FOCAL POINT |
Year One Company Onboarding

What will Private Equity's Operating Playbook be for newly acquired firms?

Co-Authors:
Steven Koinis, Managing Director, Private Equity, Catalyft LLC
John Bova, Transformation and Operational Excellence Leader, Private Equity and Portfolio

As executives with P&L responsibility position their firms amidst multiple supply and demand shocks: **how will they prioritize the team's actions?** Unforeseen modeling contingencies - such as disrupted supply chains, rapidly shifting buyer behaviors, reduced net new logos of clients and stitched-together remote teams - probably tops most lists. Additionally, ever-changing state requirements, blending both company and landlord responsibilities & obligations, now pile on new requirements. A Chief Health, Safety and Compliance Leader is now added to already-slim organizational charts. Profits will be generally subdued. Risk mitigation will take on an outsized focus for leaders. Cash preservation will be even more critical as each firm charts mercurial consumer & business demands, new internal collaboration structures and external brand strategy.

What will these new challenges pose for private equity (PE) portfolio companies in Year One when they already have lean organizations, tentative processes & institutional procedures, and executives stretched beyond core business knowledge? Investment theses based on growth strategies and reporting through the onboarding process in Year One will be strained in an environment of incomplete diligences, reduced travel and curtailed onsite engagement.

How does the "New Normal" look in the challenging first 12-month period? And how will PE firms adjust to this new environment rife with uncertainty?

Let's assess several acquisition paradigms within the context of these external conditions:

1. **New Deal Environment Challenges:** The environment for distressed, or perhaps, underperforming companies with questionable leadership may provide the largest pool of deals to come. Diligence, valuation, EBITDA(C) and working capital calculations will be the hardest to evaluate for some time. The pressure to efficiently deploy new assets and productively support & manage acquired talent - rather than relying upon Limited Partner (LP) capital calls for one-time capital injections to stabilize an older portfolio – will take on renewed enthusiasm, albeit cautious enthusiasm.

2. **Limited Partner-General Partner (LP-GP) Relationships become more critical:** If the fund structure is a standard 10-year model, it may come under strain as assets in deep remediation and operating model transformations will be 6-7 year holds, or perhaps longer. Side letters, amendments, co-investment, and other challenging discussions may impact the LP-GP relationship.

3. **Valuation Uncertainty:** Supply and demand for certain deals will push valuations up quicker than they came down. Industry and stage thesis will come forward in areas of healthcare services, tech-enabled services and human capital collaboration models as hot-focus industries pivot to remote work-enhancing technology and teaming visioning/collaboration technology services. This shift will create opportunities within each firm's business model - but may stress the investment model as a group.

This area of investment could be more growth equity (earlier stage) in need of immediate roll up. Companies with inconsistent or limited histories of revenue and earnings may stress even the most experienced, steadiest investment committees. Safeguarding investment choices while stretching the boundaries of investment criteria will be an issue.

How will deal diligence and operating teams align their actions with investment theses? (such as implementing building strategies, developing sustainable/defensible market positions, growing revenue and EBITDA, etc.)

Some new considerations for the deal process and Year One Playbook may include new tools and approaches:

Modeling Data and "Mock" Month-End Reporting Packages Pre-Acquisition

Alignment of deal team to diligence build out (internal and 3rd party providers) will need to happen earlier, and with more consideration of how to thoughtfully address necessary changes during diligence to lock up Letter of Intent (LOI) stage.

For example, more pressure on digital data room providers for collaboration tools and data analytics as part of the work done will need to be understood and fully utilized. Additionally, using internal teams to cleanse & normalize data applied to creating mock month-end reporting packages, operational performance baselines and first-stage predictive analytics will be more prevalent. If a PE firm's support team can quantify the quality of the data early in the process and be able to report and model with it, future data challenges and reporting flow can be better understood. Realistic timelines to address constraints can be considered earlier. This will give post-acquisition teams the resources to understand problems within the acquired firm more thoughtfully, and potentially, facilitate an earlier transition to crucial month-end reporting packages, annual budget and strategy alignment and value-enhancing implementations. Playbook development, in advance of creative and customized onboarding, will be needed.

