Private Equity International

Operational excellence 2019

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Growth Strategy

Profit margin

Asia-Pacific

Expansion

Digitisation

Turnaround

Americas

Innovation

Global ambitions

Customer service

State-of-the-art

New facilities

R&D

EMEA

Best practice

M&A

Product launches

Buy-and-build

Exit multiples

Know-how

Internal rate of return

Sales spike

Robust IT systems

ESG

Disruptive technology

Cost savings

OpEx Awards: Who are the best value creators?

Private Equity International

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Insight

Key trends **Five things we learnt from the Operational Excellence Awards 2019**

Now in their eighth year, entries to our annual Operational Excellence Awards never fail to provide a rich variety of insights, ***writes James Linacre***. Here are five key lessons to take away from this year's showcase of the best and brightest work done by general partners to transform companies.

Whether companies are embracing ESG as a way to increase productivity or beefing up their offerings with a string of bolt-ons, expanding their horizons geographically or looking to innovate with research and new products, the best GPs formulate a strategy and commit to executing it.

1 Strong leaders get strong results

New blood can always help, but it was striking how many entries replaced not just the CEO or a couple of senior figures, but the entire board. That was certainly true of AniCura, a veterinary care company within which Nordic Capital acquired a majority stake in 2014.

The appointment of a new board, with a new CFO and in-house M&A function, helped to turn what had on entry been a 50-clinic company in Scandinavia into a leading pan-continental platform four years later. Nordic invested heavily in professionalising AniCura, creating a new organisational and operational structure and installing a whole corporate culture.

It was a similar story for one of our Americas winners, as L Catterton built Zarbee's Naturals from a four-man team selling one product to a nationwide business with a full suite of offerings. It did so by building the entire management team, starting with the CEO but also including a chief customer officer, chief marketing officer, and chief product and strategy officer.

The same theme played out in Asia-Pacific, as Blackstone installed a new CEO and senior board members at global business process management provider Intelenet Global Services. With affordable housing finance company Aavas Financiers, Partners Group targeted executives specifically to drive better branch service, to drive a 'digital first' model, and to preserve its culture.

In the case of New Zealand-based Manuka Health, Pacific Equity Partners built a fresh board with one consideration always front and centre – ESG. New appointees were specifically chosen for their expertise in food products, agribusiness and social responsibility.

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AWARDS 2019

operational excellence

2 Embracing ESG enhances earnings

Manuka honey producer Manuka Health truly took ESG to heart, as did many of this year's entries. Not only was the new management team picked with ESG factors in mind, but the company worked to identify land suitable for regeneration and led industry engagement with regulators both domestically and in key export markets to tackle counterfeit production. It also implemented an initiative pioneering the use of climate and bloom monitoring technology.

Not many companies could do more on ESG, but ELIX Polymers, a supplier of ABS polymers and products used in the manufacture of consumer goods, electronics, medical devices and automotive dashboards, which Sun European Partners acquired in 2012, excelled in coupling strides forward in ESG with leaps in earnings.

The plastics industry faces ongoing challenges around environmental

impact, but ELIX reduced its energy consumption and its greenhouse gas emissions – each by more than 10 percent – and reduced waste generated per tonne manufactured by almost 5 percent. It also increased R&D spending on sustainable products markedly, all while EBITDA quadrupled over the hold period. Embracing ESG does not mean having to compromise on earnings.

3 Smart acquisitions achieve pole positions

With its new leadership in place, AniCura set out on an aggressive growth plan which took it from 50 clinics in just three countries to more than 200 across 11. There were 150 acquisitions completed in just three years.

The extensive expansion broke the veterinary care provider out of Scandinavia and across Europe. By increasing the company's presence so dramatically, Nordic Capital turned AniCura into a continental leader.

A similar strategy worked for Arbor Investments on the other side of the Atlantic. Arbor transformed five regional bakeries into one large continental operation, Rise Baking Company.

Rise's ascension began with the acquisition of an artisan bread manufacturer in 2013. After five years, a succession of cookie and dessert bar manufacturers had been added to create a high-quality bakery with a suite of products and manufacturing assets stretching from coast to coast.

Add-on growth was crucial for a very different American company, Selmet, which manufactures titanium castings for the aerospace industry. Under Blue Point Capital Partners' guidance, it absorbed Onamac Industries and Western Metrology to both expand its geographical footprint and add machining capabilities the company did not have.

Back in Europe, the same winning strategy helped EQT Partners to pick up a second award – Outstanding Achievement in Innovation – for automation and robotics specialist Piab. Piab bought four strategic bolt-ons – Kenos, Vaculex, SAS Automation and Feba Automation – in the space of only two-and-a-half years.

> “Embracing ESG does not mean having to compromise on earnings”

4 Travel broadens the mind – and earnings

Seeing more of the world isn't just good for individuals, it is a very sensible approach for portfolio companies as well. It certainly helped EQT portfolio company AutoStore, a warehouse automation company.

EQT increased AutoStore's focus on a clutch of key, high-potential geographies – the US, France, Germany, Japan and the UK – but it also expanded into eight new countries. The expansion helped AutoStore to take advantage of industry tailwinds from megatrends such as e-commerce, advances in technology and growth in global urbanisation.

Transnorm, another warehouse automation business, this time held by IK Investment Partners, also got ahead through developing its footprint overseas. The company is headquartered in Germany, but looked to develop its footprint in both North America and Asia, with the Americas and Asia-Pacific accounting for 28 percent and 8 percent, respectively, of its sales last year. Transnorm's dedication to international expansion also saw it open a centralised production site in Thailand and establish a Chinese entity with a dedicated sales team and local warehouse.

Piab was another portfolio company to look beyond Europe, particularly to China. It installed a country head, a trio of sales managers and a team of full-time sales employees. Its revenues in that market accelerated to 50 percent run-rate growth and formed a significant factor in its subsequent purchase by Patricia Industries as EQT exited.

> “Seeing more of the world is a very sensible approach for portfolio companies”

5 R&D reaps dividends

Doubling down on R&D proved to be another popular play. All three EMEA winners built their success by prioritising R&D.

For EQT Partners with AutoStore this has been accompanied by a significant uptick in intellectual property efforts. In fact, the company has been the most frequent filing company in Norway over the last two years, increasing its number of patent filings by 250 percent.

Fellow warehouse automation business Transnorm enjoyed significant investments into R&D on IK Investment Partners' watch, as the company sought to meet the demands of the parcel and e-commerce industries, including singulation and sorting solutions.

EQT's other automation portfolio company, robotics specialist Piab, also leant heavily on R&D. Significant investment in innovation and product development played a key role in its ability to release eight new products each year.

Automation was also key for Intelenet Global Services, the global business process management provider which Blackstone acquired for a second time in 2015. It created a dedicated team to develop automation tools, including an analytics tool for unstructured data, a natural language processing tool to calculate fares, and a robotics solution for improving customer experience.

Meanwhile, Nordic's AniCura also invested to keep itself at the cutting edge of its industry, building a specialist veterinary neurological centre in Sweden. AniCura Albano Animal Hospital is Scandinavia's first specialist neurological centre within veterinary medicine and is located in Stockholm.

The variety of stellar outcomes the winners of our Operational Excellence Awards 2019 have achieved is testament to private equity's ability to transform companies for the better. It is what the awards are all about. ■

Editor's letter

Changing the game, one portfolio business at a time

James Linacre
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It is the eighth year of our Operational Excellence Awards and the entries are as impressive – and varied – as ever. As the market has advanced through the cycle, strategies such as buy-and-build have come to the fore, and so has understanding that these have to be carried out not just quickly, but also sustainably.

Operating partners are also receiving the respect they deserve. All of the top 25 funds – as ranked by *PEI* – have an internal operating group, as earnings growth and higher valuations are more widely recognised as the key to driving superior returns now that the market is fundamentally mature.

Indeed, eyes are already scanning the horizon for signs of any coming downturn. Although few people are sticking their necks out to forecast when that downturn will come, plenty of companies are realising the importance of positioning themselves right now for when it does arrive.

“Operating partners are also receiving the respect they deserve. All of the top 25 funds have an internal operating group”

If that downturn is triggered by a trade war then being able to bridge the US-China tensions, as Hony Capital portfolio company Jushi Group has done, will be helpful. It provides a fascinating case study.

There are also many examples of early, decisive changes in leadership being necessary to really transform portfolio companies. Firms thrive when their leaders have the requisite drive, talent and respect of their team. A CEO missing those ingredients is not going to hit the heights required, and should be replaced with haste.

These themes playing out across the market are reflected in our award winners. The best value creators have embraced these challenges and emerged with tales truly worth telling. It is a privilege to be able to share their stories.

A sincere thank you to our expert judges, who make these awards possible, and huge congratulations to our winners, each and every one of which shows private equity operational excellence at its value-creating best.

James Linacre

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KEYNOTE INTERVIEW

Integrating IVC: Combining investment and operations expertise


There are significant benefits to having investment and operations teams working hand-in-hand, say Partners Group's Todd Miller and Paul Swaney

In a climate of high valuations, no one argues with boosting portfolio company growth as the route to elevated returns. Despite continuing scepticism in some corners of the industry, the emerging consensus is that operating partners play a key role in the pursuit of alpha.

The spread of operating teams is evidence of that. All of the top 25 funds have an internal operating group, according to a McKinsey survey. However, few firms, including those with assets under management of more than $25 billion, have hired in-house operations teams of more than 15. Not so at Partners Group, where the internal private equity industry value creation (IVC) team already exceeds 35 professionals globally, and is poised for more growth over the next five years.

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Given the firm's investment in operational expertise, we asked Todd Miller and Paul Swaney, respectively managing director, private equity, Americas, and senior vice president and head of industrials, Americas, to explain how the investment and IVC teams work together.

Q How has the role of the industry value creation team evolved since it was first created?

Paul Swaney: We formed the IVC unit in 2011 and today have an in-house team that is fully integrated into the investment process. Todd and I are linked throughout the entire investment process: at sourcing, execution and exit. The IVC team even sits on the investment committee and has a vote on the deals that we work on.

We are incentivised with the same compensation structure tied to investment performance. We have an institutionalised approach. We treat value creation as a science, not an art, and build standardised, repeatable processes that we can scale.

