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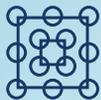
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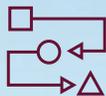
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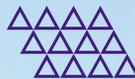
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Beyond the hype



GRAEME KERR
EDITOR'S
LETTER

“Everybody talks a good game,” says Joncarlo Mark, who has years of experience listening to GP claims of operational excellence. Until 2011 he was senior portfolio manager with the California Public Employees’ Retirement System, responsible for more than \$48 billion of investments, much of it in private equity.

He has watched as the implementation of operational partners and value-add has “accelerated exponentially” over the last 15 years, as purchase price multiples have increased.

And he has come to be very wary of GP claims about their expertise. The onus, he says, is on LPs to differentiate between “what a firm does, what they say they do, and if they really do execute”, as he tells Isobel Markham on p. 38.

All of which makes Mark the perfect judge for our Operational Excellence Awards 2018, the results of which we reveal in this supplement.

Now in their seventh year, the awards are a chance to celebrate the best examples of value creation in the private equity industry. The idea is simple enough. Every June we ask GPs to submit their best examples of how they deliver operational value as owners. Returns are only part of the criteria. The 10 expert judges also look for true ground-breaking work in creating value.

Turn to p. 14 for the list of winners and read their stories on the following pages. While all GPs may claim operational prowess, it’s heartening to read case studies where private equity has created genuine value.

Elsewhere, the Operational Excellence Special gives *PEI* the chance to delve into the changing face of value creation, and look at

how operating partners are becoming an established presence on the deal team (p. 48). There’s growing recognition that portfolio companies need a credible back-up plan to guard against a future downturn, as we report on p. 6.

Diversity is also increasingly seen as a driver of returns. On p. 42, we highlight the seven steps you need to take to ensure an inclusive workplace.

Our keynote interviews and expert commentaries shed light on a wide range of operational issues. Nordic Capital describes its “commercial excellence toolbox” (p. 10), PwC partner Tobias Blaser looks at extracting maximum value from a corporate carve-out (p. 22) and Blue Ridge Partners’ Jim Corey discusses the inefficiencies holding back sales teams (p. 29).

Jon Caforio of RSM looks at why two-thirds of bolt-on acquisitions don’t achieve the expected synergies (p. 36) and Phillip McMullan of CompleteSpectrum considers how the right branding can bolster a buy-and-build strategy (p. 40). There are also expert commentaries from Efficio (p. 45) on platforms that can track procurement savings and TBM Consulting Group on how operational due diligence has risen to the fore as valuations have soared (p. 51).

The sheer variety of the content is testament to just how operational issues have risen up the private equity agenda. And while GPs may talk a good game, all the evidence here is that they are putting increased effort into improving their expertise.

Enjoy the supplement

Graeme Kerr

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OPERATIONAL EXCELLENCE AWARDS

Value creation: 5 things we learnt

Our Operational Excellence Awards demonstrate the vital role played by add-on acquisitions in bolstering growth, writes **Graeme Kerr**

Now in their seventh year, our annual Operational Excellence Awards showcase the best examples of general partners transforming portfolio companies. Here are the key strategic takeaways from this year's honour roll. Turn to page 14 for the full list of winners.

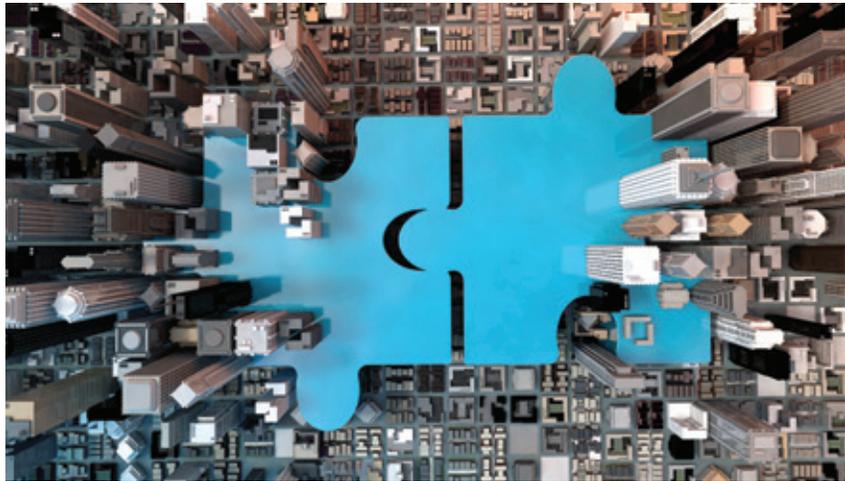
1 ADD-ONS ADD VALUE

Bolt-on acquisitions are probably the single most favoured strategy by our Operational Excellence Awards winners, with Nordic Capital alone completing 13 add-ons for its investment in payments business Bambora, winner of the EMEA large-cap category. "A truly exceptional case," said judge Katja Salovaara, a senior portfolio manager at Ilmarinen. Other GPs to successfully pursue a buy-and-build approach for their winning entries included Partners Group which completed more than three bolt-ons of more than \$100 million for its Hong Kong-headquartered apparel label manufacturer Trimco International.

2 EMBRACE NEW FRONTIERS

Operational Excellence Awards judge Joncarlo Mark says a more international outlook – what he describes as "geographic value creation" – is one of the new frontiers for operating partners, with even mid market firms "much more global" than they used to be. That's borne out among this year's winners where there were some noteworthy examples of international growth – especially in the US – boosting the bottom line.

EQT Partners formed a dedicated US advisory board for its sports data firm Sportradar to target the opening of the US



sports betting market. Meanwhile, KKR's white goods manufacturer Qingdao Haier pulled off one of the largest-ever transactions by a Chinese company when it bought Kentucky-based GE Appliances from parent company General Electric in a (successful) bid to bolster its US presence.

3 DON'T SCRIMP ON AD SPEND

When L Catterton created a strategic plan for upmarket pet food brand Ainsworth Pet Nutrition, the main focus was a nearly tenfold increase in consumer advertising spend. The strategy paid off spectacularly. The first TV ad garnered a string of awards, and, within two years, its main Nutrish brand was the fastest growing consumer packaged goods brand in the US, according to Nielson, with L Catterton securing a gross cash-on-cash return of 8x on exit.

4 STICK TO WHAT YOU KNOW

Among the winners, it was notable how many of the GPs had previous

experience in that particular portfolio company sector. L Catterton attributes at least part of the spectacular growth of Ainsworth Pet Nutrition to its prior success in the pet food category. Meanwhile Cerberus Capital Management leveraged its "experience with global automotive businesses, highly complex corporate carve-outs and operational turnarounds" for its impressive restructuring of troubled auto interiors business Reydel Automotive, according to senior managing director Dev Kapadia.

5 QUALITY COUNTS

Unsurprisingly, perhaps, product quality was a focus for many of the award winners. Carlyle Group transformed Spanish data centre operator Telvent by focusing relentlessly on "high-end connectivity driven customers" and Brookfield Asset Management says a focus on product quality was at least partly responsible for what the judge Steve Kaplan termed "a stunning improvement" at electrode producer GrafTech International. ■

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We are pleased to receive the **2018 PEI Operational Excellence Large Cap Deal of the Year Americas** award.



CRISIS MANAGEMENT

In search of a Plan B

The market currently shares many of the characteristics seen in the lead-up to the 2007-08 crisis. But is private equity better prepared for a future downturn this time around, ask **Vicky Meek** and **Graeme Kerr**

Few would argue that we are, right now, in a hot M&A and private equity market. Fuelled by liquidity in the private equity world (dry powder stood at over \$1 trillion at Preqin's last count) the ready availability of debt and a corporate appetite for acquisitions, worldwide M&A increased by 5 percent by number in Q1 2018 over the same period in 2017, with numbers forecast to increase by 8 percent in the second half of the year, according to Intralinks Deal Flow Predictor.

This is having an inevitable effect on M&A valuations – in 2017, average M&A EBITDA multiples hit their highest recorded levels, at 10x in North America and 7x in Europe, PitchBook figures suggest. And what's striking is that, in a reversal of historic norms, private equity is often paying more for deals than strategics. In the UK, for example, private equity deals were struck at an average 13.5x EBITDA in Q2

2018, considerably higher than the 11.6x for the overall private company universe and higher even than FTSE All-Share valuations of 12.9x, according to BDO's PCPI.

FUTURE SHOCK?

With the re-emergence of all-equity underwritten deals in some instances (with a plan to raise debt following the deal), plus a hefty dose of cov-lite (86 percent of new institutional loans issued in Europe in H1 2018 were cov-lite, up from just over 8 percent in 2007, according to LCD, S&P Global Market Intelligence), it's not surprising that many private equity houses and their advisors are considering the future with some degree of trepidation, given the pain many suffered in the aftermath of the global financial crisis.

"There is a mismatch between the quality of assets and the price currently," says

Ewa Bielecka Rigby, head of value enhancement at LDC. "In a year or two, we will see the next wave of restructuring. The money you can borrow on the market is extremely cheap and that can hide a lot of problems."

Indeed, there is a growing feeling the music will have to stop – it's just a question of when. "Capital structures are as rich as they could be for debt," says Amanda Good, partner at HgCapital. "We're not yet seeing any signs of contraction in the financial world and that is driving incredibly high valuations – there's still a lot of flex in capital structures. But these will inevitably change at some point. We're at all-time high levels of debt and that's not sustainable."

LESSON LEARNED

Yet while there is a sense of inevitability about a future turning of the cycle, there is also a degree of confidence that private equity could weather a turning of the economic cycle reasonably well. "Today's capital structures are very similar to what we saw in 2008," says Jim Corey, managing partner at Blue Ridge Partners. "Yet the financial crisis is still very much in peoples' minds. There are bubbles rising in various parts of the market, but one of the key lessons from last time around is the importance of moving quickly. Private equity is better prepared to react promptly to a change in conditions – firms know they need to take costs out of the business and make deep cuts."

Many point to structural changes in the make-up of today's firms versus 10 years ago. "Private equity has done a lot of work around operational improvement in »





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“There is no deal team or investment committee discussion that doesn't include an analysis of what a downside or recession case would look like

Fredrik Henzler

WORRYING SIGNS?

10x



M&A EBITDA multiple in North America in 2017 – an all-time high

13.5x



EBITDA multiple for UK PE deals in Q2 2018

8%



Of new institutional loans issued in Europe in 2007 were cov-lite

86%



Of European institutional loans were cov-lite in H1 2018

Source: PitchBook, LCD S&P Global

» the years since the crisis – they have hired people in-house to drive operational change,” says Mike Mills, partner, KPMG. “That means there is a lot of focus even at pre-deal stage today about how operational change can drive value, 100-day plans have evolved into value creation plans and firms now look at a three-year horizon.”

This greater pre-deal preparation is also behind the increased use of advisors to test downside scenarios. “We are involved more and more in recession-proof due diligence,” says Mills. “Firms are looking at cashflow and how they can squeeze out additional working capital. They are much more focused on these areas than 10 years ago.”

WHAT IF?

This external work complements and helps inform internal conversations around the effect of a recession on a company well before deals are completed. “There is no deal team or investment committee discussion that doesn't include an analysis of what a downside or recession case would look like,” says Fredrik Henzler, partner at Partners Group. “We take the development of the industry and its competitors as a proxy for examining what effect a V-shaped or U-shaped recession would have or what a drop in EBITDA or cashflow would do.”

Firms are also creating plans for different scenarios – in fact, as Good says, this was one of the main lessons her firm learned from the crisis. “From an operational perspective, you can't always expect that Plan A will happen,” she says. “This is especially so when looking at organic revenue growth. You have to question whether the budgets will be there the following year. Will companies spend more with you next year if their budgets get cut? You have to devise a case for if there might not be as much money to spend on your products or services. You have to have a Plan B that might be very different from your original investment case.”

They are also looking at which sectors or niches are likely to weather any future downturn better than others. “You can't create a company that's recession-proof,” adds Good. “You have to look at industries that are more recession-resilient. For us, that's areas such as technology that provides critical workflow services businesses – you can't turn off the back office in patient healthcare records, for example. You have to know what kind of industries you, as a firm, are going to be more comfortable with if a downturn hits.”

CAUTIOUS APPROACH

With the right operating partners on board, private equity firms should be in a better position to manage portfolio companies in a crisis. “One of the big lessons we learned was that it's not enough to buy a company and then just let the management team run with it,” says Bielecka Rigby. “That only works in one in 10 instances. We have to apply our own skills and experience to help management teams to deliver better results. Operating partners, which have become a much more common feature of in-house teams, bring a lot to the table, from increased focus and monitoring and changing targets when conditions shift through to being at the top of the game all the time.”

Whether these changes in the make-up and priorities among private equity firms mean the industry's portfolio weathers the next downturn better remains to be seen.

As Mills says: “I don't know whether private equity businesses will be recession-proof in the event of another crisis.”

Yet it's clear what happened 10 years ago is still imprinted on many executives' minds. And perhaps one sign of a more cautious approach at a time of high valuations is that many firms we speak to not only acknowledge the fact that prices will have to reduce at some point, but are also making the assumption in many investments now that their exit multiples will be lower than those at entry. ■



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BEST PRACTICE

The eight levers that generate growth

Nordic Capital's **Olof Faxander** and **Peter Thorninger** explain how sharing a 'commercial excellence toolbox' has added value across the portfolio

Driving operational change at a portfolio company requires laser focus. A manager needs to show sharp discernment in asset selection, deep sector expertise, heavy-duty operational skills and be proactively engaged, as well as pursue the value creation plan without relying on external market circumstances.

As managers strive to transform business operations, implementing commercial best practice, a critical lever in driving top-line growth, is central to creating value across the entire portfolio, say Nordic Capital operating partner Olof Faxander and operations director Peter Thorninger.

Q Some people still question the role of operating partners. What would you say to them?

Olof Faxander: If you don't have strong engagement in operations then you are missing the opportunity to leverage your strength as a large, experienced firm and apply it across your whole portfolio. I was the chief executive officer at two large-cap companies for 10 years. In organisations that size you have a lot of resources

and knowledge [at your disposal]. Many of Nordic Capital's investments are in much smaller companies which may lack resources, expertise and knowledge about, for instance, commercial excellence. We can support them and share best practice consistently across the portfolio to help them get things done faster in their organisations.

Q You mentioned commercial excellence. Why is that important?

Peter Thorninger: If you look at value creation across our portfolio companies, half of that uplift comes from top-line growth. To communicate to management teams what best practice looks like, we developed a 'commercial excellence toolbox' of eight levers. First is a go-to-market strategy. You need to access customers in the right markets with the right channels and the right approach. One of our portfolio companies, Vizrt, designs digital graphics for the broadcasting industry. They want to break into new areas. They can't go directly to all of their customers – there are thousands of them – so they need to change their go-to-market approach and increasingly work with a channel-partner.

Another element is market mapping and the product offering. Bambora is a prime example of understanding where to sell the product (market mapping) and a relevant product offering (payments solution) to merchants including a smooth onboarding. To sell the offer, each company needs to equip its sales team with good tools to explain the

ADDING VALUE

After five-years helping to steer Danish logistics company Unifeeder Group on a growth journey, in early August, Nordic Capital exited its investment. The firm sold the business, which transports containers from large liners at the final leg of their distribution and offers short sea services, to Dubai-based terminal operator DP World for €660 million. By then the company had completed two add-ons, of United Feeder Services in 2013 and Tschudi Logistics' short sea services in 2015, and employed around 400 staff in 25 countries. Nordic Capital's operations director Peter Thorninger (pictured right) explains the strategy.

Q Talk us through the commercial improvements at Unifeeder.

Two years ago, the CEO told me he that he felt the business was being pushed on price. He wanted the sales team to be more confident. In December 2016 we hosted a workshop to help them articulate the value proposition. Step-by-step we talked through six areas, including frequency of service and flexibility on weight. We realised there were several areas where the business offered better value [than its competitors] and Unifeeder should communicate that even more clearly. For instance, if the standard container weight is 14 tonnes and Unifeeder often transport heavy containers (above 14 tonnes), they provide better value and should charge for it. If a customer sends a container only one-way, Unifeeder needs to handle the empties and should as a minimum communicate the value we create and ideally



“ It is 10 times more costly to win a new customer than to keep an existing one

Peter Thorninger

charge for that too.

We drew up new standard terms to reflect where Unifeeder was as a company. We explained that to our customers, the shipping lines, which accepted them. If they didn't meet the new terms Unifeeder would charge a little premium. The business started to talk more about being more frequent or flexible on weight and one-way traffic. Suddenly the customers recognised the value. This supported a volume growth to Unifeeder. The second thing we did with the commercial team was to address key accounts. Instead of spending most



of their time talking to local teams on the harbours that book the cargo, they started to contact its client's headquarters. That's the level at which to talk about how Unifeeder is adding value.

Q How receptive was management?
PT: From a small push at the beginning, Unifeeder started to get that pull from the organisation. Now they are in the final rounds of hiring a commercial director who will drive commercial initiatives forward as we step out.

value proposition. That was key at logistics company Unifeeder. On sales excellence, it's classic stuff about training your sales people to push your message and developing a sales pipeline. Then, once you have won a customer you have to make sure they are satisfied. It is 10 times more costly to win a new customer than to keep an existing one. Another example of sales excellence is Handicare, a healthcare company offering mobility solutions for the disabled and elderly, where we ran a full sales excellence project supporting the company prior to its flotation on the stock exchange.

Pricing is not usually high on the [management's] agenda, but you need to charge for the value you create. Then you create accountability through reporting and processes so that everyone understands what is expected. The last tool in the box is people and performance. Without good people, talent development and performance processes, your commercial organisation can't improve.

Q Of these eight elements, which is most important to grow the top line?

PT: It varies vastly across our portfolio. We have used all of them for all our investee companies. A payments company like Trustly has a good sales excellence set-up and reporting, but they are working on their go-to-market strategy and how to attack new verticals. If you try to push an old direct sales model in a new market you can invest a lot of resources and not really move the needle.

Q What results have you seen?

PT: Focusing on sales excellence alone we've seen top line uplift of 10-15 percent. At Virzt we have worked extensively on the product strategy, defining what we're selling and the value proposition. »



Return journey: Unifeeder sold for €660 million

SUPPORTING TRANSFORMATION

There is as much focus pre-deal as post-deal on ownership excellence, says operating partner **Olof Faxander**



Nordic Capital highlights 'ownership excellence'. What do you mean by that?

