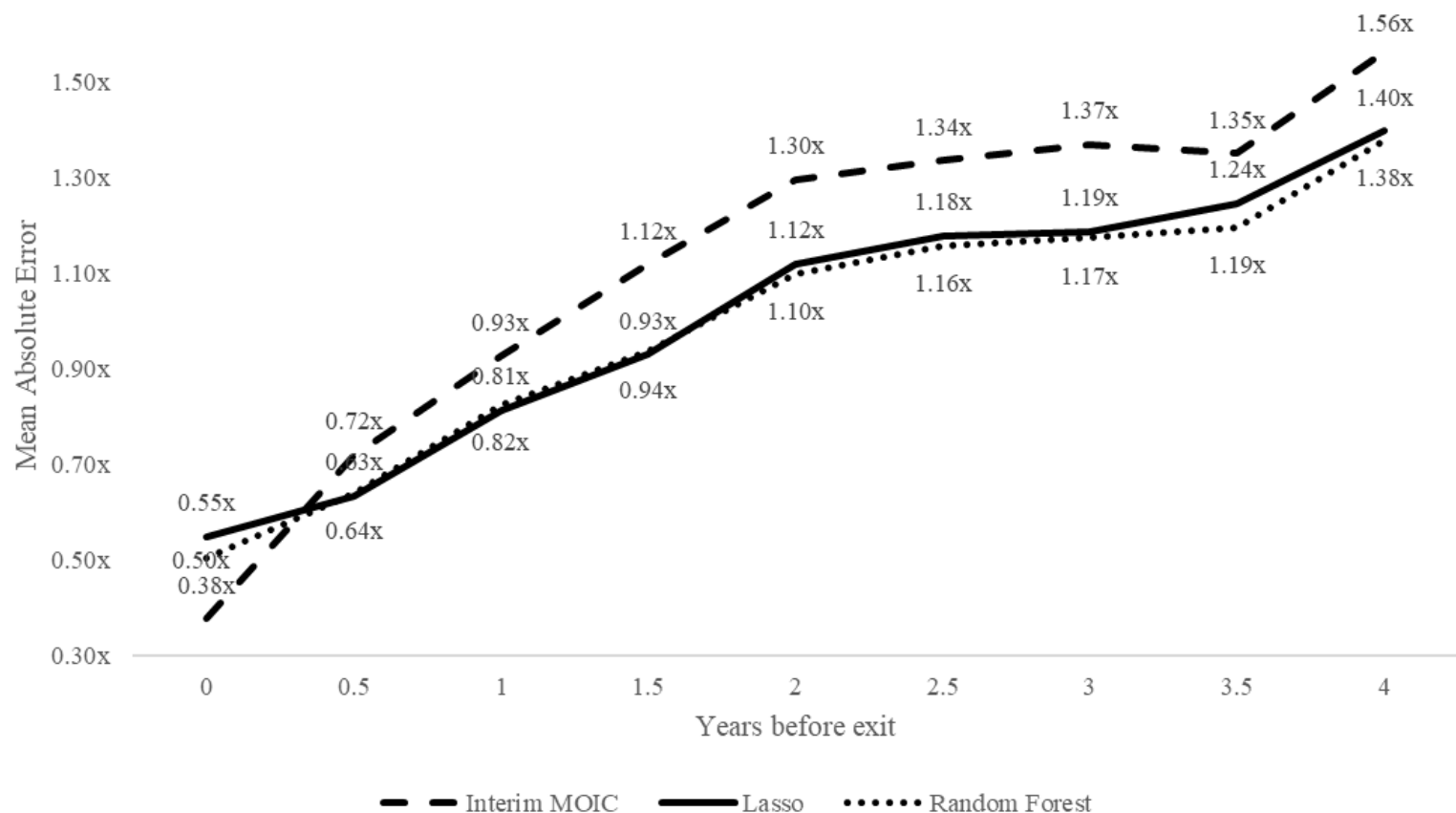
- **Europe vs US:** no news is good news in Europe, while no news is bad news in the U.S
- **Controls included:** Financial growth, fund size, generation, age, fundraising status, auditor type, investment size, realization share, report length
- **Fixed Effects:** Investment age, Semester, Industry (GICS), Region

MOIC Uplift: Lasso-predicted

Predicted MOIC Uplift quartiles:						
	Median	Lowest	3rd	2nd	Highest	High – low
Panel A: All Semesters						
Median		-0.01x	0.12x	0.64x	1.19x	1.20x
Panel B: By Deal Age (in Years):						
1-1.5	1.33x	-0.13x	0.36x	1.26x	1.40x	1.53x
2-2.5	0.96x	-0.28x	0.22x	0.92x	1.27x	1.55x
3-3.5	0.49x	-0.01x	0.13x	0.62x	0.83x	0.84x