Over the last couple of years, the change has been in scaling the IVC team at the senior, mid and junior levels as we grow our direct assets under management. We are also building out some functional horizontals, including sales effectiveness, marketing and procurement, and already have environmental, social and governance expertise. Personally, I cover lean manufacturing and production globally.

Q Why do you need an IVC team?
Todd Miller: Our market is largely mature and we believe fundamentally that the way to drive superior returns is through earnings growth and higher valuations. The only way to do that is to have a very strong operational philosophy that encompasses the IVC team of industry experts and operating directors, who are individuals who have run companies, sit on our portfolio company boards, and get their hands dirty alongside management. We also deploy mid-level and junior level resources that are all instrumental in executing on the value creation plan.

Q What's the difference between the role of the investment and IVC teams throughout the investment lifecycle?
TM: People on the investment team have generally grown up in the financial community, whereas Paul's team has a more strategic background. The marriage of those two skillsets is a real differentiator.

In early stage sourcing and origination, there is a real collaboration between us. Some of Paul's team members have research backgrounds and help us to spot secular trends and evolving business models and assess specific assets that will benefit from those trends. Then we network into those companies and get to know the management team.

In underwriting, from our side, there is a long list of things that need to happen that are not fundamental to the company's performance and driving value but require transactions skills, such as legal documentation, financial due diligence, tax work, etc. We don't want our IVC team bogged down in that.

At that stage, we spend a lot of time clarifying our investment hypothesis. The evolution of a value creation plan is a real partnership between the IVC and investment teams, although Paul's team drafts it and diligences whether it's realistic.

Post-acquisition there's a six-month process as we work shoulder to shoulder with the management team to finalise the plan. The investment team is very involved in any M&A, but it's the IVC team's mandate to drive many of the other initiatives alongside management.

PS: As a firm we are not expecting to buy low and sell high. On all of our deals, we're underwriting a certain level of multiple contraction, which means we're going to have to underwrite a certain level of operational improvement. A lot of my job is not just considering what we could do, but also what we can scale and diligence and bake into the underwriting case.

Because of my background, I'll take the lead during onsite due diligence on a manufacturing business. My role includes anything from cost management to assessing the capacity of the site. I also deal a lot with ESG topics. For example, health and safety is particularly important. I benchmark key data on environmental compliance, water and air permits, and safety reporting against a similar competitor. We'll always bring the deal professionals along with us during diligence because it's an opportunity to further build a relationship with the management team.

One of the most important things after we close an investment is the onboarding of a new portfolio company. At the beginning,

Partners Group Five "I"s of value creation

1	**In-house** Dedicated, globally deployed team of industry specialists to assess and control the progress on the operational value creation.
2	**Integrated** Operational value creation approach and organisation is integrated in the entire investment process from diligence to exit.
3	**Investment committee** Value creation leadership are voting members of the investment committee and therefore critical to making investment decisions.
4	**Incentivised** Compensation and career paths fully aligned with investment teams to ensure engagement of best in class industry specialists.
5	**Institutionalised** Standard, tried-and-true processes to identify and monitor opportunities to move the bottom line.

Source: Partners Group 2019

"We treat value creation as a science, not an art"

PAUL SWANEY

we're very hands-on as we set up the governance structure. A significant part of my job is spent codifying best practice around functions, systems and governance.

Governance is key to the value creation plan, so everyone knows his or her role from the beginning in supporting the management team. Once the governance structure is in place, we need to ensure that it is ahered to until we exit.

A sale process or an IPO can be taxing on a management team so our job is to make sure that we stick to our standard processes. I work hands-on with multiple portfolio companies at a time offering my specific industry expertise.

Q And at exit?

TM: Positioning a company to maximise value starts 18 months to two years before we really want to sell. At this juncture, Paul's team gets involved in developing the marketing materials that explain the core business model, the industry and the data, as well as ensuring the underlying business reality marries up with the key messages we are promoting to potential buyers. The investment team will lead a sale process and negotiate with potential buyers, but positioning the business properly is a partnership between the investment team and IVC.

Q How would you describe the interaction between the investment and IVC teams?

PS: Todd and I go back and forth all the time throughout the investment process. We don't work on separate work streams and then meet up at the investment committee. Our desks are co-located.

Todd and his team could be putting together a teaser document that proposes we can get 200bps of margin improvement on an asset. I might look at it and say that I've worked with similar companies with a similar margin profile and we can probably improve upon that during ownership, and so we will diligence it a bit more intensively. Todd and his team are constantly dropping by my desk. We are in lockstep the whole way.

Q Is there an example you can share where you've worked together to create value?

PS: A few years ago, the management team of a manufacturing business merged two factories into one right before we closed the acquisition of the asset, adding 30 percent demand to a single site. I was deployed on the ground for several months after closing. With the help of an external consultant from my network we were able to smooth the plant consolidation process greatly.

Meanwhile, as I was buried in the factory for 30-40 days that year, the investment team worked on the original value creation plan and underwriting thesis, and acquired assets globally to scale the business. We couldn't put the brakes on the growth of the asset while we were working through a plant consolidation, so the collaboration of both teams was critical for success.

> *"The evolution of a value creation plan is a real partnership between the IVC and investment teams"*
>
> **TODD MILLER**

Q The level of collaboration is intense. Are your roles blurring?

TM: 'Overlapping' in certain areas might be a better description. When we're working on an opportunity, I need a thought partner and having one with a different background to me is very helpful.

Q Who else contributes to the success of an investment?

TM: We will typically have three external operating directors sitting on the board of a portfolio company. We pick them – board construction is also a collaboration between IVC and the investment teams – to complement our skill sets. These individuals usually have an industry background.

He or she, for instance, might have been the CEO of a competitor, or, if there's a specific technology strategy at a company, they might have run a related technology business. Each director tends to get mapped to a specific initiative and spends time working on that. One of them will act as the lead operating director or chairman. And our capital markets team assists raising debt financing or pursuing a public listing. ■

Q What skills make the best IVC team members?

PS: My target profile depends on whether it's a mid or senior level post, but in general I look for significant operating experience where the individual has directly managed people. It's helpful if hires have a few years of consulting experience as well, so they can take a top management view.

Investment teams are trained to take an executive perspective but most of my experience is bottom up on the line. Spending time at a consultancy helped me develop a board level outlook.

Todd's team gravitates more to the chief executive and chief financial officer and I gravitate more to the chief operating officer and senior vice-president of operations. Interestingly though, when we're conducting due diligence, particularly at a factory, I spend a lot of time talking to the production manager. I tend to show up in jeans so I can really assess the machines and get into the detail.

On the minds of operating partners

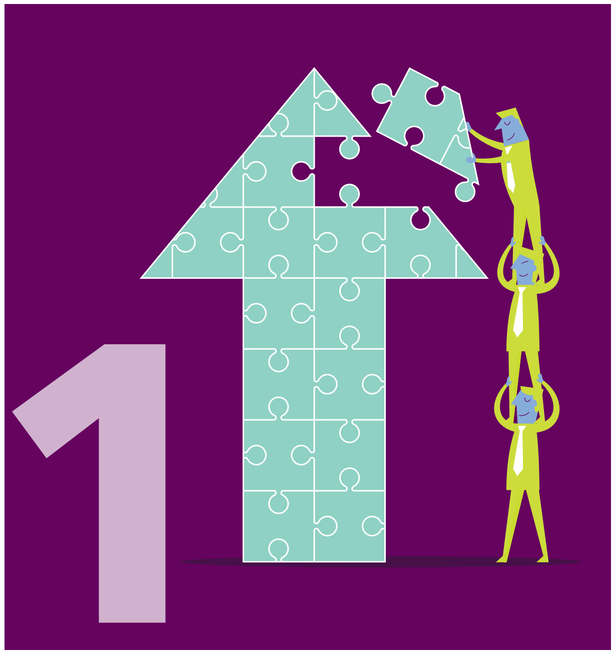
What strengths are they bringing to the team and how is the role changing?

Our panel

James Markham
Partner – portfolio management, Graphite Capital

Geoff Tomlinson
Value creation partner, LDC

Cory Eaves
Operating partner, General Atlantic



Q Where can operating partners add the most value?
James Markham: In the lower to mid-market, an SME portfolio company may have grown in a certain way up to the point of our investment but now needs to evolve how it goes to market and how it executes its growth plan. The management team may not have been through that journey before. Operating partners, working with the management team and deal colleagues, can help appraise the operational capability of the business. They can bring their expertise of seeing many businesses of a similar size go through similar growth challenges and then find bespoke solutions.

Geoff Tomlinson: We back management teams rather than businesses. We know that working in partnership with an ambitious management team is the best way to help a firm grow and increase shareholder value. It's why we have built a team of experts with an unrivalled breadth of real industry experience. Through the team's deep functional and sector experience, our value creation partners support business leaders across LDC's portfolio, helping them to identify pressure points and growth opportunities, and supporting the delivery of improvements in areas from sales and marketing to cash collections and working capital. We work in partnership with management teams to help create value throughout the investment to achieve long-term sustainable success. In order to maximise the value we can bring to bear, we have developed a significant partner support network who help us in specific projects across the portfolio to help both with the volume of improvements and also bringing specialist skills and experience where required.

Cory Eaves: At General Atlantic, operating partners engage across the entire deal lifecycle, from diligence, through on-boarding, building teams, driving specific value-creation initiatives, and onto the exit process. Our experience shows that we can add the most value by partnering closely with both our deal teams and our portfolio company management teams in two key areas: firstly, helping companies build great management teams by recruiting, coaching and optimising the organisational structure, laying the foundation for growth; secondly, working with the company to identify and execute targeted value-creation initiatives, often heavily supported by technology. By focusing efforts on the most important initiatives, impact can be achieved more quickly.