Within Nordic Capital, we've made a significant investment into this function with the purpose of helping support management drive value creation. We've added resources – there are six of us on the operations team now and we also have industrial advisors and further specialist consultants' resources – we've worked a lot with processes, and now we have a very extensive engagement with our portfolio companies. We believe this increased focus has contributed very positively to the financial performance of the portfolio.

What is your goal as a GP?

We are there to help the management team succeed and achieve their target. Nordic Capital is very good at delivering the money multiple. In today's world investors are increasingly measuring the speed at which we are generating that return, and we have therefore set the aim at achieving similarly good money multiples as in the past, but accelerated by 12 months.

What is your role?

I head the operations team and chair the Portfolio Development Board, which follows the deal teams and the portfolio companies throughout the fund's ownership. We have a continuous set of reviews and meetings with the company. The frequency depends on where we need to focus the most energy.

In the due diligence phase, our four operations directors and strategic HR professional are selectively involved where they can add value. There is as much work pre-deal as post-deal to evaluate the strength of the management team. However, they spend 80 percent of their time or more on the existing portfolio and post-deal support. We also bring in industrial advisors, some we call operating chairman, which we work closely with and they can be chairmen/sit on several portfolio company boards.

How important are people to the success of the value creation plan?

We are continuously building our network of advisors. We support the deal team to appoint the board and company CEOs build their management teams. Typically, when a private equity firm buys a company its ambition level increases and that needs to be reflected in the management team. The alignment between Nordic Capital – as owners – and management is very important.

» In some countries where Virzt has a presence, we've seen a revenue uplift of 10 percent plus over the last year.

Q What challenges arise instigating change in a commercial organisation?

PT: We use a framework to assess the maturity of an organisation across these eight elements. Inside a single commercial team these can differ vastly. Where you see different maturity levels you always go for the one where you can have the most impact. That's a dialogue you have with management. Management is typically very open to receiving support for their product strategy, developing new sales tools, improving sales excellence, and making sure they have the right reporting. On pricing, less so. We continue to push on pricing. Price is always more sensitive – it is very close to a sales person's heart. But there is a lot of value there.

Q How involved does an operations team need to be?

PT: You don't go in and magic occurs. You need to be there to offer support and ensure structures stick. If you implement a dashboard for your CRM you need to ensure sales reps are trained and understand the value of transparency in their sales pipeline; that it's for their benefit. They can show what they are doing and can ask their manager for support where necessary. Success doesn't happen overnight. It might take three, four or five iterations to get it right.

It's important you create pull, that you plant the idea with management so they want to do it themselves. We work individually with companies and then every six months we host a sales network event for portfolio company sales leaders. We share our own experience and try to inspire them. But it's also important that we come with a bit of a push. ■



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operational
excellence
awards 2018

Welcome to *Private Equity International's* seventh
Operational Excellence Awards – our annual celebration
of the industry's best value-creation stories of the last year



AMERICAS

- **Large-cap**
Brookfield Asset Management - GrafTech International
- **Upper mid-market**
L Catterton - Ainsworth Pet Nutrition
- **Lower mid-market/Small-cap**
The Riverside Company - Tate's Bake Shop
- **Editors' Award**
Apax Partners - GlobalLogic

EMEA

- **Large-cap**
Nordic Capital - Bambora
- **Upper mid-market**
Cerberus Capital Management - Reydel Automotive
- **Lower mid-market/Small-cap**
The Carlyle Group - Itconic
- **Editors' Award**
EQT Partners - Sportradar

ASIA-PACIFIC

- **Large-cap**
KKR - Qingdao Haier
- **Upper mid-market**
Partners Group - Trimco International
- **Lower mid-market/Small-cap**
Mekong Capital - Traphaco
- **Editors' Award**
LeapFrog Investments - Mahindra Insurance Brokers

The best value creators

Just how successful is the private equity industry at creating lasting value? It's a question that reaches to the heart of our annual Operational Excellence Awards, celebrating the GPs that have done most to transform their portfolio companies.

Every June, we ask managers to submit their best examples of how they deliver operational value as owners. To be eligible for this year's awards, an investment had to be either fully or partially realised after 1 June, 2017. Entries are invited from three regions – Americas, Asia-Pacific and Europe, Middle East and Africa. We then divided them into three categories, according to the deal's entry price – large-cap (greater than \$500 million), upper mid-market (\$150 million-\$500 million) and lower mid-market/small-cap (less than \$150 million).

The entries then go before a judging panel comprising some of the leading scholars and operational experts in the private equity industry. Competition is tough, with record entry levels in many of the categories.

Returns form only part of the criteria. GPs are also expected to provide specific details of the changes and the initiatives they had undertaken, from product development and acquisition activity through to supply chain improvement and management enhancement.

And not just details but tangible evidence of how these initiatives created value. Impressive exit numbers were clearly a plus, but the main thing our judges were looking for was some genuinely ground-breaking work.

This year's winners were a typically diverse bunch, including everything from a premium pet food manufacturer to a struggling Spanish data centre operator.

In recognition that operational excellence can take many shapes and forms, this year we also introduced an editors' award for each region to reward those entries that shone in one particular area of management expertise. The inaugural winners were LeapFrog Investments for the healthcare impact from Mumbai-headquartered Mahindra Insurance Brokers; EQT Partners for its "carefully crafted" M&A programme for sports data collector Sportradar; and Apax Partners for its impressive growth strategy for US tech company GlobalLogic.

The multiples achieved by the winners and the range of growth strategies employed are testament to the impressive operational expertise the private equity industry has developed over the last three decades.

Congratulations to all the winners and a sincere thanks to all the GPs who entered in what the judges said was probably the toughest ever for entries.



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REALIZING POTENTIAL IN PRIVATE MARKETS

Meet the judges

An influential panel of industry experts from across the three regions assessed the relative merits of the submissions

Americas

STEVEN KAPLAN

University of Chicago Booth



Steven Neil Kaplan is the Neubauer Family Distinguished Service Professor of Entrepreneurship and Finance at the University of Chicago's Booth School of Business. His research focuses on private equity, venture capital, entrepreneurial finance, corporate governance and corporate finance. He is co-creator of the Kaplan-Schoar PME (Public Market Equivalent) private equity benchmarking approach. *Fortune* called him "probably the foremost private equity scholar in the galaxy". He co-founded the entrepreneurship programme at Booth, helping start its New Venture Challenge competition, which has created over \$10 billion in value from companies like GrubHub and Braintree/Venmo.

MICHAEL McKENNA

Alvarez & Marsal



Michael McKenna is a managing director of Alvarez & Marsal's Private Equity Performance Improvement group. He works with private equity investors across the transaction lifecycle to identify and execute transactions, accelerate portfolio company performance and provide a smooth investment exit. His primary area of focus is finance operations, driving improvements in working capital management, accounting and treasury operations, and reporting and analytics.

JONCARLO MARK

Upwelling Capital Group



Joncarlo Mark is the founder of Upwelling Capital Group, a registered advisor that provides advisory and capital solutions to institutional investors. Prior to forming Upwelling in 2011, he was a senior portfolio manager at the California Public Employees' Retirement System, where he was responsible for investing in global private equity partnerships and direct investments, with a portfolio that exceeded \$48 billion of exposure. In addition, from 2007 to 2010, Mark served as chairman of the board for the Institutional Limited Partners Association.

Asia-Pacific

VERONIQUE LAFON-VINAIS

Hong Kong University of Science and Technology



Veronique Lafon-Vinai is associate professor of business education in the School of Business & Management of The Hong Kong University of Science and Technology, where she is the executive director (career development and corporate outreach), associate director of both the undergraduate and World Bachelor in Business programmes, and a project director of the MSc in Global Finance programme. Lafon-Vinai is a seasoned financial market professional with over 20 years of banking and capital markets experience.

LIAN HOON LIM

AlixPartners



Lian Hoon Lim is a managing director with AlixPartners. He has more than 25 years of experience in all aspects of operations improvement, including sales and distribution, manufacturing, procurement, product development, overall supply chain management and transportation operations. He has consulted to the automotive, electronics, consumer goods and chemicals industries and held management positions in electronics, shipping and logistics industries in South-East Asia and Greater China.

IVO NAUMANN

McKinsey & Company



Ivo Naumann is a partner with McKinsey & Company where he leads the Private Equity and Institutional Investor practice as well as the RTS service line, a special unit that delivers a proven approach for transformational change, for Greater China. Naumann has more than 20 years of experience in supporting shareholders and management to restructure and improve performance of underperforming businesses in Asia. He has acted in multiple management roles and served on various boards of directors in China, Japan and South-East Asia.

EMEA

MILES GRAHAM Metro AG



Miles Graham is an operating partner at Metro AG, a €37 billion revenue, Frankfurt-listed food wholesale business that has adopted a private equity-style operating model.

He has been in private equity for 20 years, serving as president of 3i portfolio company John Hardy, which he restructured and sold to L Catterton, and was director and head of active partnerships at 3i Group, where he oversaw improvements across a \$6 billion portfolio of 100 companies. He spent five years in McKinsey & Company's private equity practice, and is a non-executive director of Age Checked Ltd and the Operating Partners Group.

LUDOVIC PHALIPPOU University of Oxford



Ludovic Phalippou is a Professor of Financial Economics at the Saïd Business School, University of Oxford. He specialises in private equity funds and focuses on issues such as risk management, liquidity and measurement of returns.

Phalippou's research in this area has been published in leading academic and practitioner journals.

“Each year
the entries
continue
to get better

Michael McKenna

KATJA SALOVAARA Ilmarinen



Katja Salovaara has been a senior PE portfolio manager at Ilmarinen since January 2000. Ilmarinen is a mutual pension insurer based in Helsinki, managing €47 billion. Currently 6

percent of the assets are invested in private equity. Before joining Ilmarinen, she worked at the Shell UK Pension Fund in London analysing private equity funds and monitoring a global private equity portfolio with over \$1 billion of commitments. Prior to that, she was an investment analyst in the European team at private equity specialists Pantheon Ventures.

ANTOON SCHNEIDER Boston Consulting Group



Antoon Schneider is a senior partner at The Boston Consulting Group and leads the Principal Investors & Private Equity practice in London. He has advised leading principal

investors and more than half of the 50 largest private equity firms globally on a range of deal sourcing, due diligence and firm strategy projects. He has also worked extensively with their portfolio companies on 100-day value creation planning and operational improvement projects, and has deep experience in corporate strategy and M&A.

WINNER - LARGE-CAP

Brookfield Asset Management: GrafTech International

When Brookfield Asset Management agreed to invest in GrafTech International in August 2015, the company was generating roughly \$45 million of EBITDA and revenue of around \$530 million. By the time the company listed on the New York Stock Exchange in April, its estimated full-year EBITDA for 2018 was more than \$1.2 billion – a “stunning improvement” in the words of judge Steven Kaplan – and its revenue was up to around \$1.8 billion.

In 2015, GrafTech – a producer of graphite electrodes, a key component in steel manufacturing – was struggling. In the first quarter it reported a net loss of \$56 million, driven by declining demand for graphite electrodes, lower end-market demand in certain steel-consuming sectors and continued high Chinese steel exports. During due diligence, Brookfield identified specific production improvements and strategic positioning opportunities to boost profitability.

Upon completion of the acquisition, Brookfield seconded senior operating executive Jeff Dutton into the business, first as chief operating officer and ultimately as interim CEO. Dutton helped to reposition the business through selling off non-core assets that were distracting from the company’s core focus on its electrodes business.

By 2017 when the market began to recover, GrafTech had established itself as an industry leader and was

in a strong position to execute its operational repositioning plan, which resulted in more than \$100 million in annual cost savings.

These included shifting production from six electrode facilities to three – while increasing annual production per active facility from 34,000 metric tons in 2015 to 67,000 this year; increasing focus on product quality, reducing volume of dissatisfied customer reports by 40 percent between 2015 and 2017; implementing continuous performance improvement and cost reduction across plants to maximise profitability; and halving headcount and optimising the manufacturing process at Seadrift Coke, the company’s key raw material supplier.

In 2010 GrafTech had acquired Seadrift Coke, a supplier of petroleum needle coke, the primary raw material for graphite electrode manufacturing. This vertical integration put GrafTech in a unique position as the only electrode producer able to provide customers fixed pricing and surety of long-term electrode supply.

This allowed Brookfield to successfully implement a new commercial strategy to sell 60-65 percent of GrafTech’s production capacity through three- to five-year fixed-volume, fixed-price take-or-pay contracts – the first time this approach had been used in this industry.

As part of that, GrafTech contracted more than \$6 billion of revenue at more than twice the



GrafTech:
a ‘stunning
improvement’



\$45m
EBITDA on entry



\$1.2bn
Annualised
EBITDA for 2018



\$100m
Annual cost
savings

long-term average electrode price.

GrafTech completed a debt recapitalisation and then listed on the New York Stock Exchange on 23 April, with Brookfield selling 35 million shares of common stock at \$15 per share. Brookfield further sold down its stake in August, but remains a significant shareholder.

“We are pleased with the turnaround of GrafTech and believe there is an outstanding future ahead for the company,” says Cyrus Madon, senior managing partner and head of Brookfield’s PE group.

The \$855 million investment has returned approximately 9x based on GrafTech’s current stock price.

“The Brookfield transformation of GrafTech epitomises operational transformation,” judge Michael McKenna says. ■

WINNER - UPPER MID-MARKET

L Catterton: Ainsworth Pet Nutrition

When L Catterton invested in fifth-generation family-owned pet food manufacturer Ainsworth Pet Nutrition in May 2014, its premium Nutrish brand accounted for roughly 30 percent of the company's total sales. But the deal team saw a big opportunity in the brand's value proposition.

"Based on our prior success in the pet food category, we identified an opportunity to bring pet store quality pet food to the supermarket, and were proactively targeting companies that were positioned to deploy that strategy," Scott Dahnke, global co-chief executive of L Catterton, tells *Private Equity International*. "We saw Nutrish as a brand uniquely positioned to capitalise on that strategy."

It was a big leap of faith to make an all-equity investment, the majority of which was put straight onto the balance sheet as primary capital, into a business with EBITDA of just over \$10 million, but it was a risk that paid off.

When L Catterton sold the company to JM Smucker Company four years later, it had grown EBITDA organically by a factor of more than 10x.

"[Ainsworth is an] excellent summary of value-add – a complete transformation of an OK business into a market leader," says judge Joncarlo Mark.

So, how did they do it? L Catterton partnered with the founding



>10x
Organic EBITDA
growth



8x
Gross cash-on-cash
return for L Catterton

Lang family and the management team to create a strategic plan to build the Nutrish brand, increasing consumer advertising spend by nearly tenfold.

"We had a strategy that we would turbo-charge the Nutrish brand and advertise it aggressively," Dahnke says. "We worked with them to write the first TV ad, which won a lot of awards."

By the time of exit, Nutrish accounted for more than 80 percent of total revenue.

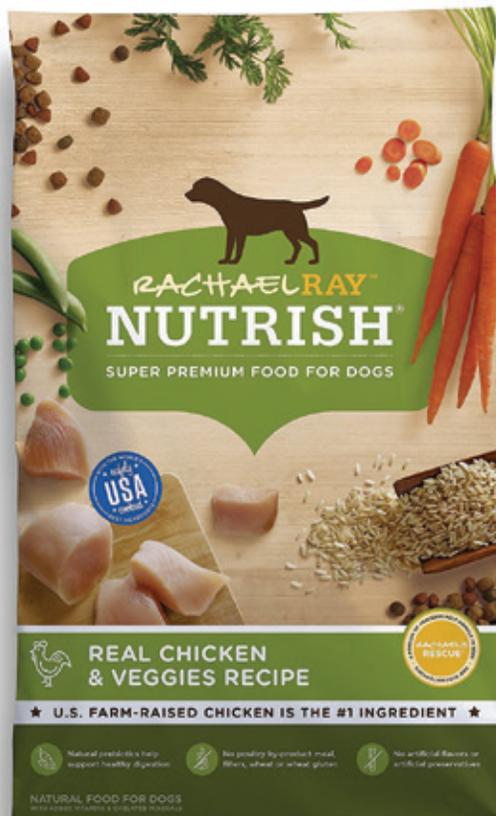
L Catterton initially streamlined operations, selling off a plant in Dumas, Arkansas, focusing energies on its original plant in Meadville, Pennsylvania. During the investment the firm invested more than \$40 million into the plant, growing its manufacturing capacity by more than 70 percent as well as reducing the cost of manufacturing per ton by almost 50 percent, enabling the company to double its gross margins.

Ainsworth added a new VP of sales and tripled the size of its sales force, more than tripling Nutrish's national distribution points and building a new e-commerce platform. It also launched two Nutrish sub-brands.

In June 2017 Ainsworth acquired Triple T Foods, its largest co-manufacturer. This strengthened the company's control over its supply chain, adding a Kansas facility to support continued manufacturing growth.

"In 2016, as measured by Nielson, the Nutrish brand was the fastest growing consumer packaged goods brand, not just in the pet category but in all measured categories," Dahnke says.

In late 2017 the firm retained Goldman Sachs as an advisor to explore both a strategic sale and a public listing. The business was sold to JM Smucker Company for \$1.9 billion, delivering a gross cash-on-cash return of roughly 8x to investors in L Catterton's \$1.68 billion seventh buyout fund. ■



Ainsworth Pet Nutrition: a big leap of faith

WINNER - LOWER MID-MARKET/SMALL-CAP

The Riverside Company: Tate's Bake Shop



64%

Rise in capacity over the course of the hold period



10

New varieties of cookie developed during Riverside's time at the helm



104%

Increase in size of team at Tate's

Judge Steve Kaplan described this as the toughest category in the Americas section, with all entrants putting forward compelling cases for the top spot. In the end it was Tate's Bake Shop, producer of America's number one cookie (in the view of celebrity chef Rachael Ray, among other arbiters of taste), which won out.