Tech-Enabled Collaboration Strategy

Introduction of technology tools and remote collaboration, early and often, will need to be structured by the fund's operating team. Unquestionably, this is needed by the portfolio for reporting. Other areas that will test portfolio leaders command of operational & financial metrics will be dramatic changes expected from stretched supply chains and the real-time need for clear, easy-to-interpret operating performance measurement. However, the PE fund will have more pressure to take technology and related strategies in-house or at a high level of the operating partner model. The go-forward technology and collaboration levers will not be developed portfolio-by-portfolio but through a comprehensive commitment by the fund and the portfolio management teams to implement within the acquired firm and integrate across portfolios for these to have maximum impact. Nevertheless, it will be imperative that the fund supports technology and collaboration changes to maximize data-driven decision-making for management teams while providing early-warning signals if the team strays from the investment thesis.

Accelerate tool development with outside subject matter expertise and experience—build and deploy Playbook models at end of diligence to close stage

In the "New Normal", the strong and organized will survive. The lifts will always be tough in Middle Market firms that are recipients of their first real institutional capital. Preparation and onboarding of the CXOs through remote collaboration will be needed (infusions of support may need to be in linear waves or agile bursts). It's incumbent upon the PE operating partner/ resource team to have at-the-ready resources so CXOs can rapidly adapt to changing market conditions and drive business cases for investment more aligned with the latest market realities. Burst speed with greater command of data sets will be integral to thriving in the "New Normal" for leadership in private equity portfolio companies.

The "New Normal" will be changing rapidly and will go through multiple iterations. The massive business dislocations the pandemic has created, though, will certainly live on – manifested in talent constraints, spending pattern shifts, savings rate changes, reduced travel, remote working environments, commercial & residential real estate demand adjustments, and many, many more.

What we expect, however, is that the Year One onboarding process of new or add-on portfolio assets in the "New Normal" **will be significantly altered** to include more prevalent "pre-close" modeling data and "mock" month-end reporting packages, larger adoption of digital communication tools and remote collaboration strategies, and accelerated tools & processes implementations partnered with outside expertise. Building and deploying all-encompassing Playbook models prior to close has never been more difficult - or more valuable.

Ultimately, what does this mean for private equity firms in this "New Normal"? We expect these changes will positively impact value creation post-acquisition, **if implemented properly**. As we suggest, more pre-close "mock" month-end reporting packages, and digital communication and collaboration tools should make the first 100 days of onboarding a new asset a different but smoother process in the medium-to-long-term.

With more powerful visualization methods and a PE onboarding team (utilizing in-house operating partners or outside resources), having more focus along with optics on remote transformation excellence should result in more stress testing. So, the first 100 days can become a time for accelerated value creation between the PE operating team, any needed outside resources and portfolio management.

As deal flow and related assessments of new companies considering EBITDA(C) begin, large issues (such as supply chain disruptions and talent management) will continue.

Without a doubt, this raises several complex, novel challenges when acquiring and assimilating a new acquisition into the portfolio.

We leave you with several of these questions to consider with your Team (Deal, Due Diligence, Portfolio CEOs, and Operating Partners). A few of the more pressing include:

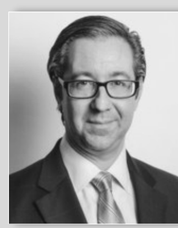
- Is this a period to focus only on add-ons with better integration and value creation plan revisions?
- How will PE firms make further investments in technology, data and reporting and structure remote collaboration now?
- Does consideration of regional human capital models become a near-term solution to talent constraints?
- Does the "Operating Advisor" become more hands-on for the Operating Partners and GPs who put them there in the first place?
- What are the drivers of culture and operational, organizational, and financial measurements needed in successful remote collaborations (moving from Diligence to Year One Playbook Implementation to Next-Level Value Creation)?

About The Authors:

catalyft
Business Improvement & Advisory Services

Steven Koinis

Steve leads the Private Equity Practice for Catalyft LLC, a practitioner-led, boutique operating partner firm focused on strategy implementation and operational improvements in Middle Market businesses acquired by Private Equity, investment firms and Family Offices. Steve has held several senior executive positions with the sovereign wealth fund Abu Dhabi Investment Company, Huron Consulting Group, and as C-level executive and Board member of private firms in the US, Europe and Middle East. He earned his MBA from Harvard Business School and has two Bachelor of Science degrees in Mechanical and Materials and Metallurgical Engineering from University of Michigan, Ann Arbor and speaks conversational Greek, German and Arabic.



John Bova

John is a Transformation and Operational Excellence Leader in Private Equity Firms and Portfolio Companies. John has played many roles in the private capital space over 30 years Including senior executive to fast growing middle market companies, Independent Sponsor, PE and Family Office Advisor and Consulting Practice Leader.