Q **How important has ESG become in operational matters?**

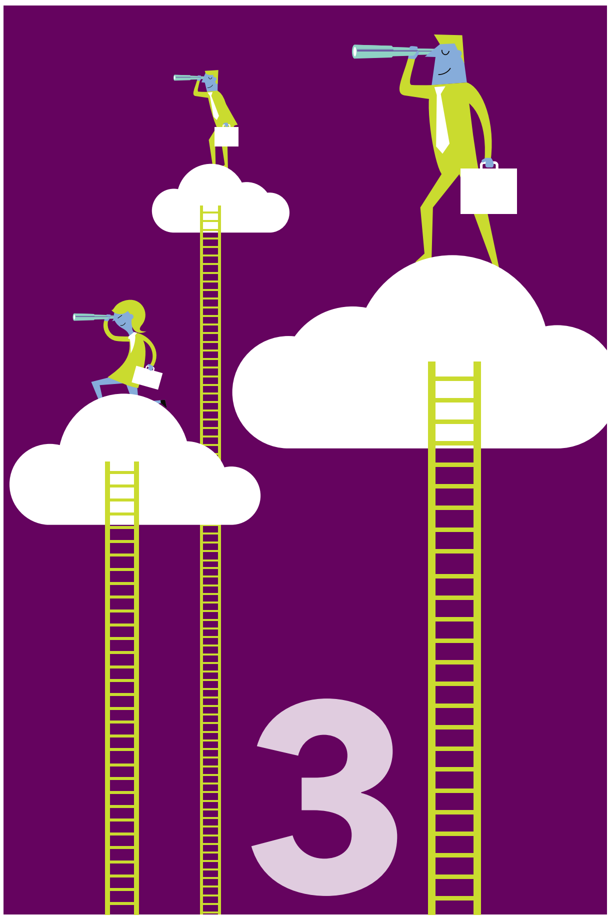
GT: We work with the management teams of our portfolio companies to develop strategy in a range of ESG issues, including environmental performance, workforce health and safety, governance and diversity. Our tailored approach helps to ensure that these companies address the ESG issues that can have the biggest impact, and ESG continues to rapidly rise up the agenda in terms of its importance. Operational efficiency means achieving maximum productivity and minimum waste. Savings in energy, water and waste can require an introduction of expertise or an injection of capital. Our ability to bring new resources to the table can help to improve a plant quickly. Our investments frequently result not only in greater efficiency for a portfolio company, but also measurable environmental gains.

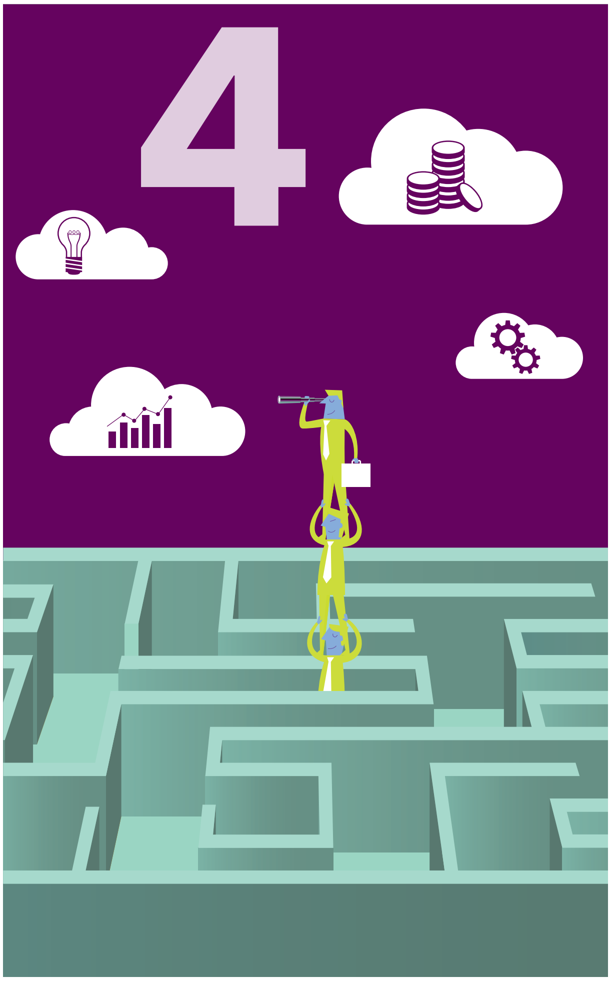
JM: The ESG criteria that underpin responsible investing have a very natural and obvious overlap with general risk management. Managing risk is a key part of operational management anyway so the underlying ESG criteria have always been important. What has changed in recent years is that there is more direct measurement and reporting on this activity, partly influenced by increased LP engagement in ESG. This in turn has increased the level of accountability in the world of investing and has better ensured that fewer issues get missed.

Q **What is a trend that doesn't get enough attention?**

JM: People. Historically, there has always been a focus from PE on the most senior people in the management team but typically it stopped there. The focus on the human element of a business has increased in recent years but more can still be done. The working culture and having an engaged, enthused and incentivised workforce with the right organisational design is critical to success. Private equity executives, sitting on boards, also need to be engaged in appraising these areas and offering solutions if required.

GT: Different private equity firms take different approaches. An increasing number are focusing on value creation through hiring in consultants to help drive change within the business. At LDC, our value creation partner model is different, more sustainable and more collaborative. Rather than only adopting a top-down strategy, our experts collaborate with management teams to guide the business through the growth cycle. By spending a significant amount of time onsite with businesses, working closely with the leaders of different functions, the highly experienced value creation partners become an extension of the management team, often taking a non-executive role on the board. This leads to a deeper relationship with the business and a more open approach, which in turn delivers more successful improvement and growth.





Q **What is the biggest challenge facing you in the next few years?**

JM: The pace of change and disruption through technological innovation is an enormous challenge. This impacts upon both the selection of what to invest in and how to grow existing portfolio companies. It presents both a risk and an opportunity, and the challenge for us is being on the right side of that.

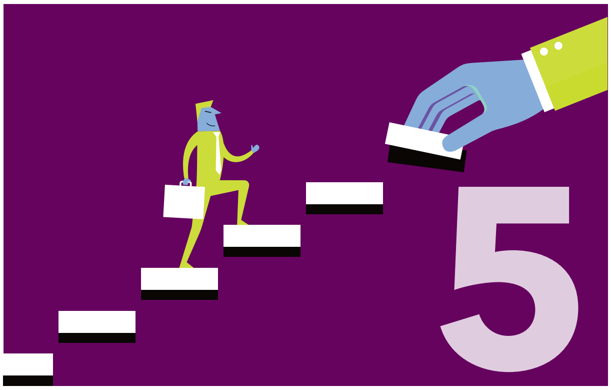
GT: The biggest challenge for LDC's value creation partners is supporting portfolio companies to best capitalise on opportunities so they can realise their full potential. This is both in terms of providing the right support at the right time and also for matching with the most suitable value creation partner and partnering with third parties to meet the demand. This is increasingly challenging for two reasons: firstly there are more opportunities to support our portfolio through a period of increasing uncertainty and identifying the opportunities this climate creates to help them grow; secondly, we are involved at more stages of the investment cycle so we are more in demand to support key initiatives with management teams throughout their journey.

Q **How is the role of the operating partner changing?**

CE: Over the past decade, I have seen the role of operating partner evolve to be more systematic, more focused on value creation, and more specialised. Early operating partner efforts were often a broad catch-all for managing diverse projects and industries. As best practices have come into focus, and individual operating partners have developed networks, skills, and experience, operating partners are increasingly developing specialties around certain industries or functional areas. Technology is also playing an ever-increasingly important role in value-creation projects, both supporting revenue growth and expense control. Finally, I believe the talent marketplace for operating partners has now become sufficiently mature in that private equity firms are able to recruit operating partners with the specific experience that meets their investment profile.

JM: The role didn't really exist in the UK mid-market when I started but now most firms have some form of portfolio or value creation or operating partner role. As the private equity industry matures, the amount of capital to be deployed grows and pricing increases, then within a portfolio strategy there really is no alternative to building stronger and better businesses – with organic growth being a key component. That puts extra emphasis on operational delivery and the role of the operating partner is becoming more prominent as a result.

GT: We aim to support portfolio companies throughout the lifecycle of an investment – from pre-deal, through the growth strategy implementation and journey to exit, and possibly even beyond, if we reinvest in a business. This is a much broader responsibility for operating partners than has previously been the case, particularly in pre-deal. For example, in pre-deal the team works alongside management and the investment teams to help identify both growth opportunities and pressure points where improvements can be made to the business. During this due diligence phase, we work with the investment team to understand how the company operates, its position in the market, and the macroeconomic factors that affect the business, by gathering insights from customers, suppliers and other stakeholders. We help identify opportunities and potential areas of operational improvement. These are built into the deal and form the basis of the 100-day plan, which is critical to long-term value creation. ■



KEYNOTE INTERVIEW

How to navigate US-Sino trade tensions

Hony Capital's experience with Jushi Group shows how Chinese firms can thrive in the US, regardless of the current political climate, says John Zhao

At a time when many nations are withdrawing into themselves, private equity firms must still look internationally for growth. Hony Capital is one such firm. The Beijing-headquartered company specialises in buyouts and the marketisation of state-owned enterprises, providing growth capital to high-growth Chinese enterprises.

Over a period of 13 years, Hony transformed fibreglass manufacturer Jushi Group from a domestic, state-owned player to a multinational heavyweight accounting for over 20 percent of the global fibreglass market share. It is currently the largest fibreglass manufacturer in the world.

Hony's second period of ownership – having exited and later reinvested – saw the firm navigate frayed US-Sino tensions to establish Jushi as a North American producer in the heartland of the US. Not only did the investment deliver strong results for Hony, it serves as an invaluable blueprint for growth in a tricky diplomatic environment and an important reminder of why countries must resist the temptation to look inwards.

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$75m

Initial deployment from USD Fund III

Hony Capital's founder and CEO, John Zhao, tells us what the experience taught his firm.

Q State-owned enterprises are a distinctly Chinese phenomenon. What is the appeal of such an investment?

When we started Hony in 2003 we positioned ourselves as a creator of value. We chose to invest in state-owned enterprises and make them more competitive through mixed-ownership, which allowed us to bring improved governance and introduce new strategies.

The Chinese government advocates mixed ownership of state enterprises, believing that an external market force coming into the company would be able to enhance

Welcome to America: Jushi Group has production bases in China, Egypt and now the US

the governance and deliver more competitive results. Corporate restructuring is one of our specialties and the investment into Jushi Group in 2006 was a prime example.

At the time, government policy called for marketisation and the modernisation of SOEs. Jushi was a fibreglass manufacturer and the second-class subsidiary of a centrally owned SOE, China National Building Material Group. It was growing very quickly but had limited resources and global reach, so we decided it would be a meaningful project.

Q How did you invest in that particular SOE?

We initially deployed $75 million from our $580 million USD Fund III to become the third-largest shareholder, after the state and the founder. The company later went public and Hony's share was diluted before fully exiting.