Founded in Southampton, New York, by lifelong baker Kathleen King, who opened the first branch in 1980, Tate's has experienced turbocharged growth since the entry of The Riverside Company as an investor four years ago. What started as a highly regarded but small operation on the East Coast is now part of the empire of confectionary giant Mondelez, which snapped it up for a cool \$500 million in June of this year.

"With a unique and authentic brand and truly delicious products, this acquisition gives us an attractive entry point into the fast growing premium cookie segment," said Dirk Van de Put, chairman and chief executive of Mondelez, at the time.

When Riverside came along in June 2014, Tate's Bake Shop was looking to take the good work it had done in its local market and replicate it nationally. Most important, it wanted to do this without losing any of the special touches that had helped it stand out from the crowd in the first place.

King stayed with the firm to focus on product development and public relations, the functions she had performed so well up to that point. Within two days of the

investment closing she was joined by a new chief financial officer, with a new chief executive following three months later.

Vice-presidents of sales, marketing and operations, a plant manager and a raft of other more junior hires joined in quick succession, creating a strong basis for growth. Between entry and exit, the firm's staff expanded from 187 to 383 employees.

Tate's Bake Shop started about expanding its output by moving into a new warehouse and management offices, putting in an ERP system and adding two new automated manufacturing lines. Over the course of the hold period, the company's manufacturing capacity increased by 64 percent.

Realising the strength of Tate's brand and the loyalty of its customer base, the new management introduced fresh packaging, more than 10 new flavours and formats, and raised prices on existing products in order to bolster profitability.

Distribution expanded to include more than 70 percent of the grocery channel, with the company making dents in the convenience market and gaining contracts with a number of superstore chains.

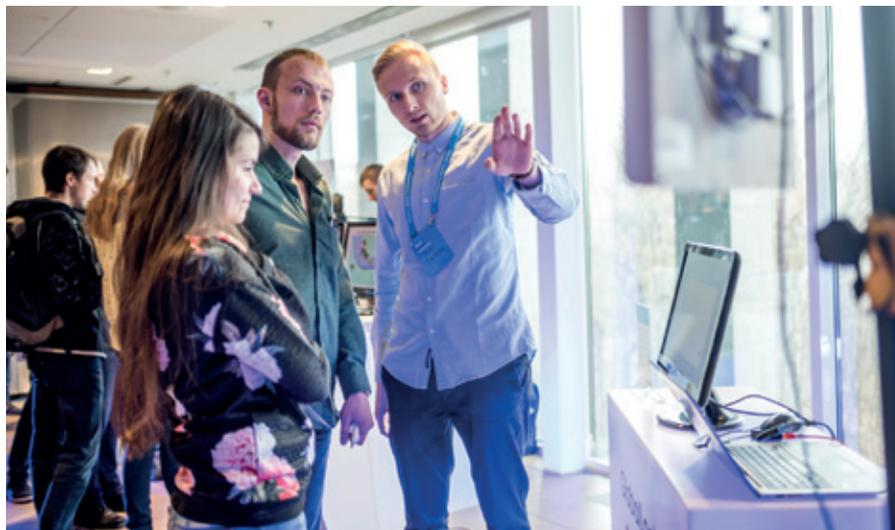
The result was Tate's Bake Shop becoming the fastest-growing premium cookie brand in the US, top-line revenue growth in the hundreds of percent, and Riverside achieving a gross cash-on-cash exit multiple in the mid-single-digits. ■



Tate's Bake Shop: producer of America's 'number one cookie'

EDITORS' AWARD

Apax Partners: GlobalLogic



GlobalLogic: increasingly creative product offering

In the public consciousness, Silicon Valley is mainly associated with the cut and thrust of the start-up scene. But it's also home to many mid-sized technology companies with strong track records, proven cashflows and big potential for growth – perfect for private equity investment.

One of these is GlobalLogic, which won the Editors' Award in the Americas for its impressive growth strategy. Founded in San Jose in 2000, the firm helps business customers design, build and deliver digital products. It was already a well-established name with an international presence when Apax Partners came along in December 2013 with a plan to take its growth to the next level.

Apax saw the huge long-term potential for the outsourced product development industry, having made a number of successful IT services



3x
EBITDA growth
from the end of
the first year on



5.4x
Gross multiple
on exit



5-6%
GlobalLogic's
share of a
fragmented
market

investments in recent years. It also saw that GlobalLogic's delivery capabilities, strong customer base and good management team made it the right horse to back in a fragmented market.

Together with the firm's management, Apax developed a strategy focused on five areas of growth: investing in new capabilities; geographic expansion; operational improvements; targeted management upgrades; and accretive M&A.

In practice, this meant investing heavily in sales and marketing, broadening the firm's offering in sectors such as healthcare and telecoms, and expanding into retail and automotive production. This broadened, increasingly creative product offering was driven by a business development operation focused specifically on Fortune 500 companies that aspired

to achieve disruption through digital transformation.

The board was revamped with hires including a new CFO, chief marketing officer and chief delivery officer. GlobalLogic also strengthened its non-executive board by appointing Sir Peter Bonfield, former chief executive of BT, as chairman.

Unusually, perhaps, for a PE-backed firm, GlobalLogic's EBITDA margins decreased by 250 basis points in the first year after Apax doubled down on investing for growth. Since then the business has grown substantially, increasing EBITDA by nearly 3x and margins by more than 300bps. Between entry in 2013 and exit in May 2018 headcount doubled to 12,000, driven by the establishment of new engineering centres in Norway, Poland, Slovakia and India, and the upsizing of its customer sales and delivery functions in North America.

As a result, GlobalLogic's market share has increased from 3-4 percent to 5-6 percent.

The investment was exited in two stages. In April 2017, its funds sold a 48 percent stake to Canada Pension Plan Investment Board. In May 2018, it announced the sale of its remaining interest to Partners Group. On completion of this transaction, the investment in GlobalLogic will result in a gross multiple of around 5.4x and an internal rate of rate of more than 50 percent – not too shabby at all. ■

NON-CORE ASSETS

Value creation in carve-out deals

With competition for deals intense and purchase price multiples reaching all-time highs, private equity houses are increasingly turning to corporate carve-outs to generate returns. PwC partner **Tobias Blaser** explains how to create maximum value from these non-core assets

Creating value in portfolio companies has become even harder over the last few years. With record amounts of dry powder to deploy, private equity firms are competing fiercely for assets while high levels of corporate cash are driving strategic buyers to acquire businesses, too. Announced M&A globally reached \$2.6 trillion in the first half of 2018, according to Bureau van Dijk, just shy of the record \$2.65 trillion announced in the first half of 2017.

In turn, purchase price multiples have rocketed: in 2017, median enterprise value to EBITDA multiples in M&A rose to their highest recorded levels in both the US (above 10x) and in Europe (above 7x), Pitchbook data shows.

With such elevated prices being paid, private equity firms are having to work at value creation strategies to ensure they can deliver the promised returns. That often means looking at less well packaged deals found in secondary buyout situations and turning to corporate carve-outs. We spoke to Tobias Blaser, partner at PwC in Germany, about how firms can ensure they have the best chance of maximising the potential value from these non-core asset sales.

Q Corporate carve-outs have become a more popular source of deals over recent years. Why do you think this is happening?

Carve-outs have certainly been increasing in the last five years. One of the main drivers for this has been corporates' ever sharpening focus on core competencies. German conglomerate Thyssen Krupp, for example, faced repeated calls from shareholders to simplify its complex structure and cut down on corporate expenses seeking to eliminate the conglomerate discount, as Reuters reported. Another driver is firms

starting to create holding structures, as grown companies are often too inflexible to react to market changes quickly. A holding company with a specialised business model allows for a lean structure and facilitates to adapt the corporate group to a demanding transaction market by divesting business units more easily and faster. For instance, Siemens recently listed its healthcare business Healthineers.

We're also seeing mega-mergers. The Bayer-Monsanto tie-up is one example; Linde-Praxair is another. These large transactions are subject to anti-trust investigations and sometimes the only way to get the deals past the regulators is to agree to dispose of certain parts of the business.

And, of course, with the high prices being paid in today's market, there is more appetite for divestiture among corporates, so that is driving some of the activity, too.

Q What type of buyer is showing most interest in carve-outs: private equity or strategic?

We're seeing high levels of competition across industries. Private equity firms have become much more interested over recent years, as they can see plenty of opportunity to increase the value of these businesses. They are especially interested if these businesses have not been restructured beforehand because there is much greater potential to create value, while strategic buyers may find these less optimised/unrestructured situations more difficult to deal with.

Q With strong competition from other firms and corporates, how are private equity bidders improving their chances of winning these kinds of deal?

The competitive nature of the market means that private equity firms have to



Blaser: more appetite for divestiture among corporates

WORKING WITH A STRATEGIC PARTNER



Q You mention that private equity firms and trade buyers are pairing up. How can the arrangement work for both sides, given the often competing objectives of financial and strategic investors?

There has to be a clear agreement from the outset. Often these arrangements are structured so that, for example, a strategic investor will contribute 30 percent or 40 percent of the capital, with the private equity firm investing the balance. However, they will often have the same voting rights on the board. This is in recognition of the fact that a strategic investor can bring considerable knowledge to an investment, such as in-depth sector expertise and market intelligence. The combination of smart, patient capital with this kind of expertise can be quite a compelling one.

For the arrangement to work, there has to be alignment on the plan for the business and, importantly, what happens at the end of the investment. There needs to be a clear exit plan – and investment time-frame – from the outset. So, there could be an agreement to exit via IPO and/or the strategic investor could have an option to buy out the private equity firm's stake at a later date.

There are some deals currently being worked on that include just such an arrangement and one of the benefits of the two sides pairing up is to deal with anti-trust rules, which can be extremely complex and require the knowledge and insight of a strategic partner to position the acquirer as a viable competitor. Also, while private equity firms mainly provide operational expertise, strategic buyers contribute valuable industry expertise and infrastructure – such as an existing management – that can be leveraged to realise synergies and maximise the enterprise value.

Indeed, firms are very conscious of competition in these deals. Whenever we introduce such a deal to private equity, houses are very interested to know the bidder universe and which strategic buyers are likely to make a bid – sometimes with a view to teaming up with them. ■

identify these assets early. We introduce and discuss potential carve-out deals with them – from a commercial, financial, carve-out and value creation angle. That way they can create a value creation story and an exit case at the earliest available opportunity and be ready to move on quickly. They are attempting to pre-empt auctions.

While around 80-90 percent of carve-outs still go through the auction process – unsurprisingly, given the competition for assets – they can proactively approach companies at an early stage of the process and avoid lengthy negotiations if they have done the groundwork. In some instances, we're seeing private equity firms and strategic buyers pair up to acquire carve-outs of large businesses in risk-sharing arrangements.

Q What do firms need to have ready if they are to move fast on a deal in today's market?

Firms need a combined team of inter alia carve-out, financial, IT, operational and legal advisors to assess the full value creation potential and have the advisor team onboarded prior to the transaction ideally. These teams need to align and co-operate closely and seamlessly and the ultimate goal of every work stream should be to create and deliver deal value in each functional area. For instance, a lawyer might highlight a legal topic but should also understand that it might have an impact on the commercial and operational aspects of a deal, and run through this with the respective advisors.

Due to the multidisciplinary nature of carve-out topics, the carve-out advisors are usually in the lead to drive communication and manage the overall value creation process. In our experience, it really helps to have advisors on board that have worked together on a number of transactions »

» over the years – you really need an A team on your side to win. PwC's deals practice supports private equity clients and provides guidance along the whole M&A process.

For sell-side clients, we usually start by helping to define a clear deal vision and strategy. Firms need to have a well-defined concept regarding the assets to divest and need to consider the right transaction structure as well as the right timing to make a move.

For buy-side clients, the process usually starts with a rigorous due diligence and value assessment to validate robustness and upside potentials of the target. We then accompany our clients along the entire deal cycle, from negotiations to day one readiness and even to the post-deal value realisation which in turn may also include an exit strategy.

Q So what kinds of value creation strategy are the most effective in carve-out situations and how can firms hone in on the right course of action?

Before acquiring the business, firms need to know what has to be done with an asset so they can get moving from day one. That means looking at the strategic levers, such as additional M&A in the form of further add-on acquisitions or divestments. They need to have a clear picture of how they are going to grow sales, either through entering new markets or enhancing or developing new products.

They also need to understand what they can do alongside the P&L – top-line initiatives such as volume scaling, price adjustments or footprint optimisation as well as bottom-line via COGS optimisation or G&A right-sizing. Many carve-outs often emerge from their parent with an oversized corporate function – there is often significant overhead that gets transferred. Simply right-sizing this part of the business

“ We’re seeing private equity firms and strategic buyers pair up to acquire carve-outs of large businesses in risk-sharing arrangements

can have a significant and lasting effect on the bottom line.

Procurement is often another area of focus – it is usually not in perfect shape and so much can be achieved through renegotiation and changing suppliers. On the other side, dis-synergies resulting from lower bargaining power when ceasing purchasing under the parent's umbrella have to be bypassed. And then there is optimisation of the business's regional footprint, which will contain some legacy arrangements that made sense while the business was part of a larger entity, but don't necessarily as a separate business. Does it need the presence it currently has in different areas and/or should it move into new areas to maximise sales potential?

Firms need to identify some of this during due diligence, but also have clean teams that continue to identify and validate value creation possibilities throughout the deal process.

Q What's the key to getting this right?

Given the high multiples being paid, firms need to fully realise the value creation potential in a business to make the numbers work. Sometimes, you see firms do all the preparation and then leave it to management to get on with the work. In fact, it requires a comprehensive carve-out assessment which provides visibility on

the current status of operational entanglements, day one readiness with regards to operations as well as on the standalone financials such as the standalone EBITDA and an optimised EBITDA. So, the carve-out assessment indicates potential red flags and their corresponding mitigation.

Effective private equity firms monitor the business regularly against detailed KPIs and they interlink value creation measures with the P&L. Firms should also focus on leaving TSAs (transition service agreements) as quickly as possible – they need to create a business that can operate on a standalone basis and the sooner this is done, the more identified value they can create and the more hidden value they can unlock. Overall, adequately orchestrating throughout the post-deal phase is key to realise the envisaged values.

That said, management also clearly has an important role to play here – strong teams really drive value creation.

Q And what kinds of development in the process are you seeing when it comes to carve-outs?

One trend we are seeing with more experienced corporates is that they are working to create a standalone business ahead of the process to minimise having to negotiate and put in place TSAs. So, for example, they may already have implemented IT systems and outsourcing agreements so the business can operate separately from day one. That can help boost the pre-sale value of a business as it reduces risk for a private equity buyer and it helps the seller because it's a cleaner break.

The other trend is the increasing importance of digital disruption and digital deal analytics to private equity buyers. Firms are focusing on this much more than in the past and they now use digital teams to assess and identify value creation potential from a technological perspective. ■

WINNER - LARGE-CAP

Nordic Capital: Bambora

“A truly impressive case” is how judge Katja Salovaara, a senior portfolio manager at Ilmarinen, describes Nordic Capital’s investment in payments business Bambora. She highlights the GP’s vision and use of its strong sector expertise and networks “to create a payments powerhouse with an end-to-end offering for the mid-market distributed on a global scale”.

Having mapped out the payments space and looked at several assets, in May 2014 Nordic Capital Fund VIII secured the carve out of Swedish bank SEB’s payment division, Euroline. “We had a long dialogue with the seller,” says Fredrik Näslund, partner at Nordic Capital. “We convinced SEB that Nordic Capital was the right owner and would invest into the products and the people.”

The Bambora brand launched a year later focused on an underserved segment of small and medium-sized merchants demanding digital and cross border services. “The platform [acquisition] didn’t have an

end-to-end offering. We had a vision to create a new type of player that would change the payment landscape and bought a number of adjacent companies, the products Euroline was missing,” says Näslund.

These included three deals secured during the buyout. In the course of Nordic’s ownership, during which it invested €55 million into products and sales, Bambora completed a total of 13 add-ons and expanded its geographic coverage across the Nordics, Switzerland, US and Australasia.

Nordic appointed familiar face Johan Tjärnberg, the ex-chief executive of payment business Point that the firm acquired in 2004 and exited in 2011, to head up an entirely new leadership team.

“Since Euroline was a carve-out, we had to support the incoming management team with significant resources, especially on the financial side and IT and invested heavily in products, some through add-ons and also through adding development



13
Add-ons during Nordic Capital’s ownership



€55bn
Transactions processed a year



50
Employees on entry



700
Employees on exit

Bambora:
‘exceptional execution’

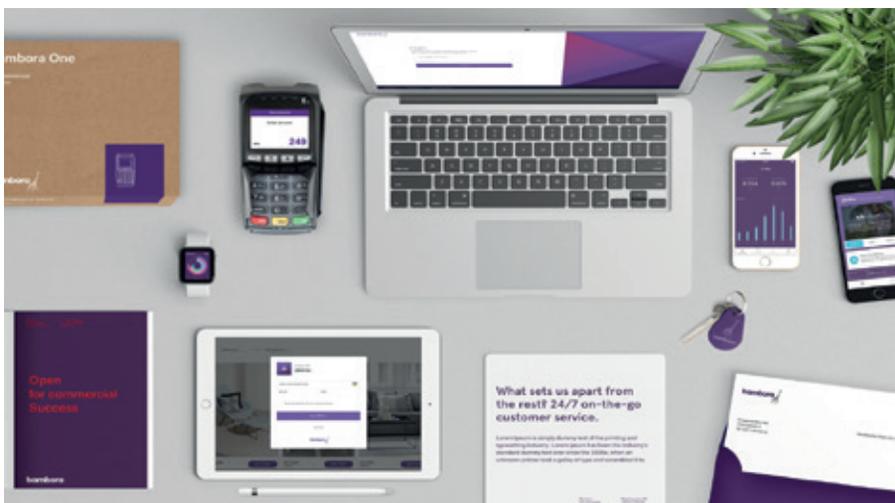
resources,” says Näslund. The number of IT engineers rose from four at entry to 200 over the course of the investment, he says. “And we were smart about using modern technology such as the Amazon cloud for hosting, which was very cost efficient.”

The team undertook “significant work on customer needs”, says Näslund, interviewing thousands of customers. “We invested in commercial excellence, added sales resource and segmented the market. Then we focused on customer support, where resources were also added.”