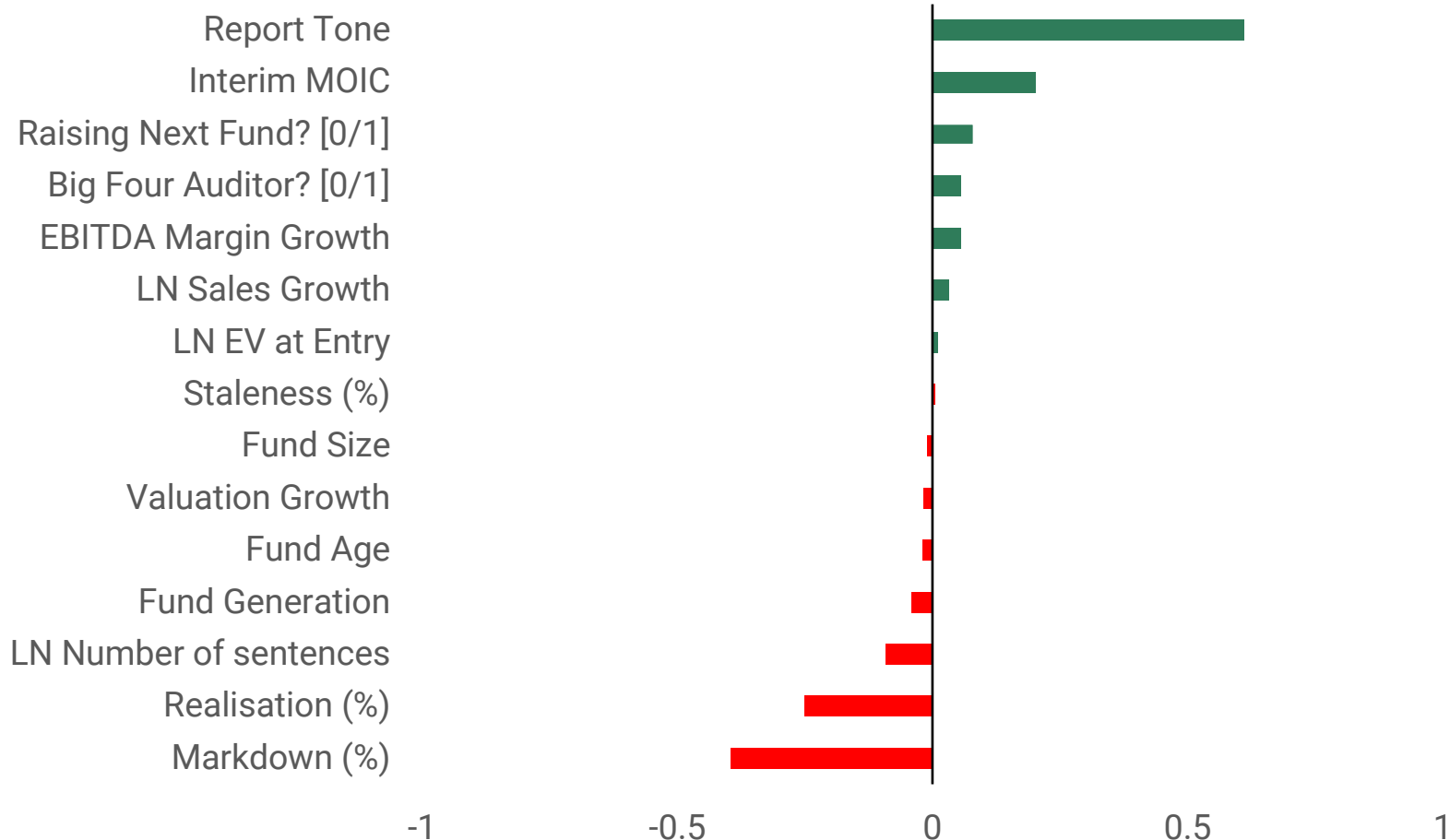
- Lasso regression predicts continuous MOIC uplift for out-of-sample investments (trained on 2014-2020 exits)
- We sort predictions into quartiles and compute median MOIC uplift for each category.
- High-Low spread of ~1.2x demonstrates substantial predictive power

Mean Absolute Error of ML algorithms versus Interim MOICs



- Machine learning approaches consistently outperform interim performance as a predictor of subsequent outcomes across all years prior to exit, except in the final reporting period where interim performance mechanically converges to realized outcomes.

MOIC Uplift: Lasso-predicted



- Average standardized coefficients of the most significant predictors of MOIC uplift outperformance.
- Positive coefficients (in green) indicate variables that positively contribute to investment success, while negative coefficients (in red) indicate factors negatively associated with performance.

Conclusion & Implications

What We Show:

- **First large-scale evidence:** PE narratives systematically predict outcomes beyond NAVs
- Positive tone → +0.18x uplift (≈8% annual return)
- Effect 2.6x larger than interim MOIC itself
- Robust: tone measures, geographies, institutional settings, deal lifecycle
- *ML confirms: Tone = #1 predictor*

Why This Happens:

- **Double agency:** Principals demand aggregable NAVs; supervisors need forward-looking narrative signals
- **GP incentive structure:** Over-marking NAVs = litigation/regulatory risk; narratives = "cheap talk" channel to informed parties who control re-investments
- **Fundraising reveals strategy:** Established GPs (+60% tone reliance) vs. young GPs (NAV reliance)

Implications:

- **Policy:** Move from "NAV accuracy" to "**NAV + narrative consistency**" oversight
- **AI disruption:** LLMs democratize narrative analysis → reduces remote principals' monitoring disadvantage → may reshape information equilibrium
- **Bottom line:** NAVs are predictably inaccurate. Narratives convey information to supervisors. AI may change this game.