In 2016, the founder decided to become a multinational by launching a new factory in the US. We opted to invest alongside him from our separate account of USD Fund VIII as the sponsor, while Jushi remained controlling shareholder. Our second time around we initially deployed $45 million, and, as we neared production, market demand indicated that we could add another $15 million to enlarge capacity.

Q How do you approach value creation in a Chinese manufacturing business?

During our initial ownership, there were three pillars of value creation: newly invested capital which enabled rapid expansion of capacity; restructuring to ensure the company had the most efficient supply chain; and investment into engineering R&D. Fibreglass making is very process-driven and it very much depends on the engineering. It requires a lot of experimentation, both on the lab level and on the production level, which needs investment and resources.

Q What obstacles did you need to overcome?

We got a bit of a storm in 2008 and many companies found themselves in terrible overcapacity. That also hit us and we had to do a lot of restructuring to sharpen our focus so we did not get harmed by the recession and could emerge stronger.

The founder is very entrepreneurial and he was initially spread pretty wide by producing a lot of other products in addition to the fibreglass. A lot of the restructuring we did was realigning the focus onto fibreglass and advising him to sell companies that were not relevant to that part of the business.

Q How does the SOE angle play into value creation?

The number one difference was the governance. As a major shareholder and board member, we ensured the company had transparent governance, which in turn enabled the management team to focus solely on global expansion. We were the market force that made a huge difference for the company by helping it not only produce consistent results but also ensure that capital markets, both private and public, would

> *"We chose to invest in state-owned enterprises and make them more competitive through mixed-ownership"*

What is Hony's secret sauce when it comes to value creation in China?

Our secret sauce is investing in people.

It does not matter whether it is a private entrepreneur or an SOE business leader, we want to build deep, trusted relationships with that person so we can become a long-term partner. China is still developing and its history of business practice is short, so very often it is the case that success depends on individuals. You need to find a business leader who is able, trustworthy and has integrity.

Even when a company looks great, we will not invest if the business leader does not meet our standards. Likewise, if the industry is not sexy or a company has lots of problems, but the business leader and team is of a certain calibre, we will consider investing. We have always done well when that was the case, and been hurt when it was not.

actually recognise that and provide efficient financing for M&A and its IPO.

For the second phase, when we jointly invested in this US greenfield project, governance continues to be something that all parties expect us to deliver. That is why the shareholder structure is similar to the original one; it is very balanced between the state, the management team and Hony.

Q What results have you seen?

The number one difference was the governance. As a major shareholder and board member, we ensured the company had transparent governance, which in turn enabled the management team to focus solely on global expansion. We were the market force that made a huge difference for the company by helping it not only produce consistent results but also ensure that capital markets, both private and public, would actually recognise that and provide efficient financing for M&A and its IPO.

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Q How do you turn a Chinese SOE into a successful multinational?

As the company grew in size, capacity and international exposure, Jushi's founder became more interested in becoming a multinational. The company was selling to the US in large quantities and it became very inefficient to serve so many North American customers from China. Like many global multinationals, we wanted to have more balanced involvement outside of China to manufacture and serve its customers locally.

> *"The trade war has no winners; today you can be on the lucky side but you can easily fall on the other side tomorrow"*

In our second tenure as owner, we sponsored a new factory in South Carolina – the heartland of the US – to service the North American market. The manufacturing process of fibreglass is mostly automated and the US has the best-trained skilled workers, so we are comfortable being based there.

Although the production costs are much higher than China, the work ethic and legal environment really supported much higher productivity. The project is expected to create 500 local jobs, so this is good for us and good for the area, as well.

For this US project, our investment thesis is slightly different. This one is less risky than our first investment and it has been a more obvious decision, because Jushi was already selling to the US in large quantities and the customers loved the project.

From our reading of sales marketing and customer satisfaction, this looks like it will be a winner. We have slightly lower financial targets because there is less risk associated with it, so we are looking at this being something that will return a net IRR in the mid-teens.

Q What are the implications of the trade war for Chinese multinationals?

The challenge, since we started the multinational project, was growing concern about globalisation and the resulting trade war. Before we could ever anticipate the trade dispute turning into a full trade war, we sensed growing protectionism and knew it would help to have local production, even if just for tax benefits.

We got luckier than some other manufacturers because as the tariffs started and the threats became more real, we found ourselves having more demand for the US factory as customers stopped trying to buy from China.

We happen to benefit if President Trump continues with these tariffs because we are manufacturing locally, employing locally and using local services. That is why we invested more capital to increase capacity.

However, it is certainly still a challenge, because the trade war has no winners; today you can be on the lucky side but you can easily fall on the other side tomorrow. We are still in the middle of this and it is a very severe, ongoing challenge.

History is marching on and it is meaningful for a Chinese company like Jushi to become a multinational. While this is a reasonably successful investment project for Hony, it is also a model investment for a much larger trend, especially at a time when the world is rethinking globalisation.

I have seen how the world has benefited from globalisation and, even though it exposed severe problems like the wealth gap, the solution to those problems is not going back to a nationalised economic system. ■

John Zhao is the founder and CEO of Hony Capital. He spent 12 years studying and working in the US before returning to China in 2002. He teamed up with Legend Holdings to create China's first buyout fund in 2003.

Private Equity International AWARDS 2019

operational excellence WINNER

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

EMEA

EQT Partners
AutoStore

IK Investment Partners
Transnorm

Nordic Capital
AniCura

Americas

Arbor Investments
Rise Baking Company

Blue Point Capital Partners
Selmet, Inc

L Catterton
Zarbee's Naturals

Asia-Pacific

Advantage Partners
Fasford Technology

Blackstone Group
Intelenet Global Services

Pacific Equity Partners
Manuka Health

Outstanding Achievement in ESG

Sun European Partners
ELIX Polymers

Outstanding Achievement in Growth Strategy

Partners Group
Aavas Financiers

Outstanding Achievement in Innovation

EQT Partners
Piab

Meet the judges

An influential panel of industry experts from across the three regions assessed the 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 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 and cofounded 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.

JONCARLO MARK
Upwelling Capital Group

Joncarlo Mark is founder of Upwelling Capital Group, an investment advisor that provides capital solutions to premier institutional investors. He was previously a senior portfolio manager in the alternative investment management programme at the California Public Employees Retirement System and was also chairman at the Institutional Limited Partners Association. He continues to serve as a faculty member for the ILPA Institute. Mark is currently a trustee for the University of California Davis Foundation, having served as chairman of the Finance and Investment Committee from 2017 to 2019.

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.

Asia-Pacific

VERONIQUE LAFON-VINAIS
Hong Kong University of Science and Technology

Veronique Lafon-Vinais 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-Vinais is a seasoned financial market professional with over 20 years of banking and capital markets experience.

JIAN LI
AlixPartners

Jian Li is a managing director at AlixPartners' Shanghai office. He is a senior management consulting professional with extensive experience in supply chain management and large-scale operations transformation in Asia. He has worked with clients in the consumer goods, industrial goods and logistics sectors. Prior to his consulting life, he was with P&G and ExxonMobil in China in the area of operations and supply chain management.

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' 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

PABLO ECHART
Scale Capital

Pablo Echart is a private equity investor and operating partner. He worked for 3i first in London in the active partnership group and then as head of the Spanish Office, focusing on business services, consumer and industrial sectors. Prior to his investment career, he was a consultant with McKinsey & Company focusing on value creation and operations improvement in various industries around the world.

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.

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.

Private Equity International

AWARDS 2019

operational excellence

It's about creating value

It has never been more important for firms to demonstrate their value-creation credentials if they want to stand out from the crowd. Now in their eighth year, *Private Equity International*'s Operational Excellence Awards 2019 celebrate the achievements of the industry's best-in-class operators.

Every summer 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, 2018. Entries are invited from three regions – the Americas, Asia-Pacific, and Europe, Middle East and Africa. There are three awards per region and, for the first time this year, a further three awards recognising Outstanding Achievement in ESG, in Growth Strategy and in Innovation.

All entries go before a judging panel comprising some of the leading scholars and operational experts in the private equity industry. Competition is tough and 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.

These details are backed up by evidence. While exit numbers are looked at closely, the Operational Excellence Awards recognise those managers that go beyond the numbers and conduct genuinely groundbreaking work.

As ESG has become ever more important, the Outstanding Achievement in ESG criteria took into consideration factors as diverse as management and workforce training, fixed asset investments, board and operational guidance, as well as a host of idiosyncratic examples such as reducing accident rates or reducing energy consumption or waste, as indeed our eventual winner did.

The Outstanding Achievement in Growth Strategy award was based on the building or adding of product lines and channels, as well as headcount growth and expansion into new countries and territories. The Outstanding Achievement in Innovation was judged on criteria such as product innovation, innovative approaches to management, the intelligent use of technology and digital go-to-market strategies, and investment in R&D.

As always, our winners are a varied lot. Automation is clearly a sector where innovative approaches can create real value, with EQT Partners picking up two awards – and IK Investment Partners, one – for work with portfolio companies which specialise in automation. Our winners also include everything from honey manufacturers to affordable housing finance providers, from sellers of paediatric cough solutions to the manufacturer of titanium casings for the aerospace industry.

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.

It has been another very strong year for entries. Thanks to all the GPs who entered and congratulations to all of our worthy winners.

KEYNOTE INTERVIEW

Buy-and-builds in a digital age

Private equity buy-and-builds are on the rise, driven in part by rising multiples and increasing dry powder, but how are today's add-ons different from before? PwC's Friederich von Hurter and Filip Debevc discuss how firms can create maximum value from their acquisitions

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Buy-and-build has become one of the most popular strategies for creating value in portfolio companies. PitchBook data suggest that add-ons account for around 70 percent of US buyout activity today.

That is up markedly from 2006, when less than half – just 46 percent – of deals done by US private equity houses were acquisitions by portfolio companies.

While the strategy has been around for a long time, the rise of technology and digitisation has made buy-and-builds an even more attractive option for private equity houses as industries seek to create new business and operational models.

A recent PwC survey, *Private Equity Trend Report 2019*, found, for example, that digitisation was among the top three most important influences on equity stories for acquisitions this year.

We caught up with PwC's Friederich von Hurter, M&A integration partner, and Filip Debevc, senior manager, deals, to explore how M&A in the digital era is driving value in private equity portfolios.