Digitisation slashed the customer onboarding time from weeks to minutes. Intake soared to around 3,000 new customers a month, up from around 200 at entry. At the same time, staffing levels increased from 50 to more than 700 people, of which more than half were directly recruited.

In just two years, annual revenues reached €200 million. By exit in July 2017, organic net revenue growth had accelerated from zero at entry to 30 percent, and profits had tripled. With 110,000 customers in 70 markets, Bambora was processing transactions totalling around €55 billion a year – a five-fold increase.

The business was sold to payments business Ingenico Group for €1.5 billion after just 30 months. The speed and extent of the transformation were truly impressive. Salovaara agrees. Nordic Capital’s engagement with Bambora shows “exceptional execution with investments in products, capabilities and organisation”, she says. ■



WINNER - UPPER MID-MARKET

Cerberus Capital Management: Reydel Automotive

The automotive industry is going through a period of significant change. It is within this context that Cerberus Capital Management's turnaround of Visteon Corporation's global automotive interiors business into Reydel Automotive is even more impressive.

It's little wonder the judges picked Reydel – in addition to creating cultural shifts, and change at both the corporate level and on the plant floor, Cerberus expects to make a whopping 7.8 times multiple on invested capital and a 112 percent internal rate of return upon exit which was signed in April.

New York-listed Visteon had wanted to divest its automotive interiors unit – which operated 20 plants, R&D and sales facilities across 16 countries – for several years prior to Cerberus's 2014 acquisition in what was a proprietary deal. The unit was losing money and was substantially cashflow negative in 2013.

It was Cerberus's experience in the global automotive business as well as in complex corporate carve-outs and operational turnarounds that made the firm the ideal partner for the Visteon unit. Cerberus in fact viewed the automotive interiors sub-sector as ripe for consolidation and believed the unit could become a prized part of this area – something that would prove to be right when Indian automotive parts maker Motherson Sumi

Systems agreed to buy Reydel for \$201 million in cash in April this year.

How did Cerberus turn a troubled automotive interiors business into a success story? It first set about reorganising the company. The deal – valued at around \$185 million – included a \$35 million primary equity investment and around a \$150 million injection into the business. The interiors business was renamed "Reydel Automotive", the unit's original name from the French family business when it was founded three decades earlier.

With improving efficiency a key part of Cerberus's strategy, the firm set up a manufacturing plant in Chennai and relocated production; it separated IT systems and invested in capital equipment and software licences.

One of the biggest changes was to executive management. New



-\$16m
EBITDA on entry



\$68m
EBITDA on exit



7.8x
Expected multiple on exit

recruits included a vice-president of operations, treasurer, controller, head of Asia sales, general counsel and chief technology officer. Cerberus executives including more than a dozen operations professionals spent substantial time with the new leadership team to implement the carve-out and turnaround plan and drive operational improvements across finance, human resources, manufacturing and legal areas.

Cerberus was relentless in improving manufacturing efficiencies. The firm introduced a review of new programme bid proposals to focus on "core assumptions" which protected Reydel against margin risk. It also focused on "continuous improvement" at each of Reydel's plants which included a company-wide programme that collected input from all levels of staff at every plant. This removed the siloed culture from each facility and helped lead to year-on-year cost reductions of at least 5 percent annually.

Over a three-year period with the help of Cerberus, Reydel's EBITDA grew from negative \$16 million to \$68 million.

"Reydel was a successful partnership that leveraged Cerberus's experience with global automotive businesses, highly complex corporate carve-outs, and operational turnarounds," says Dev Kapadia, senior managing director of Cerberus and co-chair of the firm's private equity investment committee. ■



Reydel Automotive: relentless in improving efficiency

WINNER - LOWER MID-MARKET/SMALL-CAP

Carlyle Group: Itconic

Imagine acquiring a business that not only suffers from falling revenues and profits but has no financial or performance data you can analyse. That's what Carlyle Group faced when it spun Telvent Global Services out of Schneider Electric in 2015.

When the global private equity giant invested in Spain-headquartered Telvent, an IT infrastructure management business with data centres across the Iberian peninsula, the business had no standalone finance, tax, legal, human resources or property management functions. The firm, which used its €656.5 million Carlyle Europe Technology Partners III fund to invest in the deal, had to build all these functions from scratch.

Carlyle rebranded the business to Itconic and set about strengthening the management team, including adding a chief executive, new chief financial officer, two senior executives and former Teleticity chief executive Mike Tobin as a board director.

One of the key elements in Carlyle's value creation story was the increase in products. Carlyle developed a cloud exchange point allowing connectivity with Amazon Web Services – the online retailer's massive on-demand cloud computing platform – as well as Microsoft's Azure. In addition to adding major regional internet exchanges to Itconic's portfolio, the firm acquired CloudMAS, an AWS reseller for Spain, and expanded its offering to cover Azure and Google Cloud as well as offering a full suite



Itconic: data centres across the Iberian peninsula

of hybrid cloud products as part of a single platform.

One of Carlyle's priorities was to refocus and invest in Itconic's core data centre unit, which had strong telecommunications connections in the Iberian peninsula but which had been suffering from neglect. The private equity firm worked with the newly implemented management team to increase capacity at the Barcelona, Madrid and Lisbon data centres and focus on "high-end connectivity-driven customers". It was this element that boosted Itconic's market position to one able to compete with global players.

In just over two years, Carlyle had transformed a business with falling revenues and profits to one that delivered strong underlying topline revenue and EBITDA growth.

In 2017 Carlyle agreed to sell Itconic to internet services firm Equinix for €215 million. The deal marked the first exit from CETP III and media reports at the time noted the firm made a seven times return

on its investment. The business now operates the largest network of data centres in Spain and Portugal.

Fernando Chueca, managing director in the European technology team, said: "The acquisition of Itconic by Equinix for €215 million only two years after the original acquisition by Carlyle was a testament to the substantial changes made in the business through a combination of improved strategic focus, attracting leading international customers to the business and delivering additional investment into cloud technologies."

Katja Salovaara, OpEx judge and senior private equity portfolio manager at Finnish pension insurance firm Ilmarinen, describes the Itconic deal as a spinout from a corporate that was "completely transformed" from a business with falling revenues and profits to strong growth. "The refocusing and investment in the core data centre division paid off with securing global marquee cloud customers." ■



7x
Reported multiple
on exit



€215m
Sales price on exit

EDITORS' AWARD

EQT Partners: Sportradar

Fans of sports statistics: ever wondered who is counting all those passes? You may be surprised to learn it is the same people – or at least the same company – that is beaming live video footage to fans, gathering data for bookmakers and monitoring games in search of possible match-fixing.

Switzerland-headquartered Sportradar has more than 7,000 freelance sports data journalists on its books and partnerships with sports federations from the NFL and NBA to the German Handball Bundesliga. Its pitch – “the source code of sport” – refers to its positioning at the “intersection of the sports, media and betting industries”.

Using its sixth flagship fund, the 2011 €4.25 billion EQT VI, EQT Partners acquired a co-control stake of around 35 percent in the business from its own EQT Expansion Capital II fund and other minority shareholders in 2014. The enterprise value

was not disclosed, but is understood to have been in the region of €400 million. By the time EQT would come to sell the company in 2018 to Canada Pension Plan Investment Board (an investor in EQT VI) and tech investor TCV, it would have an enterprise value of around €2.1 billion.

The value creation programme earns our EMEA Editors' Award for the way in which it tapped into the innate potential of the business, expanding into adjacent segments, and executing what one of the judges described as a “carefully crafted” M&A programme.

Over the course of EQT's ownership, Sportradar grew its data “event coverage” so that it was tracking and reporting data on a wider portfolio of sports events (it has now covered more than 400,000 events) in new geographies going deeper into lower leagues. It also diversified its client base, growing beyond its traditional

core customers (sports betting operations) to a wider group. These now include sports federations – like the Bundesliga, Germany's football league – who use Sportradar's Integrity Services unit to guard against match-fixing and betting fraud, or the International Mixed Martial Arts Association, which uses Sportradar's OTT (“over the top”) service to stream and monetise video content directly to its fans.

During EQT's investment period Sportradar's annual sales grew at a compound annual growth rate of more than 40 percent per year to approximately €300 million during the most recently completed 12-month period. In the same period, Sportradar increased its headcount by 1,400, a rate of 25 percent per year.

In EQT's own words per its press release at the time of the exit, the company “expanded via several add-on acquisitions and secured a strategic investment by [growth investor] Revolution Growth which led to the formation of dedicated US advisory board comprising Ted Leonsis, Mark Cuban and Michael Jordan. The strong focus on the US market over recent years has positioned Sportradar well to capture the significant growth potential from the opening of the US sports betting market”.

Carsten Koerl, founder and CEO of Sportradar, who will continue to lead the business with EQT as a minority shareholder, described EQT as a “great partner supporting Sportradar in its globalisation and diversification”. ■



~€400m

EV on entry, according to market sources



€2.1bn

Enterprise value on exit



~35%

Ownership stake



~25%

Annual employee headcount growth



Sportradar: 'the source code of sport'

BEYOND GROWTH TARGETS

Are you spending too much on sales?

Sales leaders are too busy trying to hit their revenue targets to focus on cost inefficiencies, says Blue Ridge Partners managing partner Jim Corey

“Sales organisations are built to optimise profitable revenue growth. They are not built to optimise economic efficiencies



Corey: CEOs fear 'touching the wrong wire'

How efficient is your sales force? Probably less than you think, says Blue Ridge Partners managing partner Jim Corey. Whether it's too much time spent chasing unpromising leads or inefficient go-to-market models, sales teams can “accumulate layers of economic inefficiencies that begin to cost a material amount of money”, he says. Corey talked to *Private Equity International* about how to cut out waste in sales and why CEOs lack the experience to step in.

Q Where do you find these inefficiencies?

The most important area involves human performance. In our experience, sales people tend to spend dramatically less time selling than anyone would have envisioned. We have found it averages about 30 percent. The leadership team is often surprised it's that low. The rest of the time is spent undertaking a number of administrative and customer service tasks that aren't selling. This hurts the economic value of a sales hour.

Often companies have the wrong people in sales jobs. For many of our clients we conduct a 'skill-will' assessment and many sales people, often a third, don't have the right skills or aren't making enough effort. Some of these people are just in the wrong role: they are 'farmers' employed as 'hunters' to seek new leads, but they are never going to be successful.

And, sales people often waste time chasing unqualified leads. Because they are under tremendous pressure to show a pipeline of productive leads for fear of receiving unwelcome criticism, they overinvest in leads that never close.

Q Why doesn't management notice?
They do. These inefficiencies are seen but accepted. Sales organisations are built

to optimise profitable revenue growth. They are not built to optimise economic efficiencies. Sales leaders are so focused on making their targets that they tolerate lower levels of performance. They think some revenue from a weak performer is better than none [from an open vacancy].

However, we often find by squeezing out inefficiencies there is the potential for 10-25 percent savings and reinvestment. In that range they become material. The business could apply this money to new products, enhancements to current products, entering new end-markets, being more effective in cross selling or building new tools for their sales reps.

Q And what could be done with the time?

Many sales organisations are struggling to hire new people. And when they do, they experience a very slow ramp-up period that is often twice as long as they expected. Right in front of them are proven, experienced sales reps who, if they were released from non-selling tasks, could double their selling time. That is so powerful. It's not just about money; it's about getting more out of the current investment in sales people.

Q If the impact is material, why do businesses underestimate the value of fixing these inefficiencies?

I'm quite sure all sales leaders are aware that these inefficiencies exist, but they don't have time to fix them and they don't know the economic value of them. They don't have the facts. They probably don't even know how much time is being spent [on each task]. Most sales leaders are very effective at working in the business and can produce revenue growth. They aren't necessarily very good at working on the business. »

» That's a different skill set and it's hard to find a sales leader that can do both.

Q So why don't chief executive officers step in?

Executive search firm SpencerStuart undertook a study that revealed only 17 percent of CEOs have direct experience in leading a sales organisation. The 83 percent who do not are very reluctant to wade into a complex area where their sales leader is busy producing revenue numbers for fear of touching the wrong wire and losing customers or their best sales people.

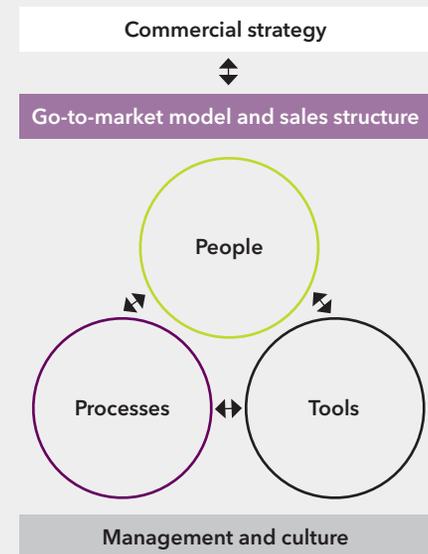
However, when you talk to sales people, they are begging for help with this topic. They often believe they are being held back because processes are too complex or they think the company isn't giving them the tools that they need or prices are set too high. They are receptive to changes because they believe they are going to be helpful. Poor performers might feel threatened, but in many cases they are people that should be exited from the business anyway.

Q You say sales leaders are often reluctant to dismiss weak performers. What's the solution?

Usually a sales rep quits or a company eventually gets fed up with weak performance and exits a person. The HR team kicks into action, understands what skill set is required, puts the spec together and finds candidates. Or the sales leader says they might know someone. Typically, when a sales opening materialises there isn't a ready supply of qualified candidates. The answer is to maintain a pipeline of potential candidates. This prepares sales managers to exit an underperformer as they know there are other candidates that could be better.

Q To help businesses cut inefficiencies, you have developed the Commercial

THE COMMERCIAL EFFICIENCY FRAMEWORK



The tool to identify and prioritise commercial efficiency focuses on six key areas:

Commercial strategy - aligning sales expenditures with the aspirations, strategic actions and economic expectations for the sales organisation.

Go-to-market model and sales structure - customising the sales model for each major customer segment and designing the most economically appropriate sales organisation.

People - recruiting, onboarding, developing, compensating and retaining sales personnel to provide the quantity and quality of skill sets required to economically deliver on the commercial strategy.

Processes - establishing structured, scalable sales processes that remove unnecessary complexity and are repeatable across the sales organisation.

Tools - providing sales reps and sales supervisors with automated support to productively plan, execute and monitor bid/proposal activity.

Management and culture - establishing a leadership style focused on openness, accountability, high performance and winning; creating a culture that rewards success and has real consequences for underperformance.

Efficiency Framework. What is it?

Sales organisations are very complex and they have lots of moving parts. In an effort to try and simplify it, we developed a framework to identify and prioritise actions that can result in material savings by reducing economic inefficiencies. Of the six dimensions, the most important is the people, followed by the commercial strategy. A company has to have the right people in the right role spending the right amount of time against the right

“Sales leaders are very effective at working in the business and can produce revenue growth. They aren’t necessarily very good at working on the business

SALES EFFICIENCY CUBE

Relative spending level in sales	More			A More output with more spending
	Same			B More output with same spending
	Less	Declining business lines	D Same output with less spending	C More output with less spending
		Less	Same	More
		Relative output from sales		

Q In this sales output grid, where do businesses want to be?

In the lower right corner, where businesses are getting more and spending less. In the middle of the bottom row, if your business is under some pressure and demand is weakening, you’re going to try to sustain flat level revenue growth but spend less to get it. All the way over on the left you have a declining business. If a business is unwilling to ring out these inefficiencies, or if they are unable or don’t have the time, they might migrate to the upper right corner, which is where a lot of companies sit. Businesses in Cell A accept the existing cost structure. Our point is that it’s more sensible to move down the right-hand column by squeezing out some of the inefficiencies to help find those incremental expenditures necessary to grow.

Q How does this work in practice?

I’ll give you an example. A global provider of information services realised their sales reps were not touching many of their high-potential prospects. As a result, the company wanted to increase the size of their direct sales team. This incremental cost was largely offset by lowering the number and cost of non-quota carrying personnel and reducing the number of sales reps assigned to low growth products. The result was a doubling of revenue growth rates with no increase in costs, Cell B.

opportunities otherwise sales organisations are not going to perform well.

Even so, they have to execute against a sensible commercial strategy and know their sweet spot, where they are going to win, where they are likely to lose, how they are positioned against competitors. And, of course, they need to be supported by processes, tools, management and culture. All these six elements are highly intertwined. Leaders have to assess the impact of changes in one area on all the others. That is why it’s hard to squeeze out these inefficiencies.

For example, the sales commission and incentive scheme is an important thread running through all these pieces. A company may believe its growth will come from rolling out a new set of products, but sometimes sales reps can make more money selling older products and are not going to spend time selling the new ones. A business needs to design a compensation system that helps it achieve its commercial strategy.

Q Where should a business begin as it seeks to make its sales organisation more efficient?

The first thing is to understand the facts underpinning performance in each of the six areas. For the people element, we often conduct a survey of sales reps to ask where they spend their time. That is often eye-opening for the leadership team. Another is to understand individual sales rep performance relative to their cost. We have a return on investment calculation that takes the gross margin dollars a person produces and divides it by their total cost, ie, their pay, including base, bonus, compensation plan, all of their travel expenses and benefits. Then you start to realise that a very large percentage of gross margin dollars, it could be up to 90 percent, are produced by only 25 percent of your sales people. Then people realise that something different needs to be done. ■

WINNER - LARGE-CAP

KKR: Qingdao Haier

White goods manufacturer Qingdao Haier was already a leading name in the Chinese consumer electronics market when KKR acquired a 10 percent stake in June 2014 for \$603.5 million, one of the largest private equity deals by KKR in China at that time.

The Shanghai-listed company was looking for a global partner to expand and accelerate its growth ambitions as domestic competition increased. The KKR deal offered the most compelling vision for its future – a global network and industry expertise, as well as operational improvements and transaction integration led by KKR Capstone, a team of 60 full-time expert operating professionals across the Americas, Asia and Europe dedicated to support the firm's portfolio companies.

In just four years KKR significantly grew company revenue from 88.8 billion yuan (\$13 billion; €11

billion) to 159.3 billion yuan, a compound annual growth rate of 21.5 percent. The company also further expanded into Europe, East Asia, South Asia and Australia.

One transformative M&A was that of Louisville, Kentucky-based GE Appliances. Qingdao Haier bought the unit from parent company General Electric for \$5.4 billion in 2016, one of the largest overseas transactions by a Chinese company at that time. The acquisition brought a number of strategic benefits to the company – an expansive distribution network, wide product portfolio, and most notably, a US presence that would provide Qingdao Haier with a key market for white goods supply and demand.

Cathy Cai, a director of KKR Capstone, notes that this was the highlight of the transaction.

"It was a landmark deal where a Chinese company was able to buy a

world renowned brand. This would not have happened 30 years ago."

The deal resulted in approximately 10 billion yuan in revenue synergies and 1 billion yuan in cost synergies. "We basically put everything into several buckets – legal/compliance, finance, HR, production and manufacturing, procurement and supply chain, sales and marketing, and channel distribution network and collectively decided to start refining our governance model, as well as integrating procurement and the supply chain network."

In line with KKR's commitment to ESG, the firm led Qingdao Haier's brand transformation into building smart and more environmentally-conscious products. The team oversaw investment in product research and development to design, manufacture and sell products that are more efficient and cost-effective.

From 2014 to 2017 the firm's other notable operational initiatives also included a two-year material cost reduction plan in which KKR Capstone worked alongside Haier to consolidate its expansive supply chain network for its air conditioning manufacturing unit, as well as implementing large-scale cost resource bidding. Under KKR, Qingdao Haier also launched at least one new high-tech and high-performance product every year in six major categories.

KKR has been offloading its stake in the last year and continues to hold minority ownership. ■



**21.5%
CAGR**

Top-line revenue growth



**14.8%
CAGR**

EBITDA growth



41.7%

Increase in employee numbers by exit

*Figures from 2014 to 2017



Qingdao: a high-end brand with environmental focus

WINNER - UPPER MID-MARKET

Partners Group: Trimco International

Apparel label and brand identification solutions provider Trimco International is no stranger to private equity ownership, having previously been owned by Navis Capital Partners since 2005. Swiss investment firm Partners Group tracked the asset through its private equity business in Asia, which helped to start an early dialogue prior to acquisition in April 2012.

When it acquired the Hong Kong-based company, its operations were local but it was ready to expand beyond Asia. Over the course of the firm's more than six-year investment in Trimco, which was made from a number of funds, including the €1.5 billion Partners Group Direct Investments 2012, it transformed a strong local leader into a global leader.

Florian Marquis, senior vice-president, private equity Asia, at Partners Group says this was achieved by "helping Trimco's regional and local management teams build a global footprint in production, sales and client coverage, mainly in the UK, continental Europe and the US".

Under Partners Group the company quadrupled the business via strong organic growth and a series of meaningful add-on acquisitions. Its revenue grew at a compound annual growth rate of +33 percent between 2012 and 2017. And its workforce expanded from about 400 to 1,500 employees in the same period.

The firm also worked hard with the founder Miranda Kong and management team, spending time



Trimco: from Asia-centric to global leader



3.4x
Return multiple



28%
IRR



+33% CAGR

Top-line revenue growth between 2012-17

travelling the world together to identify add-on acquisitions and working side by side in the integration work, Marquis says. "It was a very collaborative approach."

To support international expansion, Partners Group focused on building client relationship teams in key markets in Europe and the UK. It also expanded its manufacturing footprint in key apparel hubs across Eastern Europe, Turkey, China and South Asia. The firm completed three bolt-on acquisitions of more than \$100 million: UK-headquartered Labelon (2012), Bangladesh company Enam Labels (2014) and Denmark-headquartered A-Tex (2015). These contributed meaningfully to the EBITDA margin uplift.

The firm also worked on operational improvements across the platform such as in-sourcing/customer

pricing review initiatives and cross-selling between Clotex, Labelon and A-Tex.

In terms of corporate governance, Partners Group implemented new enterprise resource planning systems across the globe as well as global transfer pricing policies.

The winning factor was "the strong international growth and strong improvement in profitability together with a focus on strategic rationale", says judge Veronique Lafon-Vinai.

Partners Group worked with Goldman Sachs in the second half of 2017 to run a targeted exit process. It sold Trimco in January this year to Hong Kong buyout firm Affinity Equity Partners for \$520 million, generating a 3.4x investment multiple that represented a 28 percent internal rate of return. ■

WINNER - LOWER MID-MARKET/SMALL-CAP

Mekong Capital: Traphaco

In frontier markets, corporate governance can be tricky to get right. But for Mekong Capital, a pragmatic approach to compensation, personnel and board structure at Vietnamese pharmaceutical business Traphaco yielded impressive results.

When Mekong acquired a 24.99 percent stake in Traphaco in 2007, the company was ranked among the top 20 pharmaceutical businesses in Vietnam, with revenue and net profit of \$33.4 million and \$2.4 million, respectively. The firm's ownership of Traphaco would come to be a tale in three acts: building a foundation for growth, breakthroughs in performance and pre-exit shaping.

While the company enjoyed a modest 10 percent CAGR in the two years after Mekong's investment, it was not until 2009, when the firm introduced a new staff remuneration system and performance-based bonus scheme linked to net profit growth, that its financials really took off. Its annual net profit more than doubled from \$2.9 million in 2009 to \$6.1 million in 2012.

This early period of growth was also compounded by a radical change to the value chain. At the time of Mekong's initial investment, traditional medicine accounted for 80 percent of Traphaco's total revenue and was manufactured by its subsidiary, CNC. In 2011, Traphaco increased its stake in CNC to 51 percent, providing better control on production quality and efficiency, with higher profit margins.



It was in the second act that Mekong utilised governance to maximise Traphaco's growth. In 2013, the firm introduced Phan Quoc Cong – founder of ICP, one of the largest personal care product companies in Vietnam and a former Nestlé manager – to Traphaco's board. Cong overhauled the distribution network by refocusing its sales policy to go direct-to-pharmacy, rather than via wholesalers, and implemented a system to track regional sales.

Mekong also introduced Paul Lagewag, a member of Mekong's value optimisation board and former general manager of Unilever Vietnam, who identified a lack of successful products at Traphaco. Lagewag prompted the company's management team to shift its focus to launching new products and utilise market data to better understand consumer preferences and behaviours.

More governance improvements

Traphaco:
leadership
transformed by a
non-exec board

came in 2016 as Mekong prepped the company for exit. Mekong transformed the company's leadership model by creating an independent and non-executive board of directors and prompting them to set up human resources, strategy and audit committees. The board also redesigned the salary and bonus system, while boosting alignment of interest by ensuring management owned an unusually high 10 percent of share capital.

The proof is in the pudding. Net revenue climbed to \$83 million at exit in November 2017, while net profit rose at a 16.9 percent CAGR to \$11 million. Under Mekong's ownership, the company had become the second largest pharmaceutical company in Vietnam by net revenue.

The firm ultimately divested its holding for \$64.5 million, realising a 27.7 percent gross IRR and 6.3x gross return multiple. ■



6.3x
Gross return
multiple



27.7%
Gross IRR

EDITORS' AWARD

LeapFrog Investments: Mahindra Insurance Brokers

Always be prepared, as the saying goes. LeapFrog Investments took these words to heart in 2009 when it acquired a stake in Mumbai-headquartered Mahindra Insurance Brokers, a subsidiary of Indian finance giant Mahindra Group.

At the time of LeapFrog's entry, Mahindra Insurance was heavily focused on its traditional motor business. Given that adverse weather conditions can lead to volatility in the tractor insurance market, the company's new investors saw a need to diversify through India's 900 million-strong rural population.

Market research identified key areas where the insurance market was failing to meet consumers' needs adequately: healthcare, weddings savings and education savings.

LeapFrog worked with Mahindra Insurance to develop a \$2 per month hospital cover plan that would reach one million emerging consumers and their households by the time of its exit. The firm also helped launch a cashless health insurance solution that was 40 percent cheaper than competitors and had a waiver on pre-existing conditions. There are currently 300,000 policies accessed via 4,000 hospitals, in a market where formal access to healthcare remains limited.

It was this impressive impact on poorer consumers, many of whom couldn't afford a conventional health plan, that ensured that LeapFrog picked up the Editors' Award for Asia-Pacific.

LeapFrog's tenure as owner was not without its difficulties. A heavy monsoon season in 2014-15 saw motor insurance claims for vehicles such as tractors become a significant operational problem, while the Indian government's 2016 demonetisation drive voided the vast majority of India's paper currency, leaving many rural consumers without cash to pay insurance premiums.

These headwinds did not stand in the way of organic growth. Mahindra expanded its distribution network by increasing its branches to 450 from 200, while conducting numerous insurance distribution marketing campaigns to strengthen the brand and add new product lines.

LeapFrog also worked with Mahindra to digitise the company. This included a customer relationship management and call-centre

function that improved sales by enabling Mahindra to reach more potential customers and chase insurance renewals, while reducing costs.

The firm exited Mahindra in 2017 through a sale to global reinsurer XL Group. The deal – which valued the business at \$200 million – generated a high multiple for LeapFrog, with Mahindra's top-line revenue and EBITDA recording a 14 percent and 20 percent CAGR respectively during its ownership.

More importantly, with a “responsible exit” model, the firm ensured Mahindra would continue to make an impact. By exit the company had more than doubled the number of people it reaches to 12 million, of which 7.5 million were low income, and provided jobs for more than 1,000 people – up from approximately 550 at entry. ■



\$200m

Value of business at exit



20%

EBITDA CAGR

Mahindra:
impressive impact from \$2 per month hospital cover



ADD-ON ACQUISITIONS

Value-creating merger strategies

More than two-thirds of bolt-on acquisitions don't achieve the expected synergies, largely because buyers don't plan the integration properly, says **Jon Caforio** of RSM

The growth of add-on acquisitions has been explosive. But integrating two companies into a synergistic platform remains one of the most difficult aspects of a deal. More than 70 percent of post-merger integrations fail to capture planned synergies and value. Why? Because buyers underestimate the effort they need to truly merge two companies, and they don't spend enough time planning the integration. As a result, the companies never fully merge.

To successfully complete the post-merger integration process, start the planning process during the due diligence phase – before the deal is completed.

The lines are frequently blurred between pre-deal synergy planning and actual day one execution, making it imperative that management and employees are ready to execute before day one in support of the value creation strategy.

Consider what needs to be ready both before and after the acquisition. When building the timeline, management has to consider plans and milestones for day one, business continuity, quick wins, the 100-day plan and long-term initiatives.

RISK MITIGATION

Business continuity and risk mitigation are extremely important parts of the initial phase of the integration process and should be addressed with priority. Look into any financial changes that can affect transacting with customers on day one, and make sure regulatory approvals are in place, essential IT systems and infrastructure will function as intended, and critical financial reporting requirements can be met. Management should have an integration governance structure and workflow process in place on day one. This structure should encompass a steering committee to oversee

direction, and an integration management office to drive delivery and workstream leads for all major departments to execute.

On day one, the company must be prepared to seamlessly deliver to its customers. It is essential that the plan for the combined companies is communicated clearly to all employees, both in the platform and the add-on. For employees to fully execute on the plan, they must understand it.

Customers and the marketplace should not be left out of the communication loop either. Delivering a clear message internally and externally allows management to mitigate operational and process risk. However, this takes deliberate planning. Many merged companies lose out on real value creation because they underestimate the time it takes to communicate effectively with the various parties.

Quick wins are most often the immediate operational decisions that can be capitalised on with little effort or investment. Quick wins are generally focused around integrating technology and back office functions such as finance, risk, human resources and facilities functions. But don't overlook the front office functions of marketing, sales and customer service as well. Examples of quick wins can be as strategic as expanding the geographic reach of an existing product or service by immediately enabling the expanded sales team or as tactical as leveraging new revenue streams and services provided by the other company.

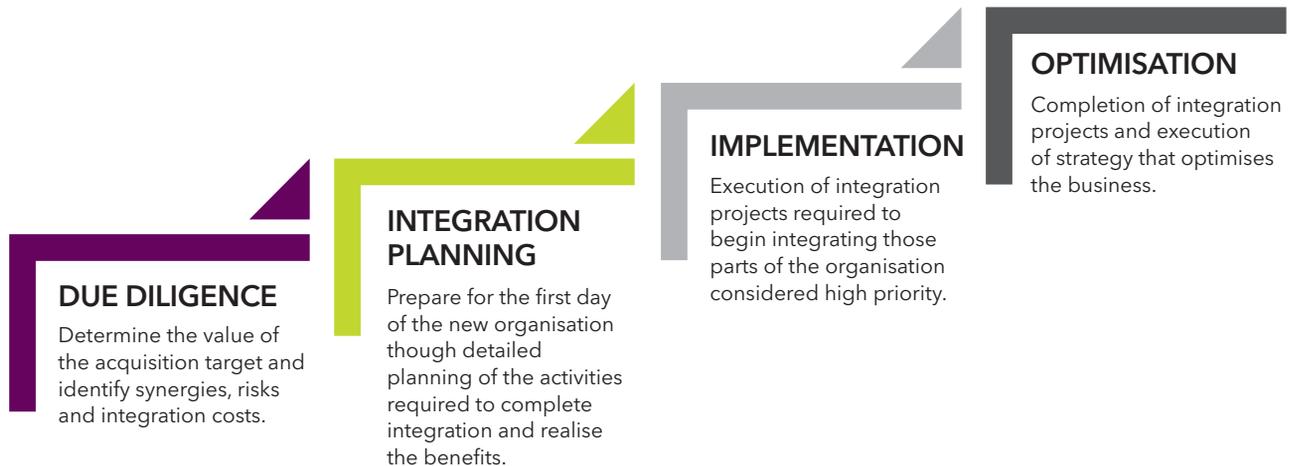
ATTAINABLE GOALS

There's no question that planning for day one is time consuming, still management cannot stop there. A comprehensive plan for the first 100 days also has to be set into motion prior to day one. The first 100 days are critical because they will determine whether the transaction will indeed



Caforio: don't confuse quick wins with long-term integration plans

THE POST-MERGER IMPLEMENTATION PROCESS



deliver value as the buyers intended. Goals for the first 100 days should be short-term and attainable. For the 100-day plan, management should conduct initial functional integration workshops and develop a list of initiatives that will be completed in approximately one to three months.

The first 100 days are also critical because it is when management is most likely able to effectuate change. Employees are expecting change during this period of time. Changes that are made during those first 100 days are more likely to last than changes made down the road after the first 100 days when it is common to see a return to a “business as usual” attitude.

During the first 100 days, management should confirm the merged company’s long-term integration plans, including the process and technology efforts that need to be completed. During these early phases of the integration, many different factors have to be carefully managed such as external and internal communications, change management, legal and regulatory issues, costs and financial analysis.

“The lines are frequently blurred between pre-deal synergy planning and actual day one execution”

The first 100 days and quick wins should not be confused with long-term integration plans and transformational change. During the first 100 days, the goal is to execute projects which meet critical business requirements and capture quick-win synergies from the combined company. During this time, departments can develop their future operating models and begin to transition towards a combined state.

Long-term optimisation initiatives are put in place to capture the full synergy and value that management is expecting to achieve. Working with a strong integration management office from start to finish will facilitate the focus required to help

buyers meet their long-term optimisation objections.

The integration management office provides the process, tools and resources required to orchestrate the necessary activities to capture deal value and realise an optimised future state. The buyers and senior leadership of the combined entity establish a vision for an integration from the very beginning. Without a well-coordinated effort to drive this vision into the projects being executed by individual departments, it can never be realised. Some projects may be expected to take two or three years. Those projects require extra focus to ensure they stay aligned with the value proposition of increasing EBITA, reducing risk or remaining compliant – which should translate into an increased enterprise value and successful liquidity event.

Having a well-managed post-merger integration effort from the beginning means “planning for success”. ■

Jon Caforio is a principal with the management and technology consulting team at RSM.

GENERAL PARTNERS

‘Everybody talks a good game...’

... but what are GPs really doing to drive performance? LPs must be prepared to ask some tough questions, says **Joncarlo Mark**, a former senior portfolio manager at CalPERS

Joncarlo Mark is used to looking beyond the hype of general partners. As a senior portfolio manager with the California Public Employees’ Retirement System, he was responsible for investing in global private equity partnerships and direct investments, with a portfolio that exceeded \$48 billion of exposure. He left CalPERS to set up investment advisor Upwelling Capital Group in 2011 and is one of the judges of this year’s Operational Excellence Awards for *Private Equity International*. He tells Isobel Markham why operational improvements have become the benchmark with which to measure a GP’s capabilities.

Q When did you first start seeing private equity firms pitching their operational capabilities?

There’s always been GPs positioning themselves as operationally-oriented in some

fashion, whether they boast about their operational backgrounds or ability to find good operators to run companies.

However, the implementation of operational expertise and value-add has accelerated exponentially over the last 15 years. It’s driven by the efficiency of the market. The bottom line is 15 years ago you were paying high single digit multiples in a traditional buyout. Today, average leverage in mid-market buyouts is six times, and purchase price multiples are well into the double digits. Whereas in the past, I think it was easier for GPs to make money on the buy, the efficiency of private equity – as so easily identified through the pricing – has made it much more difficult for private equity to just think they can buy a company cheap and sell it at a higher multiple.

What that means is you still are back-ing management but the low-hanging fruit of buying cheap has gone away. Now even before you buy the company you have to have a real clear vision of what needs to happen operationally and how to execute on that.

Q Is the 100-day plan still in play?

The traditional line you hear is the 100-day plan but it may be a two-year plan or it may be the first 30 days or the first six months. I don’t think it’s just the 100-day plan any more; companies aren’t fixed in 100 days and their value hasn’t been maximised in 100 days. The operational element, whether it’s driven by an internal operating

team that the GP brings to the company, or the company or its management using their network resources or a combination, is more relevant than before. More than ever there really has to be meaningful operational improvement for the GPs to meet the return expectations of their investors.

Q How do LPs diligence operational capabilities?

That is the exact objective of the course I teach at the ILPA Institute called ‘A Framework for GP Value Creation’ – helping enlighten LPs on the kinds of questions they need to ask managers, management teams and other people involved in the diligence process.