70%

Of US buyout activity is now add-ons, a significant rise since 2006, when the figure stood at 46%

Q What are the key trends you are seeing in buy-and-builds today?

Friederich von Hurter: One of the most important trends we have seen over recent years is that the old way of doing things – the pay and pray strategy – does not work anymore in private equity. Firms are having to be highly creative in identifying value-creation opportunities.

Buy-and-builds are one of these opportunities and have really come to the fore recently as industries and markets are being transformed by the arrival of technologies such as big data and digitisation tools. Many investors are looking to create value out of two or more legacy companies by combining them to create a greater momentum in growth and scale through the deployment of these tools, while also building on classic cost synergies.

This is also a strategy being used to mitigate against the high valuations we see in the market today. Firms are having to create strong equity stories and the buy-and-build is a familiar and tried and tested vehicle for value creation.

In addition, we are increasingly seeing private equity players team up with strategic buyers, which can bring not only financial power to the table, but also deep industry and market knowledge. They are able to provide a real boost to companies already in the portfolio.

Q Why do you think private equity firms are looking to strategic buyers as partners?

Filip Debevc: Dry powder among private equity firms has increased and so, therefore, have competition for deals and multiples paid for businesses. Attractive targets have become rarer. Bringing together the different points of view of strategics – with their ability to implement new processes and their in-depth knowledge of industries – with private equity's value creation mindset creates a good equity story.

Q How does that play out when it comes to exit?

FvH: The fact that you are creating businesses of scale through buy-and-builds provides good opportunities at exit.

If you are putting together enterprises, you can not only achieve a higher value, but you can often create businesses of the size that attract the attention of public markets. IPOs or other floating exit strategies come into play and that in itself creates value for investors.

Q And so how are big data and digitisation being used to create value in buy-and-builds?

FvH: These are mega-trends that all industries are getting to grips with. Companies are trying to create new business models from heritage or legacy organisations. Business owners, including private equity firms, need to use big data and digitisation as a toolkit for this shift in any case, but when you add in buy-and-build strategies, the potential is much greater.

Q How can buy-and-builds today help optimise working capital?

FvH: When you are combining two businesses, working capital can become a synergy-creating opportunity in itself – it is the way many CEOs see it. So, you can share exposure to customers and suppliers and if you can virtualise this, you are unlocking synergies.

For example, you can create a virtual warehouse by sharing information gleaned through data-mining around what products and services you need in stock to meet customer requirements. This opens the synergy bucket in a way you simply could not do 20 years ago.

This has an effect on capital expenditure. If a company invests in a certain methodology and its infrastructure, when you combine the businesses, they can share the cost of periodic refurbishment. By creating vertically integrated organisations, you are adding value by reducing the amount of capex needed for each part of the business.

> *"Dry powder among private equity firms has increased and so, therefore, have competition for deals and multiples paid for businesses. Attractive targets have become rarer"*
>
> **FILIP DEBEVC**

Big data and digital tools are clearly very different from bricks and mortar – they can be used and reused across structures, legal entities, channels, geographies and so on and they can be deployed quickly. They are very good tools to create value quickly across a combined entity and build modern operating models.

In terms of how that can create top line value, you have data that can be used to share customer insights, predict their needs and requirements and you can combine products and services to increase customer convenience.

There is real value to be created by adding new capabilities, services and products through buy-and-build acquisitions to serve customers better, based on these insights. You can create vertically integrated organisations around customers.

Q Can you provide an example?

FD: One recent example of a deal we worked on had a significant effect on the cost-line. Digitisation allows companies to virtually outsource processes that are not strategically important.

In this deal, we helped combine a company that was outsourcing using the cloud with an existing portfolio company, which hooked into this virtual outsourcing. The cost line improved by 16 percent and the value increased significantly – you can create value immediately this way.

Q You mentioned modern operating models. What do these look like?

FvH: Under a modern operating model, you do not think along functional lines anymore.

Companies are concentrating their value chain around the customer, where the value chain is the product or service that the customer pays for. The operating model therefore goes across countries and beyond pricing optimisation, for example.

Processes are not only improved end-to-end or digitalised by shifting manual workforce to automatised processes like RPA. A modern process on a digital operating model happens simultaneously.

Also, there are no longer cost centre buckets. Instead, you have people working together across functions to create something a customer will buy. By employing a modern operating model, you can avoid certain exposures and cost friction.

If we take the example of Amazon, when you buy something, it will often come directly from the product site, it is not touched by Amazon or even the trader – it may not even touch the balance sheet of the trader. It is the operating model for a connected and integrated world.

Q That is quite a transformation for many businesses. How can private equity firms create such organisations within their holding periods?

FvH: One of the biggest shifts is in due diligence. The legacy way of doing this is to look at the past and try to reduce risk, praying that the business will develop well in the future. We do not think that is appropriate in today's world. You cannot just look at the past; you have to invest in and investigate what will be possible for the future.

As a result, value creation has to start at due diligence phase, embracing the whole gamut of financial, operational, tax, legal and structuring and looking out to future potential. You need to create a single, sophisticated equity story rather than conduct silo-based due diligence.

Q To what extent is this enhanced due diligence a feature of deals today?

FvH: Most sophisticated firms are now taking their time ahead of investing to work out what immediate benefits they can generate from being proactive.

They are spending less effort on pure financial reports than was the case in the past – the work we do now centres around helping clients see how they can take an integrated approach to value creation across the strands of operations, strategy and commercial improvements.

"Under a modern operating model, you do not think along functional lines anymore. Companies are concentrating their value chain around the customer"

FRIEDERICH VON HURTER

The new way of a due diligence process also includes more and more a big data analysis, not only to better understand the past but also to initiate a data driven future strategy and operations. In a best-case scenario the seller has prepared sufficient data extracts for the confirmatory phase. A potential buyer will conduct a first big data analysis on, for example, detailed sales and customer data or detailed procurement data down to the purchase order level.

In any case, auctions are so tight these days, you do not have time to write books anymore, so you need to work fast to create an integrated view of what you can achieve with the company. Hence, value creation starts with the due diligence processes.

Q How do you see these trends developing further?

FvH: We will see further digitisation and virtualisation of business processes as companies and industries focus here to drive efficiency, create new opportunities and increase revenues. We will see new business models run in parallel with legacy organisations at first, but eventually, companies will no longer be product companies or trading businesses – they will go across the value chain to meet customers' needs and this will move companies to the modern operating model.

Buy-and-build is an enabler for this: instead of taking time to develop a new capability within – for example – your logistic team in-house, acquisitions speed up the transformation and the improvement of your value chain functions or of your support processes.

We will see more buy-and-builds as a result, in particular as the scale achieved by buy-and-builds offers more exit routes for private equity firms, with dual track processes more achievable. In addition, private equity is proving increasingly attractive for investors and capital will continue to flow towards the asset class. Firms will need to build bigger and more equity stories to deliver for their investors. ■

Friederich von Hurter is a post-merger integration expert, who became M&A integration partner at PwC Germany in 2017. He is based in Munich.

Filip Debevc is senior manager in the deals team, based in Berlin. He joined PwC in 2015, having previously worked at Commerzbank and RBS.

EMEA

Building better businesses

Our winners in EMEA – EQT Partners for its work with AutoStore, IK Investment Partners for Transnorm and Nordic Capital for AniCura – won big by growing big. While the first two focus on warehouse automation, AniCura cornered the market in veterinary care.

Geographic expansion was central to the strategies of all three companies. AutoStore entered eight new geographies and increased its focus on the US, other European nations and Japan. Transnorm also looked across oceans, developing its footprint in North America and Asia. And AniCura expanded from three countries in Scandinavia to 11 across Europe.

Awards judge Pablo Echart describes AniCura's success as an "amazing pan-European platform build-up leveraging the scale while benefiting from the local customer loyalty". Its eventual sale was the largest-ever veterinary deal in Europe, which is no mean feat considering it consisted of only 50 clinics when Nordic Capital entered. AutoStore and Transnorm have more in common with each other than being in the business of automation. Both expanded geographically, both invested heavily in R&D, both succeeded by developing new products and both achieved impressive money multiples at exit.

Echart notes that Transnorm, in particular, thrived by expanding into high-growth areas and leveraging synergetic acquisitions. Fellow judge Antoon Schneider was particularly impressed by the work of EQT's in-house digital team with AutoStore.

He says: "It is a good example of a successful investment by EQT as part of pursuing a theme of investing in digital opportunities. EQT also leveraged its digital capabilities to help the company develop after acquisition, stepping up digital marketing, setting up e-commerce advisory boards and by increasing R&D to develop the next generation of warehouse technology." ■

WINNER

EQT Partners

EQT already had knowledge of warehouse automation firm AutoStore when it became available to buy, giving the GP a jump on the competition

EQT first identified warehouse automation as an exciting investment proposition in 2016, based on industry tailwinds from megatrends such as e-commerce, advances in automation technology, growth in global urbanisation and increased demand for speedy and accurate delivery.

The firm carried out a comprehensive assessment of the sector, hired industry experts and mapped out potential targets. AutoStore, which the firm already knew as a supplier to former portfolio company XXL, quickly appeared on the radar.

When it was rumoured that the owner of AutoStore was selling, EQT submitted a pre-emptive offer. At the end of the sales process, the firm succeeded in entering into exclusive negotiations, despite other offers being substantially higher.

During EQT's holding period, AutoStore broadened the company's partner network, increasing market coverage by 150 percent. It increased partner collaboration, set up a new business development organisation and stepped up digital marketing, supported by EQT's in-house digital team.

EQT also increased its focus on key high-potential geographies – the US, France, UK, Germany and Japan – as well as expanding into eight new countries. R&D efforts were stepped-up to sustain competitive advantage and AutoStore came to market with several new innovations, including the launch of 'Black Line', a family of retrieval robots which expanded the addressable market by 40 percent.

To sustain technology protection, intellectual property efforts were increased and AutoStore has been the most frequent filing company in Norway over the past two years, with the number of patent filings increasing by 250 percent. Meanwhile, a comprehensive procurement programme resulted in a 160bps gross margin improvement and 30 percent increase in payable days.

In addition, sustainable product improvements including a shift from lead-acid to high-power lithium-ion batteries, which leave a significantly lower carbon footprint over their lifecycle, took place during EQT's tenure.