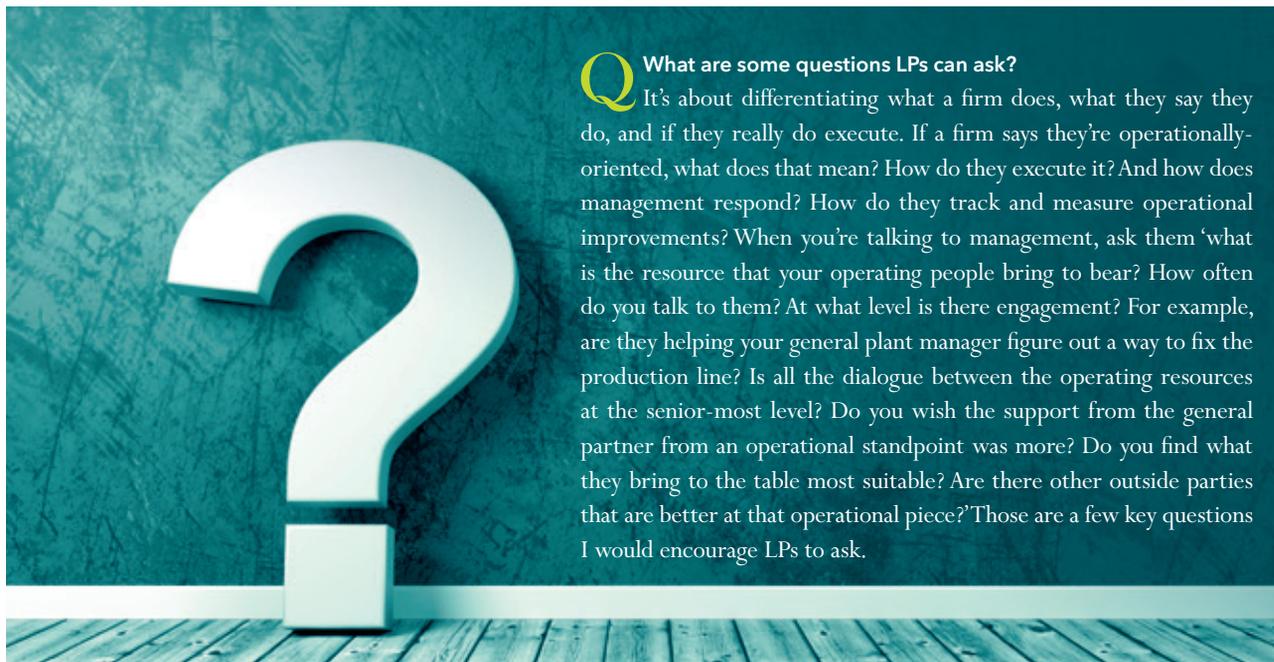
Everybody talks a good game – it’s really understanding what that means. It can’t just be ‘we have a group of operating partners that are affiliated with our firm’. That looks good, but almost everyone has that these days. It’s really identifying the exact work.

Some private equity firms are incredibly heavy-handed in their operational engagement at a portfolio company, to the point that it may create some friction with the management team – which can be good or bad. Others are primarily financial buyers, they have a network of operating people they can tap but they’re not so engaged. In these cases they’re probably buying more healthy, growth companies and really just getting behind the CEO to drive performance. Then there’s people in the middle that want to be a resource to management and help execute, but do not want to tell management what to do, because at the end of the day the CEO and the senior team is accountable for the plan.

Where the operational value-add role might be most important is in the development of the plan as opposed to its execution.



Mark: LPs need to be prepared to probe



Q What are some questions LPs can ask?

It's about differentiating what a firm does, what they say they do, and if they really do execute. If a firm says they're operationally-oriented, what does that mean? How do they execute it? And how does management respond? How do they track and measure operational improvements? When you're talking to management, ask them 'what is the resource that your operating people bring to bear? How often do you talk to them? At what level is there engagement? For example, are they helping your general plant manager figure out a way to fix the production line? Is all the dialogue between the operating resources at the senior-most level? Do you wish the support from the general partner from an operational standpoint was more? Do you find what they bring to the table most suitable? Are there other outside parties that are better at that operational piece?' Those are a few key questions I would encourage LPs to ask.

If you find a firm that is more of a financial buyer that has the right people either on their team or in their broader network of executives, that may be as effective as the firm that's got 100 operating people.

Q Do LPs have concerns about the costs associated with operational resources, particularly affiliated entities?

Some firms, for good or bad, treat operating partners like investment partners. It's very important that the operational people demonstrate, if it's an internally-driven piece, that indeed they're value-add. These are the kinds of questions an LP is going to want to ask. Did you find the affiliated operating team to be productive? Where were they strong, where were they deficient? LPs are acutely aware that affiliated operating partners or external consultants are a cost to them at times.

Sometimes operating people are salaried employees and it's just all rolled into the management fee. The real potential conflict is 'X portfolio company is paying the affiliated operations firm to do operating consulting work or is engaged at a personnel level; could that company find better operational

support at more value as opposed to utilising the GP's affiliated entity?' That's a process of reporting; what's the outcome? How has the company performed?

Theoretically the investment management team is more aligned with the LPs because if the company doesn't do well, it doesn't matter whether or not the affiliated entity made money on it – their economics are driven by the overall investment performance.

Q Are there any new frontiers of value creation we're just beginning to see firms explore?

One is geographic value creation; today, even middle market firms are much more global, or are certainly transatlantic. How does the market in Italy or Spain compare with that company trying to develop a business in the US? What are the nuances in labour relationships in Germany and how do those compare with opening up a facility in Mexico to support a global company?

Another is aligning management. If everyone agrees that getting the right managers is critical to executing an operational plan, then how do they do that? How do

GPs attract the right managers? Here we are focusing on operational value add, but maybe one of the more important things is the reputation of the general partner to be able to attract the right CEOs. Because the CEO community is pretty close so there are few secrets that a prospective CEO can't pick up with a few phone calls in the market. If a firm has a bad reputation, CEOs are probably going to be reluctant to work for that manager. How does the general partner attract the best? You can always pay people, but I think the most successful executives want to work for people who have a reputation for supporting CEOs and providing the appropriate resources – not being overbearing and being someone they can work with when things maybe don't go well.

One of the big developments that's occurring is the development of internal HR departments at the GP: dedicated hiring of HR professionals whose sole job is to find talent for their portfolio company managers. That's a huge development, particularly if one believes that the most value a GP can add is through backing great management teams. ■

M&A STRATEGIES

How brand integration drives value

Developing a successful brand can bolster buy-and-build strategies by creating a platform that is more attractive to acquisition targets, says **Phillip McMillan**, CEO of strategic growth consultants CompleteSpectrum

As GPs struggle to find assets on the cheap, branding is increasingly seen as a way to create the growth necessary to warrant the cost. But what are the integral components to deriving ROI from portfolio company branding? CompleteSpectrum's CEO Phillip McMillan and executive vice president Matthew Stein have worked with a number of private equity firms and their portfolio companies to deploy brand strategies that drive top-line growth and ROI. We sat down with them to discuss how to make branding work for the unique needs of the asset class.



Q In your experience, how are GPs thinking about brand equity now?

Phillip McMillan: Broadly speaking, branding isn't part of their playbook, when they should be seeing it as an untapped source for growth in many investments. The effort should start with an assessment of each and every one of their portfolio companies. Then they should use that information to develop road maps and strategies to go to market more effectively.

Take buy-and-build platforms, which are popular these days. There are a lot of forks in the road, a lot of decisions to make on how best to integrate those companies quickly, and in a way that makes them more than what they were individually.

We spend a lot of our time on the M&A side, and work with how best to brand that platform in a way that encourages more acquisition opportunities and drives growth objectives as the platform is built out. A lot of acquisition targets will accept a lower

multiple from a buyer, in order to partner with a platform that has a vision for their enterprise.

Matthew Stein: Whether it's the first buy or the 12th bolt-on acquisition, private equity firms have to pay attention to how these platform companies are seen in the market. But they also have to heed how the brand is communicated to staff and future acquisition prospects.

Q Why does it matter how the brand is communicated to staff?

MS: In-house talent is critical to representing a company's brand in the marketplace. They touch the customers directly and bring the brand to life. As things shift in terms of brand, they need to be kept up-to-date so they're able to stay aligned with the strategy that's devised in the C-suite.

PM: And that in-house talent is often part of the value of any acquisition. The brand has to be communicated to the staff of a target, to keep them excited about the change in ownership. Otherwise, they'll start looking for opportunities elsewhere and in this job market, they'll probably find them.

Q Over the life of an investment, when should GPs look at brand equity issues?

MS: The best time is prior to signing the deal, so brand-centric data like market perception and customer purchasing preference becomes part of the decision-making process on whether to go forward. There's

“Tapping brand equity can certainly help top-line growth, but the best strategies will move the needle in terms of ROI as well”

Phillip McMillan

also an opportunity if new leadership is introduced to a portfolio company, or when the deal team is devising the first 100 days' plan.

I'd add that every time they explore a bolt-on acquisition, they should look at their brand strategy.

Beyond the initial due diligence phase, an annual pulse check on a company's brand equity is worth doing. It's not always to make changes. Sometimes it's to report back the success of current efforts or to align to new bolt-on opportunities in the acquisition pipeline. Then when planning for the exit, it's critical to take a look at the market and what investors are spending on, and align the branding to that.

Q Some GPs may assume they already focus on branding. How does this kind of brand strategy review differ from their existing efforts?

PM: A lot of firms may include a generic brand survey as part of market diligence to help with the valuation, but that tends to focus on the risk. But they aren't looking for the opportunities.

We're looking for untapped value here. We're looking at integration of, say, multiple brands. What are the costs, but what are the opportunities to access new verticals? Our processes are built around growth and how to build awareness so that brand strategy creates value.

We always aim to ask questions that get answers that drive a concrete action. At its best, branding is about understanding how a company is perceived by the market and shifting strategies to meet or exceed those expectations.

It's about heeding the reality of how the market sees them – and finding opportunities to expand the reach.

Q Can you give an example of what this strategy looks like in practice?

PM: We worked with one organisation that through an aggressive buy-and-build strategy accumulated 32 different brands in one platform over just 12 months. The first step was to try to understand how the market saw that platform organisation. The reality was the platform had no identity of its own.

And for a private equity-backed company, that's a serious liability. To be able to exit that investment, they have to convince a strategic buyer, or other financial investors, or the public markets, that this platform makes sense, as built.

So, we devised a strategy that reduced those 32 identities into four key brands, with a simple tagline that explained what that parent company did for those four brands. We easily measured the value, quantitatively, through subjective studies of how people articulated the brand. And then we made sure that everyone, both inside the company and out in the market, understood that new identity through a robust go-to-market strategy.

Q Can GPs tackle this in-house?

MS: Most of our work is in the middle market and we rarely see this kind of expertise there. Brand equity work like this requires rolling up research and data points into actionable insights. And what the vast majority of in-house marketers do is focus on things like traditional lead generation. This is a very different flavour of marketing that translates consumer interactions, preferences, desires and competitive sets into new tactics to go to market.

PM: And that requires a team. There needs to be a digital marketing person who understands that realm and then a customer



Stein: assess your brand strategy with each bolt-on acquisition

branding expert and another one that understands analytics. Specialised branding firms can offer that, but a smaller middle market company might not. And honestly, GPs need to look at opportunity cost. What isn't getting done because someone at the firm or inside the portfolio company is focused on a branding initiative? And can they think outside the box of "what has been done" versus "what should be done"?

Q How do you tailor a branding strategy specifically for private equity?

PM: Every day, decisions get made that reflect the relatively short-term holding time of private equity. There are branding opportunities that require a long runway, but that investment won't make sense if the payoff is years down the line.

The best branding strategy is about preparing firms for their next stage – whether they go public, or are bought by a strategic, or jump up to a larger fund, there must be a branding message that will resonate in those management presentations. Tapping brand equity can certainly help top-line growth, but the best strategies move the needle in terms of enterprise valuation as well. ■

HUMAN CAPITAL

The value of diversity

No longer simply a compliance item, diversity is now recognised as a value creation driver. **Victoria Robson** outlines the seven steps you need to take to ensure an inclusive workplace

The #MeToo movement that began with individual revelations of sexual harassment in the workplace has triggered a society-wide discussion of gender inequality at work. Across the world, diversity is in the spotlight. At the same time, increasing LP pressure, particularly among large US pensions eager to see the mix of their beneficiaries reflected in investment teams, is forcing GPs to address diversity and inclusion internally and at their portfolio companies.

The big European pensions are also active in talking to GPs about gender and cultural diversity at the board level and below, amid a series of studies showing that there are better returns if diversity is taken into consideration.

Among them, McKinsey's *Delivering Through Diversity* report demonstrates companies in the top quartile for gender diversity at the executive level are 21 percent more likely to generate above average profits than those in the bottom quartile. For ethnic and cultural diversity, top quartile businesses are 33 percent more likely to outperform on EBIT margin.

With a deeper understanding of the environment in which businesses operate, a diverse team can better identify the right investment opportunity, says Adiba Ighodaro, Actis's head of investor development group Americas. "That sets you on a path to great value creation. It's important to avoid groupthink around risk and to have people bring different ideas to the table; to be not only in the market but of the market.

Diversity provides a licence to operate in the community."

In a fast moving, highly priced transaction space requiring GPs to execute aggressive value creation plans, employing a diverse workforce also contributes to increased understanding of the customer/client base; more creative thinking and innovation; enhanced employee engagement and reduced churn; and a healthier ability to anticipate market shifts and future customer needs, among other value drivers.

"Diversity is critical; you need people to look at problems in a different way," says Andros Payne, managing partner at consultants Humatica.

Clients and customers also expect it. Diversity and inclusion typically fall under the broadening umbrella of environmental, social and governance commitments businesses are expected to make. They are linked to "the transparency and trust discussion and the credibility of a business", says Graeme Arduis, head of ESG at Triton Partners, which has set a target to appoint at least one female board member at each portfolio company.

Here are seven steps GPs can take to ensure increasingly diverse and inclusive workplaces at the portfolio company level:

1 ASSESS DIVERSITY PRE-DEAL

It is never too early to consider diversity. To get a sense of a company's profile at due diligence, managers can ask questions addressing diversity and inclusion procedures, any



anti-discrimination policies, whether diversity is discussed at the board level, whether a business has any initiatives such as diversity champions, and if it is a UK business whether it has met its gender pay gap reporting obligations, says Caroline Löfgren, head of responsible investment at HgCapital.

And even if those questions are not asked directly, "consideration of diversity is implicit in the value creation plan", says Ralf Schremper, partner at Oakley Capital. "It comes into the assessment of the management structure and key talent."

2 START AT THE TOP

As the McKinsey study shows, reaping the financial fruits of diversity begins with the executive team. Leadership clones "can

DELIVERING THROUGH DIVERSITY

Companies in the top quartile for gender diversity are

21%

more likely to generate above average profits than those in the bottom quartile

For ethnic and cultural diversity, top quartile businesses are

33%

more likely to outperform on EBIT margin

Source: McKinsey

make a company single-focused”, says Désirée van Boxtel, partner at Karmijn Kapitaal, a female-led GP that invests in Dutch SMEs with a balance of male and female leadership. Enhanced performance results from combining management styles, for example, long and short-term outlooks, risk-taking and risk management, and a results-driven versus client-orientated approach, she says.

And while management spearheads diversity initiatives, the board has a role in ensuring it remains on the agenda irrespective of whether it is a live issue. Here GPs can wield significant influence. “It has to start at the top,” says Christian Sinding, head of equity at EQT. “We undertake a clear mapping of the board, which we populate ourselves. Gender diversity is most

important. Boards and managers haven’t appointed enough females.”

3 ESTABLISH DIVERSITY AS A CORE VALUE

Establishing a robust set of business values, which includes diversity and inclusion, is essential to leverage the benefits of different working patterns and approaches. Marshalling the talents of an eclectic group of employees “is a huge leadership challenge”, says Payne. “The most diverse organisations have the most consistent values,” he notes.

And once established, businesses need to ensure they retain those foundational values that have underpinned growth. “As a business scales and grows and recruits more people it becomes more difficult to stay true to the

values that often drove the client base,” says Cindy Casciani, managing director at non-executive director search company Equity Chair. “It should be a yearly conversation.”

Other ways to assess ongoing commitment to diversity include conducting exit interviews on departing employees and assessing how hard individuals are to replace, she says.

4 RECRUIT CREATIVELY

To tap into the range of talent in the market place, GP clients are requesting a more diverse list of candidates, says Casciani. “They want to see us be creative.”

Using a variety of recruiters, hosting recruitment forums, establishing female networks, using anonymous assessment software and hiring heads of talent all serve as routes to identify leaders from alternative backgrounds. Setting targets provides a clear goal against which to measure progress, says Ardu. “If you don’t set targets, you won’t move forward.”

Businesses require “robust competencies to execute the value creation plan”, says Payne. “Closing competency gaps is almost always linked to diversity and getting people that are not a clone of the current team.” To do so, businesses need to “look for areas where there is a monoculture; a blind spot”.

Uniformity can be a barrier to recruitment. “In the war for talent candidates have a choice, and choose to work for businesses that take inclusion seriously. This is important at the firm and portfolio company level,” adds Ighodaro.

5 BUILD A CULTURE OF INCLUSION

For businesses to benefit from a diverse workforce “an important prerequisite is an open and collaborative culture”, says Schremper. This requires encouraging employees to speak up and a leadership secure enough to be challenged.

“The level of participation and transparency over how a business arrives »

» at conclusions and takes decisions is important,” he says. “If management is not driving that behaviour it’s hard to enforce. If the same [type of] people have the decision-making power, the business culture won’t change.”

Instead of flourishing, “a team that is very diverse may also die fighting”, says van Boxtel. In addition to establishing a core set of values, mentoring and coaching helps a business take advantage of differences in employee style, personality and approach, she adds.

Training, for instance on the benefit of quotas, is key “so that the firm and senior colleagues on the board of portfolio companies are aware of the context and importance of initiatives and are receptive”, says Ardue. The need for awareness extends to the workforce as a whole, where employee engagement surveys are useful for assessing the broader business culture, including diversity, he adds.

As an example of how a GP can apply internal best practice to its portfolio, Actis’s leadership has participated in unconscious bias workshops that the firm intends to roll out at its portfolio companies tailored to their particular markets, says Ighodaro. “There is no point in having diversity if you don’t get the most out of it,” she says.

6 LOOK TO THE FUTURE

Working towards greater workplace diversity today enhances the future talent pool. “As we exit or individuals leave, we are building a network of people who we could hire again,” notes Ardue.

And while the profile and attitude of senior management is critical to trickling down a diversity culture, businesses also need to consider a variety of entry-level candidates. Embedding diversity from the bottom up is key to succession planning. “Entry-level people are going to be the business leaders of tomorrow,” says Casciani. “You want to make sure there is a succession [cohort] coming up, otherwise it’s going to be impossible to find leaders that are diverse.”



“In the war for talent, candidates have a choice, and choose to work for businesses that take inclusion seriously. This is important at the firm and portfolio company level

Adiba Ighodaro

7 LEAD BY EXAMPLE

Many GPs have teams comprised of a variety of international backgrounds and industry experience. However, women are scarce. They occupy only 5 percent of senior roles in European private equity, according to Invest Europe. “The challenge for many PE houses has been the historically low level of women involved in private equity, which to some extent has made them a bit cautious about preaching the benefit of diversity to portfolio companies if they feel their own houses are not in order,” says Alison Hampton, founder of responsible investment advisor Alma Verde Advisors.

Talent attraction and recruitment strategies are key in redressing gender imbalance, says Löfgren. Encouraging greater diversity ranges from including more images of diverse teams on the firm’s website and using inclusive language in job descriptions, to asking senior women to participate in candidate interviews, she says.

By offering ongoing support, devising family-friendly policies and sharing best practice with their portfolio companies, managers can lead by example. ■

TECHNOLOGY

Are my procurement savings hitting the bottom line?

The lack of effective systems to record and track procurement cost reductions has long been a source of frustration for private equity owners. One answer is to invest in a technology platform capable of monitoring standalone and portfolio wide performance, says **Declan Feeney** of global procurement consultancy **Efficio**

Finding ways to reduce costs and increase profitability in their portfolio companies is a key focus for private equity groups – which is why so many are leveraging procurement to achieve their savings goals.

Procurement spend typically accounts for up to 70 percent of revenues in a manufacturing business and around 30 percent in services businesses. It's often the case, however, that procurement isn't fully optimised within an organisation, presenting private equity groups with significant cost reduction opportunities. Yet while identifying savings opportunities may be achievable, making sure these savings flow through to EBITDA can be more challenging. That's why CEOs, CFOs and private equity companies are increasingly focusing on tracking reductions in spend to the bottom line.

WHERE HAVE MY SAVINGS GONE?

An all-too-common scenario is for an opportunity assessment to take place, significant



“For the first time, CEOs, CFOs and private equity owners have full and centralised visibility of procurement initiatives throughout their lifecycle

Declan Feeney

savings opportunities to be identified and a strategy developed to achieve them. An implementation plan is agreed, contracts are signed and the plan – which may include rationalisation or replacement of suppliers, tenders and negotiations, new or revised specifications, and more – is implemented.

At the end of the financial year however, it's not uncommon to find a mismatch between the identified savings and what is shown in the P&L. It's not clear whether the savings were achieved but aren't easily identifiable – or if they didn't happen at all. Either way this can be a tremendous source of frustration for both the portfolio company and the private equity owner.

Ultimately, CFOs need to be in a position to take procurement savings out of budgets so that they can increase profitability. But before they can remove savings they need to be sure that the savings were actually achieved.

WHY HAS THIS HAPPENED?

There can be many reasons why planned savings don't reach the bottom line. Among the most common are lack of engagement with, and support from, the business; poor implementation of the new deal; and lack of compliance from the business – all of which can result in 'leakage' that erodes planned savings over time. Add to this a lack of effective systems to record and track savings, and the challenge is clear.

It's often impossible to get a single, accurate view of how procurement initiatives »

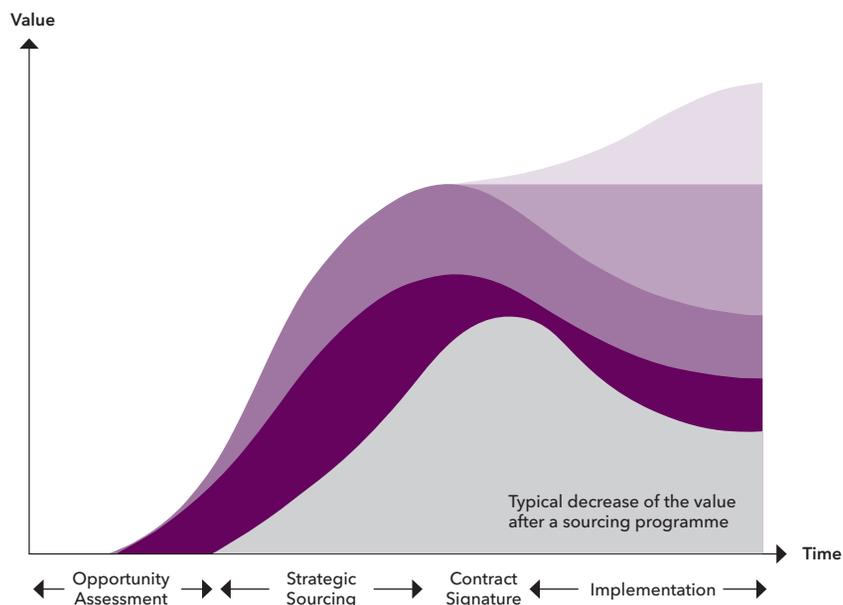


Tracking performance: a dashboard can monitor the progress of savings initiatives

Source: Efficio

SAVINGS EROSION

Ways to reverse leakage and add value



How procurement can boost bottom line

- Identifying additional opportunities as market develops
- Managing implementation, supplier performance spend and compliance
- Maximising value of savings delivered
- Identifying potential savings and delivering them sooner

Source: Efficio

» and the procurement function as a whole are performing, and whether savings are being realised. But without this information, taking timely action to stop the leakage and get things back on track can be a major challenge.

WHY ARE PROCUREMENT SAVINGS SO HARD TO TRACK?

Until relatively recently the strategic value that procurement can add has been largely overlooked. So there has been an absence of technology solutions to effectively track and manage procurement initiatives.

Companies have instead had to rely on manual, offline processes with large amounts of time and effort being spent developing and maintaining savings spreadsheets. As a result, data has been fragmented, unreliable and not very rich, with little or no information on project risks or actions. This has made it difficult to quantify savings or measure the value that procurement is delivering.

Project management software is typically too expensive and complex for this purpose. Moreover, there has been little or

HOW TO INCREASE VALUE THROUGH PROCUREMENT

For a savings plan to work effectively, there are five points to consider:

1. **Understand spend in each portfolio company.** By knowing how much each company spends and on what, it's possible to identify areas where this could be reduced through negotiating new contracts with suppliers.
2. **Work out which categories or areas could be negotiated on a shared basis.** Once savings have been identified at an individual company level, it's clearer where there is potential to help companies work collaboratively to negotiate bulk purchases. Given that private equity groups may have a variety of companies from different sectors, it may be that it is only a viable strategy for one or two categories, such as, for example, IT hardware or travel.
3. **Don't force the issue.** Private equity firms that have achieved the smoothest and best outcomes have offered their portfolio companies opt-in schemes rather than requiring them
4. **Provide a focal point for companies to share best practice on procurement.** This could be through the creation of networks and events, so that those responsible for procurement in portfolio companies can build relationships with each other and feel comfortable sharing knowledge and information.
5. **Facilitate negotiations for portfolio companies.** Produce standard contracts that companies can, for example, access online to help them negotiate and secure better terms from their suppliers.

TASTING SUCCESS AT MEC3

After Charterhouse Capital's 2016 acquisition of MEC3, a global manufacturer of ingredients for artisanal gelato, MEC3 moved to increase its strategic position by acquiring two complementary businesses. These acquisitions provided the opportunity to create efficiencies and free up cash, with procurement being a key focus. As MEC3's existing procurement team was small and had a largely non-strategic focus, Charterhouse engaged Efficio to help.

Efficio identified significant opportunities for cost reductions and rolled out a series of strategic sourcing initiatives to transform MEC3's approach to procurement.

To accurately measure the resulting savings and to enable MEC3 and Charterhouse to quantify the return on their investment in the procurement transformation programme, Efficio implemented a new measurement approach and savings tracking tools. The savings on spend were outstanding.



nothing developed specifically for procurement – until now.

At Efficio, we've seen transformative results from Pulse, a standalone component of our eFlow technology platform. Pulse provides businesses with a simple and effective way to track the progress of procurement initiatives and monitor the achievement of savings targets. There are clear advantages to using this type of tool to meet the needs of procurement projects:

- **Simplicity:** Ease of use – a simple, flexible user interface allows updates on savings, progress and actions to be entered, while reports and updates are easy to understand.
- **Flexibility:** Savings can be tracked over the full procurement pipeline; they can also be aggregated to allow focus on different categories or business units.
- **Timeliness:** Status reporting provides up-to-date snapshots on progress. Risks can be flagged and mitigations identified early on.
- **Scalability:** Option to use on a single initiative or across multiple projects

– for example, private equity groups can track savings delivery across their entire portfolio.

Perhaps the most important benefit of a procurement platform is the visibility it provides. For the first time, CEOs, CFOs and private equity owners have full and centralised visibility of procurement initiatives throughout their lifecycle – a single source of truth, all accessed from one place.

This gives CFOs and private equity owners proof of the value that the procurement strategy is delivering and evidence that savings targets are being achieved. In turn, it provides them with the confidence to take the savings out of budgets – a key step in ensuring they reach the bottom line.

From a management perspective, this allows risks to be identified early on. For example, lack of compliance within the business may be putting savings targets at risk. If left unchecked, this will continue to erode savings. But with early warning, actions can be taken to address the problem

“It's often impossible to get a single, accurate view of how procurement initiatives and the procurement function as a whole are performing, and whether savings are being realised

and ensure that savings can be sustained in the long term. It also allows senior management to see, at a glance, which initiatives will deliver the most value so that they can prioritise resources accordingly.

Importantly, this drives better engagement with business stakeholders. With improved visibility of results, stakeholders can better understand the impact a procurement initiative will have and their role in it, which further helps to ensure savings are achieved.

The potential for procurement to add real strategic and bottom line value to businesses is increasingly understood. But the ability to realise that potential has often been hampered by the lack of effective tools to ensure the benefits flow through to EBITDA.

That barrier has been removed with the development of procurement tracking platforms, which have been successfully deployed in businesses over a range of industries and sectors. They are transforming the ability of those businesses to track and manage key procurement initiatives and converting planned procurement savings into bottom line benefits. ■

Declan Feeney is private equity advisor at Efficio and specialises in issues around value creation programmes and post-merger integration. He joined in 2012 after 13 years in private equity at Permira and Fondinvest.

OPERATING PARTNERS

The new player in the deal team

Operating partners are increasingly involved before a transaction closes, write **Victoria Robson** and **Graeme Kerr**

A decade on from the global financial crisis, operating partners are a common sight at portfolio companies. Absorbed in the nitty-gritty of transforming a business during the ownership period, they have become a major cog in the value creation engine. As the number of operational specialists employed by GPs rises, the scope of their participation is also expanding.

Fierce competition for assets, high pricing and the need to originate more off-market transactions, as well as investment managers' increasingly sector specific focus, are stretching the presence of operating partners across the investment cycle. No longer confined to stepping in on specific situations once the deal documents are

signed, operating partners are increasingly involved pre-deal.

This can be as early as bringing opportunities to the deal team, says Gail McManus, managing director of private equity search firm PER. "The operating partner will sit down with that team and say, if we want to invest in this industry, these are the things that really matter, these are the trends, this is where the sector has problems, this is where the opportunity might lie. Let's talk about what we might do to take advantage of that. They are bringing knowledge and expertise. They are not there to grind out the deal."

Using their bank of industry experience, operating partners serve as a valuable



Team effort: dealmakers still 'call the shots' but operating partners are getting more involved in M&A

sounding board for investment partners scouring for deals. “When the guys go out to the market to look at potential investment targets, they come back to us and ask us about our experience within the industry, within similar management teams, [and] do we have any ideas on what kind of value creation initiatives the company can take on,” says Ewa Bielecka Rigby, head of value enhancement at Lloyds Development Capital.

QUESTION TIME

During due diligence, operating partners ask a diverse and different set of questions to the investment team, says Fredrik Henzler, co-head of Partners Group’s industry value creation team. “The investment side is very much on the cashflow, the quality of earnings and the ability to repeat margin improvement. The operating and industry side more often than not takes more time to look at whether this is the right segment of the industry that we want to play in. While we’re looking at the same topic, we are taking different approaches to looking at it. We believe that makes a better investment decision.”

Operating partners are now present at the first management team meetings, notes Blue Ridge Partners managing partner Jim Corey. “One, that helps them build a trust-based relationship with the management team earlier in the process. It also allows them to make judgments about whether this management team is change ready and willing,” he says.

It is a two-way street. While operating partners have always interacted to a degree with the deal team, “what’s changed recently is that there has to be an underwriting case

that is competitive in a market that is very hot”, says Amanda Good, HgCapital head of operations innovation team. Increasingly, operating partners are “being asked to find change agendas where the deal executives can make sure they win the deal”.

But ultimately, “it’s the deal team that calls the shots”, says Edward King, partner at executive search firm McLean Partnership, “sometimes much to the annoyance of portfolio and operations guys”.

The relationship between the operating partner and the deal team is “quite key”, says Fredrik Bürger, EY EMEA private equity value creation leader. “We see operating partners more and more frequently getting involved pre-deal, actually thinking through what can be done with a business, be that from a growth perspective, or a cost reduction perspective, whatever the investment thesis is. In my experience the most effective partnerships between operating partner and deal teams are when they work as one team and you don’t know who is who.”

This level of pre-deal engagement requires juggling time and focus. “It’s always a bit of a difficult decision, shall we get more involved pre-deal, because it takes our time [away from] working for our current portfolio companies,” says Rigby.

At one time, her team was involved in one out of 25 deals the firm executes annually. Now, she says, they participate in all major transactions. She believes it is worth it. “The earlier we can get to work with the management teams of our potential investments, the better results we can get out of ownership.”

Bringing in an operating partner early accelerates the instigation of business »



McManus: pay is structured 'completely differently'

“ In my experience the most effective partnerships between operating partner and deal teams are when they work as one team and you don’t know who is who

Fredrik Bürger

“If we look at the model currently, we have operating partners and deal doers. We’re going to see a convergence of those two separate skills sets into one role

Paul Reading

» transformation initiatives once the deal closes.

“You can put together a plan before you own the company so on day one you can go ahead and start implementing,” says Rigby.

Investment partners may be very welcoming of the additional support provided by operating partners in generating deal-flow, setting the scene for value creation and securing the asset, but the two roles remain very different.

“In private equity houses you have a lot of really smart people who are great with numbers and working out a great way of being able to fund an acquisition of a

business and hopefully come up with the right price to pay for it,” says Mike Mills, target value leader at KPMG.

“You don’t often have people who have been in there, done that and [have] run businesses in the industry and have really deep operational expertise. And that is exactly what operational partners are doing, either from a sector perspective or from a functional speciality – pricing, supply chain, procurement, whatever it happens to be.”

The jury is still out on the appropriate operating partner model. “A number of funds have chosen to outsource their operations team to consultants, and not have it in-house,” says King. “It’s a cost save, they don’t need them there permanently but perhaps on a deal-by-deal basis. They are on retainer and the funds use them when necessary.”

Paul Reading, partner in EY’s private equity value creation team, draws a further distinction between operating partner styles. “For some private equity houses, it’s functional specialists, to some it’s generalists. What’s more important than the model itself is that the model is aligned to the firm’s investment thesis,” he says.

Looking forward, some industry participants predict that eventually the role of investment and operating partner will merge. “If we look at the model currently, we have operating partners and deal doers and in many ways they are in two separate camps,” says Reading.

In future, there could be “operational deal-doers, or deal-doers with more operating experience. So we’re going to see a convergence of those two separate skills sets into one role.” ■

THE PAY DIFFERENTIAL

The different approaches of investment and operating partners is reflected in the compensation packages, which are structured “completely differently”, says Gail McManus of private equity search firm PER McManus. Generally speaking, she says: “Many operating partners are often paid as consultants and may or may not be an employee. They are probably paid a proportionate rate for days involved. They’ll have some sort of retainer or monthly fee.”

Operating partners tend not to be employed full-time or get a bonus, she adds. “They will receive carried interest or co-invest in the deal.” The potential for upside rather than cash compensation, “that’s the win”, she says.



OPERATIONAL DUE DILIGENCE

An end to the easy gains

Maximising operational value is essential in this era of high multiples and recession planning, says **Gary Hoover** of TBM Consulting Group



Hoover: PE investors are anticipating a slowdown

Every private equity deal today has some measure of operational value factored into the investment thesis. For manufacturing companies – especially those that have already gone through one or more buy-outs – the easy gains have been realised. That leaves more complex and challenging opportunities. These deals require ownership with deeper expertise to quickly grow both revenue and EBITDA.

Because time is always of the essence, operational due diligence often starts before the letter of intent is signed. A thorough assessment only requires enough time for site visits and data analysis to develop a clear estimate of a deal's operational risks and opportunities. For example, we recently assessed the leadership capabilities, plant conditions, current performance and improvement potential of a company with six plants on four continents. We identified \$9 million-\$14 million in achievable savings within six months of the deal close and an additional \$1.1 million in working capital reductions, which we detailed in a recommended go-forward plan.

Comprehensive post-LOI operational due diligence will include an execution plan that goes beyond reducing costs and provides a detailed evaluation of leadership effectiveness, the target's M&A capabilities and pipeline, and organisational readiness to support growth plans.

The prospective acquisition's true potential is revealed by overlaying the due diligence and the executive team's plans with what support the PE firm can offer to help the target move toward its goals – and beyond – as quickly as possible.

CHANGES IN INVESTMENT STRATEGIES

Record levels of dry power, high deal multiples, and the fact that we're now in the ninth

year of economic expansion – reminding everyone that a market correction is likely to occur sooner rather than later – are complicating private equity deals in the industrial space.