The plethora of operational improvements at AutoStore culminated in a sale to a consortium led by THL Partners in June 2018. The deal generated an 88 percent internal rate of return and 8.3x money multiple (or 9.3x in local currency) for EQT.

3x
EQT tripled the number of robots installed

8
new geographies were entered into

350+
AutoStore's total number of installations at exit

"EQT supported AutoStore in accelerating its growth and penetrating new geographies"

ANDERS MISUND
EQT Partners

Over the course of the investment, the company's global installations grew by 2.5x, from approximately 140 to 350, while the number of robots installed tripled.

Revenues quadrupled and EBITDA increased to 4.5x the level at acquisition. EQT has reinvested 10 percent of its total proceeds to maintain exposure to the company's future growth.

"EQT supported AutoStore in accelerating its growth and penetrating new geographies, enabled by a broadened partner network, the establishment of a new business development function and more systematic work with partners to increase sales conversion," says EQT partner Anders Misund. ■

WINNER

IK Investment Partners

Warehouse automation business Transnorm was transformed under IK Investment Partners' ownership, doubling revenues and tripling profits

Founded in 1957, Transnorm is a global warehouse automation business providing engineered conveyor systems that quickly and efficiently transport products and packages for parcel and e-commerce customers including DHL, FedEx, UPS, Amazon and Alibaba.

IK acquired Transnorm, which is headquartered in Germany, from family office HQ Equita in December 2014. Under IK's stewardship, the business went on to double revenues and nearly triple operating profits, while investing significantly in R&D, product development and production capacity extension.

IK's value creation philosophy for Transnorm was based around five core initiatives. First, the firm focused on strategic repositioning, by increasing the emphasis on the high growth e-commerce and parcel verticals, instead of airport baggage handling systems. At exit, 90 percent of sales were aligned to these high growth segments.

IK invested in new product development to meet the demands of the parcel and e-commerce industries, including singulation and sorting solutions. The firm also completed a transformative acquisition, buying UK-based Sovex Systems, a company that designs and manufactures vehicle loader and transport conveyor solutions. The deal increased product technology and encouraged collaboration across the two businesses, particularly in engineering and after-sales support.

Internationalisation was another key pillar of Transnorm's growth strategy. Leveraging mega-trends including intra-logistics and e-commerce, IK worked with the company to develop its global footprint in North America and Asia. In 2018, 64 percent of sales were generated in EMEA, 28 percent Americas and 8 percent APAC.

This expansion was supported by the development of a new, centralised production site in Bangkok. The establishment of a Chinese entity with a dedicated sales team and local warehouse further helped establish Transnorm's presence in Asia.

Finally, IK also focused heavily on Transnorm's financial performance. EBITDA margins increased from 20 percent to 25 percent, driven by improved sourcing, production efficiency and strong growth of the aftermarket business. Revenues during the firm's holding period, meanwhile, grew from €62 million to €130 million, with market share climbing from 40 to 50 percent.

"The value creation plan included significant investments into R&D, product development and production capacity expansion, with a particular focus on strengthening the e-commerce-driven parcel segment and the aftermarket business which is highly profitable," says IK partner Anders Petersson.

"When IK acquired Transnorm, the company was mainly focused on airport baggage handling systems. During the ownership we repositioned the company, playing into favourable macro trends such as growing e-commerce and package handling. It allowed us to attract a wider set of potential buyers when it was time for exit."

Indeed, exactly four years after it first invested, in December 2018 IK sold Transnorm to Fortune 100 technology company Honeywell for around €425 million. The sale generated an internal rate of return of 64 percent and a six times money multiple for the firm. ■

6x

Money multiple on exit

50%

Market share at the point of sale

65

New jobs created organically

"The value creation plan included significant investments into R&D, product development and production capacity expansion"

ANDERS PETERSSON
IK Investment Partners

WINNER

Nordic Capital

Veterinary care provider AniCura grew fourfold under Nordic Capital's ownership, expanding from three to 11 European countries to become a leading pan-continental platform

When Nordic Capital acquired a majority stake in Scandinavian veterinary group AniCura in 2014, it consisted of 50 clinics across Sweden, Denmark and Norway. It employed 1,000 staff and generated revenues of SKr870 million (about $1 billion or €980 million at today's exchange rates).

Four years later, when the firm sold the business to the world's largest conglomerate in the sector, Mars Petcare, AniCura had been transformed into a pan-European market leader, with over 200 clinics, 4,500 employees and pro forma revenues of SKr3.3 billion. The exit represented the largest ever veterinary deal in Europe and the second-largest worldwide.

This impressive growth story was underpinned by an aggressive buy-and-build strategy. AniCura completed no less than 150 acquisitions in just three years, dramatically altering the company's geographic footprint. It expanded from three Nordic countries to 11 across Europe, including Spain, Italy, France, Germany and Switzerland.

Nordic Capital, alongside former owners the Foundation Djursjukhus i Stor-Stockholm and Swedish investor Fidelio, which retained minority stakes in the business, also helped drive AniCura's organic expansion. The firm invested in securing AniCura's place at the cutting edge of technological advances, including building a new specialist veterinary neurological centre in Sweden.

In order to support this rapid growth, Nordic Capital created a new organisational and operational structure. It invested heavily in the professionalisation of the business and drove the development of a distinct corporate culture. The firm appointed a new board, including the former CEOs of both Attendo and Capio. It also turned to its strategic HR capabilities to strengthen the central management team, including a new CFO and, critically, an in-house M&A function.

In addition, it hired a new procurement manager and the business worked closely with Nordic Capital's procurement optimisation group.

"Nordic Capital focused on strengthening AniCura to become significantly professionalised, developing a unique and differentiated corporate culture recognised across the industry, and making it possible for the company to establish itself as the pan-European leader in specialised veterinary care," says Nordic Capital's Thomas Vetander.

"This included appointing a new board with highly experienced directors, which provided value-adding capabilities and tools. Furthermore, the establishment of a new organisational and operational structure ensured the highest degree of scalability for the future."

Through this comprehensive, hands-on approach, Nordic Capital quadrupled revenues in a four-year period, while the enterprise value increased nine-fold, from €200 million to €1.8 billion.

The number of animals cared for by the company, meanwhile, increased from 500,000 to 2.5 million.

Finally, Nordic Capital proactively positioned AniCura for future buyers, leading to extraordinary interest and an exit valuation that significantly exceeded market norms. It also generated one of the biggest returns in Nordic Capital's 30-year history, capping a very successful ownership period. ■

150

Acquisitions completed in just three years

2.5m

Number of animals cared for at the point of exit

€1.8bn

Enterprise value at sale

"The establishment of a new organisational and operational structure ensured the highest degree of scalability for the future"

THOMAS VETANDER
Nordic Capital

EXPERT COMMENTARY

Thoroughly assessing the CEO of a newly acquired portfolio company early and making necessary changes immediately is key to optimising value creation, says Shannon Gabriel of TBM Consulting Group

The four positions a CEO must be able to play

Last year saw nearly 3,000 mid-market PE deals, according to PitchBook, and many of the incumbent CEOs involved in those deals have already been shown the door. According to a 2018 private equity survey completed by AlixPartners, 58 percent of CEOs are likely to be replaced during the first year.

That survey shows that 72 percent of PE investors wait more than 12 months to make the switch. That can be a costly mistake. With shorter holding periods trending, companies must generate value in the first 12-18 months, or they put the deal thesis at risk. It's difficult, if not impossible, to make up for any value you fail to generate in the critical first few months.

So why waste precious time on an ineffective CEO who is ultimately on the way out? If a change at the top is in order, make it now. Indeed, research by Russell Reynolds Associates indicates that in less successful deals, the operating partners wait longer to replace the CEO. In our own research, we found that PE leaders believe subpar management can cost one to two multiples when a portfolio company is sold.

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Ask yourself if that is value you're willing to give up.

The four hats every portfolio company CEO must wear well

To make changes at the top fast, PE firms need an effective means for sizing up the capabilities of an incumbent CEO during the pre-LOI phase of the deal. That starts with knowing exactly what to look for.

Some experts say CEO success hinges on past experience. Others argue that emotional IQ trumps track record. In our experience, it takes both. PE firms need a multidimensional leader who can fire on all cylinders, all the time.

It's a tall order, but so is the task of unleashing an acquisition's full potential in just 36-60 months. The CEOs who beat the odds – and who are most successful in their roles – are capable of playing four particular positions simultaneously.

MVP: A track record of past performance with impressive stats on meaningful measures

First, you need a CEO with a history of delivering growth and financial returns in the industry in which you operate. You want to see that the CEO has consistently hit performance targets. Under the CEO's leadership, key operating metrics must have either held steady or improved. The leader must demonstrate the ability to take strategic direction and show quantifiable progress towards specific metrics and goals.

If you are acquiring an organisation that is struggling or in which performance has been declining, you will need a strong reason to justify hanging on to the current CEO. But, if you are taking on a company that is already on a top line growth trajectory, then the incumbent CEO has some victories under his or her belt. But can that leader continue moving the business forward? To do so, he or she needs to show signs of perseverance and mental toughness.

The leader will be expected to head up intense growth for three or more years. Can the CEO handle the pressure for an extended period of time without burning out? It's a question that needs to be explored.

Quarterback: Alignment with the strategic direction set by the PE firm and the ability to put it into play

The most common reason for CEO replacement is lack of fit with the portfolio company's new direction, and it is easy to see why. The person leading the team down the field must be 100 percent aligned with the PE firm's game plan. Otherwise, he or she won't be able to execute per the playbook.

Like an all-star quarterback, portfolio company CEOs must operate tactically and strategically at the same time. They need to grasp the big picture and be on board with the PE group's long-term goals and exit strategy, and they must be able to translate the end goals into short-term results. Consider the CEO's sense of urgency. Will he or she take immediate action in order to make progress in the critical first weeks and months of the deal?

While some of this comes down to past experience, much of it has to do with the leader's beliefs on how the firm will succeed in both the short and long-term. These beliefs must align with the new owners', and there must be solid agreement on the specific actions needed to realise operational gains. If that alignment isn't there, or worse, if it isn't legitimate, you jeopardise your opportunity to realise critical gains out of the gate.

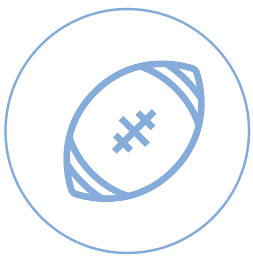
> *"PE firms need a multidimensional leader who can fire on all cylinders, all the time"*

The four roles of an effective portfolio company CEO

MVP

Track record of past performance

- Consistently delivers financial returns
- Maintains or improves key operating metrics
- Shows quantifiable progress against strategic goals



QUARTERBACK

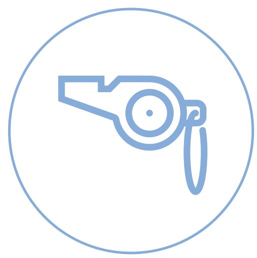
Knows the game plan and puts it into play

- Fully aligned with the PE firm's strategic direction
- Capable of acting both strategically and tactically at the same time
- Sense of urgency to put plans into action and generate value immediately

COACH

Develops and motivates the team

- Can align teams with strategy and break down long-term objectives into short-term goals
- Holds the respect of employees and is capable of creating momentum
- Develops key members of the team



REFEREE

Straightforward communicator capable of making tough calls

- The candour to articulate the facts – good and bad – in a clear and concise manner
- Comfortable communicating daily with the PE operating partners and leadership team
- Ability to quickly execute difficult decisions

Coach: Ability to build consensus, motivate the team and develop key players

It's one thing for the CEO to be aligned with your strategic direction for the portfolio company. It's another thing for him or her to drive the company there. No CEO lives or dies alone. Once you are sure that the leader shares your mindset and knows which plays to call, the next area to assess is his or her ability to get the team on board.

Driving performance comes down to three things, and the CEO must do all three well: align teams against strategy; set direction by breaking down goals into quarters, months and weeks, and; create momentum, keeping people motivated for extended periods of time.

Despite intense time pressure and the need to hit the numbers, the CEO must keep tabs on key players and work to build up individuals along with the organisation. By developing the capabilities of the team and turning out A-players along the way, the CEO helps to create incremental value for the portfolio company at exit.

All of this requires the CEO to possess an internal following. At a minimum, there must be a sense of respect and trust for the CEO across all levels of the organisation. The CEO may be asking people to work harder than they ever have before, to change the way things have historically been done and to embrace a new culture. Your leader will not succeed without existing support from the troops.

Referee: The candour to tell it like it is and the confidence to make the tough calls

Too often we see leaders unable or unwilling to share the difficult details of a business situation with the ownership team. We've even seen leaders purposely withhold information during the due diligence phase. This is not acceptable.

Your portfolio company needs a leader who can identify and accept problems. The person must be forthright enough to give you the facts, even when they aren't pretty, and must be good at articulating issues clearly. There isn't time for sugar coating when every minute counts towards value creation and the business has to achieve aggressive growth in short order.

In portfolio companies, open and honest communications with the owners and the leadership team are part of the everyday working relationship, not something that happens only once a quarter in a board meeting. Is your CEO going to be comfortable in this type of operating environment? Does he or she have the confidence to share feedback with the PE team, the leadership team and direct reports in a straightforward manner? Does the leader have the composure to accept that straight talk in return? And, if so, does he or she have the fortitude to swiftly act on the facts? CEOs must be able to make – and live with – the difficult decisions that are necessary to drive value in the business.

> *"There isn't time for sugar coating when every minute counts towards value creation and the business has to achieve aggressive growth in short order"*

How to quickly assess your CEO

Knowing what makes an effective CEO is only half the battle. PE firms need a proven formula for determining if an incumbent CEO has the right capabilities to be an MVP, quarterback, coach and referee all at once.

While most of these attributes can't be measured with a balance sheet, income statement, or facility walk through alone, it is possible to gain insight in each area before the deal is done. Here's how:

1. **Start with a detailed capability profile customised to your PE firm and your deal thesis.** Track record, shared vision, leadership capabilities and candour are musts. But there will be other attributes specific to your firm and deal thesis that your CEO must possess. List them out and be sure all the boxes are checked.
2. **Review past performance and do a metric-based assessment.** Look at the hard data for clear signs of financial results and KPI improvement.
3. **Use behavioural assessments to gauge communication skills, teamwork aptitude and leadership style.** Get a sense of the CEO's personality, beliefs and attitudes and use the results to guide further hands-on assessment.
4. **Interview players from across the organisation for additional insight.** Embed yourself with the executive team, direct reports and people at all levels of the organisation to see which common denominators emerge around the CEO's working style, urgency, ability to handle stress and teamwork capabilities.
5. **Vet assessment results with in-field observation.** Validate what you've learned from the data, assessments and team interviews by watching the CEO at work and through one-on-one conversations.

If the CEO can't play all the right parts, don't wait to make a change

Spending some time during the due diligence phase to assess the CEO's capabilities in four critical areas is one of the most important steps you can take to ensure the success of your deal thesis. Research and experience show that waiting is costly. To achieve full value creation, you must hit the ground running with a leader who knows how to win, aligns with your objectives, is capable of rallying the troops, and will be upfront with you at every step.

The sooner you know if the incumbent leader falls short in any of these key areas, the sooner you can make a change. And the better positioned you'll be to make progress right out of the gate and sustain momentum throughout the investment lifecycle. ■

Shannon Gabriel is managing director of TBM's Leadership Solutions practice, helping clients identify and resolve weaknesses within their organisational structure and hiring process, build bench strength and engage interim leaders to facilitate growth and drive immediate performance improvements.

Americas

Epitomising value creation

It would be difficult to pack in more variety than this year's winners from the Americas region. Arbor Investments' Rise Baking Company, Blue Point Capital Partners' Selmet and L Catterton's Zarbee's Naturals were all strong entries but all very different – running the gamut from baking cookies to manufacturing titanium castings and wellness products.

"For all three PE-firm winners, intentional operational engineering and value creation were crucial aspects of the investments and the stellar outcomes," says awards judge Steven Kaplan. He notes that L Catterton achieved "almost unheard-of growth in revenues", a performance that fellow judge Michael McKenna describes as "the epitome of the OpEx awards".

With Zarbee's, L Catterton took a four-person company and made it the market leader, growing from one product to a range of products and from one region to a national presence.

Blue Point Capital Partners also achieved impressive growth with Selmet, adding 600 employees to what had been a team of just 250. "Blue Point's investment in Selmet also generated an impressive 5x growth in EBITDA and a 15x-plus MOIC. They did this by helping the company expand geographically, upgrade its salesforce, improve its pricing, increase its range of products and reduce costs," says Kaplan.

Arbor Investments' hold of Rise Baking, meanwhile, shows the importance of installing the right leadership and following through on a solid thesis. As McKenna says: "The experienced team knew how to manage national customer relationships, but still deliver service like a small local bakery. This was key to building a profitable enterprise with good sustainable market share." ■

WINNER

Arbor Investments

A mix of organic expansion and add-ons saw Rise Baking Company become a leading national bakery, achieving exceptional EBITDA growth along the way

Arbor Investments' Rise Baking Company transformed five regional bakeries into one large North American bakery with a suite of products for in-store retailers and food service operators in its five-year hold period.

Arbor installed Michael Schultz, who had previously built and sold Best Brands in late 1999/early 2000, as operating partner, and together they launched Rise Baking with the acquisition of New French Bakery, an artisan bread manufacturer, in June 2013.

The Minneapolis-headquartered firm added Best Maid, a cookie and dessert bar manufacturer in 2014, followed by Hudson, another dessert bar manufacturer, in 2015. It acquired South Coast, a cookie manufacturer, in 2016 and Choice, a dessert bar manufacturer, in 2017, thereby transitioning to a high-quality bakery with a suite of products for its customer base.

"Arbor brought in big company know-how and resources that small companies like ours could only ever dream of," says Kent Hayden, president of Rise and former owner of South Coast.

Arbor provided legal and financial advisory to help Rise build the company. "They allowed us to run our business," Hayden adds.

More than 25 companies were reviewed for addition to the Rise Baking platform and the team focused on cultures that valued food safety, strong employee relationships and well-designed workplaces, according to Hayden.

Arbor consolidated the vendor base, reduced input costs and invested over $55 million to upgrade and expand Rise's manufacturing facilities. It also invested in R&D to create products for customers. The private equity firm also modified the sales team structure of the five acquisitions and made it sales channel-focused. This meant that all customers learnt of Rise's product portfolio of cookie, dessert bar and artisan bread, and the company had manufacturing assets from coast to coast.

5
Companies pulled together to create Rise

300bps
EBITDA expansion from acquisition to exit

7.2x
Multiple on invested capital on exit

"Arbor recognised there was an opportunity to provide more flexible/customised baked goods and more new products on a national scale"

STEVEN KAPLAN
Awards judge

The result? Rise added nine major customers that included Walmart, Albertsons, Costco and Wakefern, and 80 percent of its top 25 customers, including Panera Bread, Sam's Club and Target, began purchasing more than one product category.

"Arbor's investment in Rise Baking shows the importance of a solid thesis along with a combination of organic and add-on growth. Arbor recognised there was an opportunity to provide more flexible/customised baked goods and more new products on a national scale," says awards judge Steven Kaplan. "They then partnered with the right CEO to go after the thesis."

Rise delivered growth fuelled organically and through acquisitions. EBITDA grew exponentially from $4.8 million in 2013 to over $44 million in 2018; organic growth added $17.8 million in EBITDA, while acquisitions added another $21.5 million in the hold period.

Likewise, organic growth added $94.3 million to net sales in the hold period and acquisitions added $190.7 million to the $285.1 million of net sales during the hold period. The sale generated a 60 percent internal rate of return and secured a 7x return for Arbor's Fund III on its exit sale to Olympus Partners in August 2018. ■

WINNER

Blue Point Capital Partners

Blue Point identified Selmet as an attractive prospect due to its strong position in a changing market and was able to triple earnings

In the seven years that BluePoint Capital Partners held Selmet before selling it to CPP, a Warburg Pincus portfolio company, the revenues tripled and the EBITDA increased over 400 percent, according to market sources.

Blue Point acquired Albany-based Selmet in its 2006 Fund II from founder Larry Sharpf in 2011.

Selmet, a manufacturer of titanium castings for the aerospace industry, makes parts for Boeing 737, Airbus A320 and the F-35 Joint Fight Striker among others. It was an attractive acquisition for several reasons, according to Mark Morris, partner and Selmet deal lead at Blue Point.