Whatever the triggers might be, private equity investors are anticipating a slowdown within the three- to five-year holding period of any new investments. That possibility is shifting deal teams' focus to recession-resistant sectors, according to one senior operating partner at a large US private equity firm with whom we work. When evaluating potential deals, they ask if the targets still look attainable – especially at such high valuations – after factoring in the possibility of a down period that it takes a year or more to recover from. In many cases, they don't.

Today's high multiples and economic uncertainty decrease the margin of error and make operational improvement and effectiveness even more critical during the holding period and divestment. In the event of a slowdown and declining demand, well-structured and effectively managed portfolio companies will respond quickly, ratcheting down fixed costs to protect earnings.

DAILY OPERATIONAL DISCIPLINE

There are three main opportunities for growing EBITDA that we quantify and prioritise during the operational due diligence process: One-time cost savings, performance gains that deliver long-term margin improvements, and daily management effectiveness (see table on p. 52). The third, and often neglected, opportunity for driving significant financial improvements is how well the target company is managed on a day-to-day basis. We refer to this as its "management system".

A company's management system – whether it's recognised by business »

THE THREE EBITDA DRIVERS REVEALED DURING AN OPERATIONAL ASSESSMENT

	OPPORTUNITIES	CHALLENGES
One-time cost savings	One-time cost savings in a manufacturing business include plant consolidation, supplier rationalisation and shrinking inventory levels, which will lower operating expenses, material costs and working capital requirements, respectively. Aggregating spending across portfolio companies to achieve volume-based price concessions is another example.	These opportunities exist in all businesses and can deliver substantial one-time benefits. While the potential operational and financial impact can be significant, they require effective planning and project management to fully capture. The challenge is identifying what impact each initiative will have within 12 to 18 months.
Performance gains that deliver long-term margin improvements	Examples of performance gains that can yield long-term financial benefits when sustained include reducing scrap rates, improving quality, increasing productivity, speeding up changeover times and improving overall equipment effectiveness. Operational excellence and continuous improvement efforts tend to focus on these areas.	If unplanned downtime is high, it can be a warning sign that machine maintenance has been deferred to save costs in the short term. Increasing equipment utilisation by improving maintenance practices and reducing setup times can free up capacity. These capacity gains can be used to grow sales and avoid or delay unnecessary capital investments.
Daily management effectiveness (management system)	Daily management miscues and process failures are often overlooked during the due diligence process, but they can add up over the course of a single shift or week. Accounting for the extra effort required by employees to respond, fix and ship quality products on time, these performance leaks can reduce daily productivity by 5-15 percent.	Symptoms that a company's management system could be improved include short but frequent line stoppages and lengthy equipment changeovers. Others are habitual rework, excessive operator movement and the intermittent disruption of material flow because of poor lineside material-stocking practices.

“Today’s high multiples and economic uncertainty decrease the margin of error and make operational improvement and effectiveness even more critical during the holding period and divestment

» leaders or not – is how value is created and how orders get shipped out the door every day. An effective management system is an integrated set of management processes that align the company strategy and annual objectives with daily activities, performance monitoring and corrective actions. A disciplined management system reduces daily firefighting and provides a foundation for managers and employees to make process improvements and sustain forward progress.

The signs of a poor management system are often invisible to anyone without operational expertise. For example, many manufacturers post safety, quality, productivity, cost and other metrics on bulletin boards beside production lines and work cells. These can make everything appear like it’s under control and moving in the right direction. Probe a little deeper, however, and the shortcomings appear: performance measures are not linked to plant or

company performance, quality issues are being reported but they aren’t being analysed or resolved, and improvement projects have been identified but they haven’t been prioritised or assigned.

For another recent due diligence project, we evaluated the target company’s operational effectiveness, prioritised potential cost improvements and considered the growth potential of the current leadership team. The company was a solid performer but had plenty of areas where its financial performance could be improved. These included a variety of management system-related shortcomings: excessive direct labour, set-up times that could be reduced 50-60 percent and high levels of machine downtime.

In the final report we estimated that they could improve operating profit from 12 percent to upwards of 19 percent without any top-line growth. After the deal closed we helped implement a daily management

system, reduce set-up times and completely revamp the company's maintenance practices. The company achieved the targeted improvements and the increase in EBITDA identified during the due diligence process.

ACCELERATING VALUE CREATION

So far I've primarily focused on cost-savings opportunities. A comprehensive operational assessment also offers valuable insights into the potential acquisition's management team, growth potential and the M&A pipeline and integration capabilities.

Starting with the COO, VP-level operations leaders, site leaders and the continuous improvement team leaders, we look at each individual's experience and track record. Our objective is to determine if they will be able to fill the role if revenue grows as projected. Do they have the ability to accommodate and lead change? If there's one constant in private equity, it's that there will be change. You must have leaders and managers in place who will be excited by and embrace that change.

There are several ways that the operational assessment contributes to estimates of a company's growth potential. On the order fulfillment side, as noted above, manufacturing lines are often running well below maximum utilisation levels. With uptime improvements and setup time reductions, we find that the true production capacity is typically 30 percent to 50 percent higher than what current leaders believe.

That value can be captured in a number of ways. First, manufacturers can grow sales and margins by taking advantage of the newfound capacity without any increase in fixed costs. Second, they can avoid or delay investments in new equipment, thereby preserving working capital.

On the operational side, when it comes to the mergers and acquisition pipeline, we look at the in-house team's capabilities and strategy. Does the near-term acquisition

 **The signs of a poor management system are often invisible to anyone without operational expertise**

plan offer clear synergies and measurable financial benefits? We then look at how experienced and capable the operations team is of capturing those benefits in a relatively short timeframe. We also estimate what must be done to improve productivity, free-up capacity, and create flexibility and responsiveness for the organisation to successfully absorb change and grow without adding costs.

During operational due diligence for another client, we identified significant opportunities in all of these areas. Like a lot of companies that aren't in the midst of a market crisis, they were doing many things well. The plant was organised and the equipment was well maintained. Order-fill rates were best-in-class (greater than 99 percent).

What the company lacked was a clear vision regarding its cost to serve and flexibility. A lukewarm embrace of operational excellence had left some major opportunities. Specifically, based on the due diligence analysis, we estimated that total capacity could be doubled with minimal capital investments. In fact, the current footprint could support a 4x capacity increase. Better inventory management would free up millions of dollars in working capital.

Based on the due diligence recommendations, after the acquisition was finalised, the private equity firm made a number of key leadership changes. On the operations side, the new management team's objectives were to improve labour productivity

by 25-35 percent, double raw material inventory turns, improve finished goods turns, and revamp the quality system to eliminate the need for 100 percent inspection of incoming material. They achieved all of these goals. During the first 18 months the company also completed two complementary acquisitions, one for \$40 million and the other for \$150 million.

The company's valuation quickly doubled and then took off when several large corporations made competing buyout offers. Over three years the company's valuation increased over 500 percent and the private equity firm ultimately realised a 5x gain on its initial investment.

SPEED AND EFFECTIVENESS

PE firms that consistently achieve superior risk-adjusted returns must create value through operational improvements. As I noted above, today's acquisition opportunities at the current multiples require active ownership with deep expertise to grow revenue and EBITDA. This demand is even more urgent today because of the potential for an economic slowdown.

In this environment, generating the necessary value and acceptable investor returns is a function of speed. It comes down to how rapidly your firm can assess potential targets, finalise the deal, launch your 100-day plan and continue to push meaningful performance gains throughout the three-year holding period. ■

Gary Hoover has over 25 years of experience working as a senior operations executive, management consultant and as a military officer. He currently leads TBM Consulting Group's acquisition and integration practice.

TBM is a global operations and supply chain consulting firm for manufacturers and distributors. Services include operational excellence, supply chain management, management system implementation, operational leadership, and acquisitions and integration for private equity firms and their portfolio companies.

BIG DATA

Private equity's impending disruption

The operating model for sponsors has held steady for 30 years, but data science advances are set to change all that, say **Ian Picache** and **Sajjad Jaffer** of Two Six Capital

Seven years ago, Marc Andreessen issued a warning when he wrote that “companies in every industry need to assume that a software revolution is coming.” In his op-ed, published in *The Wall Street Journal*, the co-founder of the influential venture capital firm Andreessen Horowitz then went on to provide no fewer than 15 separate examples of how software was transforming different industries, from media and entertainment to autos and oil and gas. The private equity industry at large apparently missed the memo, as few, if any, firms have moved beyond Excel as an analysis tool within their business. Of course, revolutions don't exactly knock first before turning an industry on its head.

To be sure, the private equity industry has evolved quite a bit over the years. Firms continue to refine their operating capabilities, develop new specialisations or add complementary products to their fund lineup, be it private debt vehicles, longer-life funds or something else. Yet the business model, itself, has changed very little over the past 30 years. In its current state, private equity very much remains a relationship-driven business dominated by outsized personalities with deep financial acumen.

This is about to change. Advances in technology have opened the door for capabilities that couldn't exist until now. As data volumes have grown and as computing power, through the cloud, enables ever-deeper analysis, GPs have at their disposal data-driven insights that can materially optimise the factors that drive performance.

Several factors speak to why the industry is ripe for disruption. Most notable is that the tools available today have altered what's

possible. In the public markets, hedge funds have already tapped into advances in big data and analytics to carve out a unique and material edge. Private equity's impending innovation wave will similarly be powered by the cloud and data science.

EXPONENTIAL GROWTH

The scalability of cloud and parallel computing facilitates the ability to ingest billions of rows of data. Excel, in contrast, becomes noticeably slower at approximately 100,000 rows. Alongside the exponential growth in computing power, the explosion in data volumes and data types allows investors to apply statistics at scale – assuming, of course, they have the capabilities to do so.

Again, public investors have already leveraged big data, whether it's through satellite imagery of parking lots that can pinpoint retail sales trends or website scraping that identifies otherwise unseen movements in sentiment. For private capital investors, however, data science and engineering can help sponsors arrive at a differentiated and conclusive view of a company's intrinsic value, providing a better foundation for entry valuations, value creation and exit timing.

Alternatively, hard data – and the ability to leverage the flood of information to understand distinct business drivers – instills a far deeper conviction around valuations. And this provides a basis for everything else. Applying statistical models developed by professors at The Wharton School and using data stores inclusive of transactional PoS, CRM and ERP data can deliver a very granular view into the value of each and every customer and product.



As Wharton professor and Two Six research advisor Eric Bradlow says: “Whether you have 100 customers or 10 million, profits are made one customer at a time.”

PREDICTIVE ANALYTICS

The data, which can be cut an infinite number of ways, also reveals metrics around customer behaviour trends over time, the channels that produce the most profitable customers with the highest ROI, as well as insights on product lifecycle and SKU rationalisation. The ability to harness predictive analytics can then allow for scenario-building offering a roadmap for growth.

At the outset, insights can inform thesis development for sponsors and strengthen due diligence efforts. It can tell prospective acquirers when to pay a premium for assets, or conversely, at which point valuations introduce too much risk.

It's akin to a watchmaker, or horologist,



GPs have at their disposal data-driven insights that can materially optimise the factors that drive performance

who can take apart a vintage mechanical timepiece to understand what works, what doesn't and any potential vulnerabilities. Most assume everything is in working order if the second hand is moving; the horologist, though, understands how the 300-plus moving parts work together.

The ability to manipulate and unpack such large volumes of data can also be instrumental in value creation through supporting resource-allocation decisions. Again, the applications are almost limitless, but at a high level, analysis arms marketing, finance and product teams to improve customer segmentation, identify new markets or cross-selling opportunities, or optimise R&D spending. Moreover, sponsors can recognise the appropriate inflection points at which to exit an investment, thus maximising returns and providing the next owner a framework to realise similar gains.

All of this sounds good in theory.

Real-life applications, however, better demonstrate the true utility of data science. For instance, co-investing alongside a large international PE firm, we worked with a global software company to assess the scope of the opportunity. Prior to acquisition, third-party consultants had surmised that the US was oversaturated and offered little white space for the company. The data said otherwise, allowing the investor group to pay more for the asset and underwrite an untapped (and significant) growth strategy. Post close, the data further guided management to refine its target markets, focusing on global regions with the highest ROIC, while mapping out a path to adopt a subscription model that both stabilised and grew top- and bottom-line performance.

While the need for technology becomes more acute and the capabilities exponentially more dynamic, the challenge for sponsors is that to build this kind of platform in

house requires a deep investment and skill-sets not typical to private equity. So while the evolution may be more protracted than say the disruption facing bricks-and-mortar retail, PE's operating model of the future will over time better resemble the agile structure of a technology innovator, with cross-functional teams of deal professionals, data scientists and engineers.

With a data science backbone in place, the GP of tomorrow will be more scalable, requiring fewer people to produce higher conviction, faster decision making and differentiated, alpha-producing insights. Private equity, a model of active management, will see the potential for added value become more pronounced through operational dashboards offering real time feedback and agility. And the very culture of the industry, long reflecting an investment banking and consulting lineage, will see a noticeable shift as deal and operations teams collaborate far more closely with data science professionals.

The same way Bain Capital reimagined the PE model around consulting capabilities, technology will usher in the next era for the asset class. In addition to better returns through data-powered investing, these capabilities will eventually create a barrier to entry that separates the leaders from the laggards.

In today's data-rich and fast-computing world, those who can monetise this philosophy should enjoy a long-term competitive advantage. And just like the PE pioneers, data will allow tomorrow's top quartile to see value where others don't. The difference is that it will also allow these firms to see and build value in ways others can't. ■

Ian Picache and Sajjad Jaffer are managing partners and co-founders of Two Six Capital, which has developed a proprietary technology platform that leverages big data and research from Wharton.

OPERATING PARTNERS

View from the forum

The key takeaways from Europe's leading value creators at our Operating Partners Forum in London

Private Equity International's Operating Partners Forum, held twice a year in London and New York, has established itself as the leading event for value creators in private equity. At the seventh annual Operating Partners Forum Europe in London in May, more than 250 of the industry's leading operational experts met to discuss all matters related to operational expertise. Here's a round-up of some of the things we learnt:

OPERATING PARTNERS HAVE A GREATER PRE-DEAL ROLE

There was widespread consensus that operating partners are playing a far greater role in the due diligence stage pre-deal, with panellists suggesting that the roles of deal partners and operating partners could eventually merge. Operating partners are now routinely consulted by investment teams, said Fredrik Bürger, EY's EMEA private equity value creation. He sees a "hybrid" model emerging where

operational executives have a greater say in investment decisions and "investment teams have more of an operational angle".

THERE'S FRICTION BETWEEN CEOS AND OPERATING PARTNERS

A survey of CEOs and operating partners by Blue Ridge Partners unveiled at the conference found there was friction in the relationship between the CEO of a portfolio company and the operating executives sent in to ensure the business meets its targets. A degree of friction between CEOs and operating partners is "unavoidable", said Blue Ridge co-founder and managing partner Jim Corey. The key, Corey said, is to build a "trust-based relationship" where each understands their own role in the value creation process.

PRIVATE EQUITY HAS BECOME 'MORE CIRCUMSPECT'

In an interview with *PEI*, keynote speaker Justin King, Terra Firma's head of portfolio

businesses and former CEO of supermarket chain Sainsbury talked of risk and the 'ridiculously challenging' conditions in the UK care sector. Private equity firms are much more conscious of "binary" market risk than they were before the global financial crisis, he said. "We're seeing much more circumspect leverage on businesses, because people are more conscious of the fact that there might be binary risk that is genuinely beyond their control that can expose the financing structure."

DIGITAL IS SEEN AS DRIVING VALUE

Digital improvements are seen as an increasingly crucial part of the operational toolkit, according to conference delegates. Asked to name the most important value creation lever, 27 percent of the delegates said organic revenue growth, followed by digital improvements named by 20 percent. Two traditionally important value creation levers – improving management practices and procurement improvements – lagged in third place, both with 13 percent.

BUT DIGITAL CHANGE SHOULD BE INCREMENTAL

The word "digital" is attached to virtually everything, said Rob Hornby, the chief digital officer at AlixPartners. This has put competitive pressure on conventional companies to transform – with very mixed results. Failure rates in "digital transformations" range from 50-90 percent, he said. Highlighting common mistakes in digital strategies, based around "unrealistic expectations", Hornby advocated a more incremental approach using a basic cloud-based approach that aims for a major transformation with a more realistic two to three years. ■

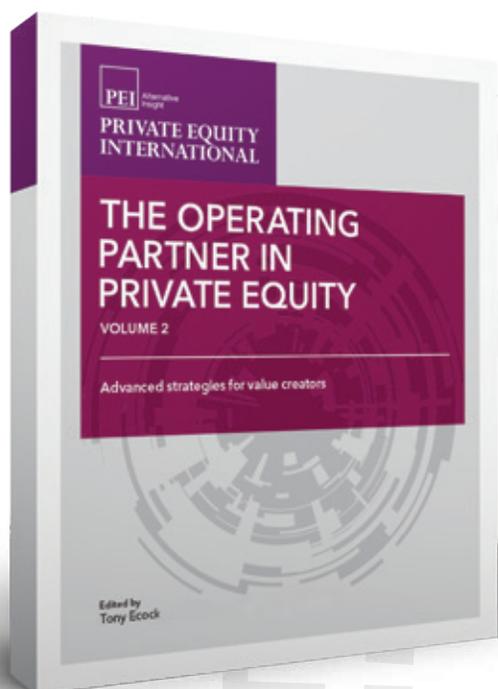


THE OPERATING PARTNER IN PRIVATE EQUITY

Advanced strategies for value creators

Volume 2

CONTENT HIGHLIGHTS:



- Dan Colbert discusses how The Riverside Company built and refined its operating approach with key lessons for achieving success.
- Scott Glickman, Dan Soroka and Sara Boyd of Graham Partners outline a programme for proactively identifying and reducing business model risks.
- Mark Gillett of Silver Lake Partners and David Moss, an independent adviser, provide a framework for assessing and implementing transformational versus incremental change.
- Sandy Ogg of The Blackstone Group, proposes three action points for ensuring the portfolio company CEO search and selection process is successful.
- Matt Sondag of West Monroe Partners provides useful tips for how to select and optimise the emerging role of the IT operating partner...plus much more

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