The industry was transitioning to titanium as lightweight and stronger material for next-gen aircraft and engines. There were high barriers to entry, Selmet was one of the four primary suppliers of titanium aerospace and defence castings in the US and had an exceptional management team, Morris says.

Blue Point set about making operational improvements and bringing add-ons to grow Selmet's business.

The acquisition of Washington-based Onamac Industries in 2014 and Oregon-based Western Metrology in 2015 helped expand Selmet's geographical footprint and added machining capabilities the company did not previously have. The in-house machining capability allowed Selmet to capture incremental margins.

Blue Point also helped improve margins with an almost 20 percent savings in raw material by identifying and sourcing production materials such as yttria, garnet sand and wire mesh from Asian suppliers.

The BPCP Shanghai team was on the ground and hands-on and provided guidance to the management team on supplier selection, according to Morris.

Blue Point supported more than $75 million of capital investments in expanding and building out new infrastructure for Selmet. Selmet added another 90,000 square feet to its facility in Albany, New York, and Onamac moved to a larger facility that helped it increase in-house machining capabilities.

During the hold period the team at Selmet increased from 250 people to 850 at exit and Rick Kenyon led the company as its chief executive officer through the period.

Blue Point also utilised the resources of its operating partners to help Selmet management with guidance and direction. These included Tom Cresante who previously held C-suite positions at Special Devices and Safety Components International and was instrumental in Selmet's strategic planning efforts. Ray Laubenthal, director of Blue Point's former portfolio company, Quality Synthetic Rubber had a strong aerospace manufacturing background that helped give the Selmet board a unique industry perspective.

These strategies helped Selmet win numerous new programmes that drove its market share well above the eight percent at entry; importantly, Blue Point helped develop a sales structure to target next generation commercial aerospace and defence programmes and a strategic pricing strategy for revenue margins enhancement.

On exit in August 2018, Selmet's topline growth had increased over 200 percent, earning the fund an attractive return for its investors, sources say. ■

400%

EBITDA increase

300bps

Revenue increase

850

Employees at exit, up from 250 on entry

20%

Savings in raw materials

WINNER

L Catterton

Zarbee's Naturals was transformed from its origins as a paediatric cough solution to a leading natural health and wellness platform

Zarbee's Naturals is a paediatrician-founded brand focused on producing natural, 'better-for-you' products in the OTC category. L Catterton invested in June 2011 and leveraged its knowledge of the 'better-for-you' adoption being witnessed across various consumer packaged goods categories in light of its successful investments in a range of baby food, pet food and beverage companies.

L Catterton built Zarbee's beyond its flagship product – chemical-free children's cough syrup – into a suite of all-natural products covering the entire family. By targeting other age groups and expanding into broader natural health and wellness, Zarbee's rocketed from a small player with negligible market share when L Catterton invested in 2011, to a clear market leader by 2018.

"L Catterton's investment in Zarbee's Naturals was impressive in proactively identifying the opportunity in kid's cough syrup, helping in expanding distribution, expanding into adult products and other SKUs, and transforming Zarbees' supply chain. This work resulted in an almost unheard of 30x growth in revenues and almost a 10x cash-on-cash," says judge Steven Kaplan.

Dramatically expanding the company's product line took it to 47 percent market share in 2018. All of this was achieved while establishing best-in-class R&D, a flexible and scalable supply chain, a global trademark and intellectual property portfolio, an asset-light manufacturing model and an internal demand planning function.

A new management team was built, with Bret Furio, who was known to L Catterton previously, appointed as CEO. Other critical new hires were added to the team, including the chief customer officer, chief marketing officer and chief product and strategy officer.

Under L Catterton's stewardship, Zarbee's grew from four employees to 50 at exit, and from one regional product to a national presence, with the beginnings of international expansion. Gross revenue grew from $3 million to $109 million, with gross margin of over 60 percent.

The growth took Zarbee's past Reckitt Benckiser-owned Mucinex as the market share leader before agreeing a sale to Johnson & Johnson at a price that represents a 9.7x cash-on-cash return and 43 percent gross internal rate of return for L Catterton.

"Zarbee's is a story of true value creation. L Catterton saw an opportunity to grow the market for 'natural, better for you' OTC meds for children. They identified a good product offering, and built the sales and marketing, manufacturing and distribution, and back office infrastructure needed," says awards judge Michael McKenna.

"While many companies have great ideas and great products, Catterton was able to execute the growth plan to create a valuable company where there had only been a good product years earlier. That operational execution success is the epitome of the OpEx awards." ■

"That operational execution success is the epitome of the OpEx awards"

MICHAEL MCKENNA
Awards judge

#1
Market leader in paediatric cold and cough category

9.7x
Cash-on-cash return

36x
Sales growth, with gross margins over 60 percent

How to pursue a sustainable buy-and-build strategy

Guest comment by **Neil Lloyd**

The CEO of healthcare network Dental Partners has five tips to scale up businesses quickly and sustainably, so ambitious buy-and-build strategies can flourish

It's always an exciting time for a business when it gets investor backing that allows it to take its growth plans to a whole new level. However, to riff on a certain movie quote, with great growth comes great responsibility.

The management team of a buy-and-build platform need to be mindful of avoiding that common pitfall of not having a truly integrated business. At Dental Partners we have grown to 42 clinics and counting in just 26 months. We not only hope to be over 60 clinics in size by Christmas, but to maintain our standard of being the best place to work and the best dental services provider.

Achieving this requires being a fully integrated business. I'm not claiming we are perfect, but we have certainly learned a few lessons along the way.

Here are my five top tips for growth success.

1 Know your market

First and foremost, you should consider if the market you're thinking of targeting is suitable. One of the attractions of the dentistry sector is that not only is it still hugely fragmented with only just over 20 percent of the market in corporate hands, dental clinics are also largely homogenous entities. In other words, the systems and processes for the services they provide are not hugely different from each other, which makes integration easier.

2 Get on top of your synergies early

With acquisitions there are a lot of costs that may flow out of the business rather than into it – staff may expect a pay rise, and corporate ownership may necessitate management or system costs, for example. To balance this, it's really important you start taking advantage of those economies of scale you get from size; renegotiate with materials and equipment suppliers, find debt synergies, etc.

3 Invest in management processes early

If you want to grow quickly you need to invest in the right processes straight away, such as practice management and clinical systems in our case. You don't want to be trying retrospectively moving 100 plus sites onto a whole new system because the existing one cannot cope with your scale and changing needs.

4 Cultural buy-in

Don't forget when you take on a new business you are also taking on new people. Act quickly to win them over – and there are always quick wins to make.

Piece of faulty equipment been bugging them for months under the old management? Get that fixed straight away and you'll be surprised how much goodwill you get in return because you are seen as a positive force for change.

It's also worth making sure your bolt-ons follow your ethos and way of doing things very quickly. Initially, we held back a bit, as we didn't want to scare the horses. However, it makes for a smoother partnership in the long run if certain expectations are laid down right away – eg, the practice management system will need to be changed.

Of course, you shouldn't go about this in a heavy-handed way. I've found making sure there's a clear line of communication to the management team for all new employees has been key in helping our new staff settle in.

5 Add value

My final piece of advice is to remember it's not all about buying; organic growth is hugely important too. Unlocking untapped potential in acquired assets allows you to derive true value from an acquisition.

Our growth opportunity is particularly within the private-pay market, so we have been facilitating clinician training, giving them access to new skills and, importantly, training on how to sell private treatments on top of NHS treatments; an essential component of patient choice.

I acknowledge that all of the above tips require an investment of time, and management teams are time poor.

However, if you work on getting these things right straight away, they will pay multiple dividends in the future. ■

Neil Lloyd is CEO of Dental Partners, which is backed by mid-market private equity firm August Equity and was created just over two years ago. He was previously CEO of Yodel and of NHS Professionals.

EXPERT COMMENTARY

High-tech data analysis tools are key to proving savings delivery flows through to EBITDA, say Efficio's Declan Feeney and Waldo Saville

Tracking procurement savings in portfolio companies

Private equity firms may be reticent about procurement as an improvement lever due to concerns around implementation in complex industries, where management may commit to cutting costs but fail to deliver on agreed plans.

It can be challenging to ensure identified savings make it through to the bottom line, often owing to poor engagement with the business or a lack of compliance from line managers who do not support the new initiatives.

It is also true that, while there will be plenty of quick wins, the greatest savings may come from high-impact categories of spend that will take longer to impact profitability.

The key to effective delivery of procurement change is to identify, deliver and then track savings. Many of these historic challenges can now be quickly addressed through the use of advanced and effective systems to record and track savings on the back of procurement initiatives.

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If CFOs in private equity-backed businesses have access to technology capable of monitoring the progress of savings programmes, the strategic value that procurement can add becomes immediately apparent.

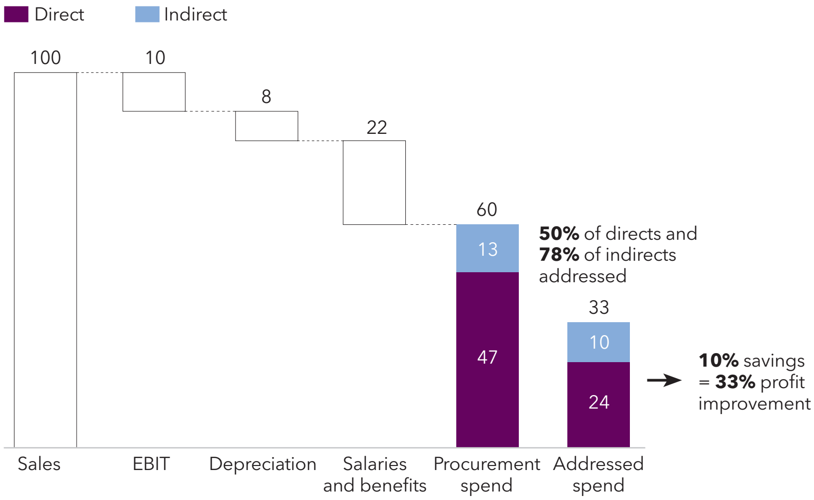
Identifying savings

Identifying savings in the procurement process requires a combination of technology, expertise and insight to analyse every area of spend within a business. Whether it is raw materials, manufactured parts, packaging, IT and telecoms support or temporary labour, each category of spend will come with its own unique supplier arrangements and contracts, all of them influenced by different contractual timelines and existing relationships within the business.

Delivering savings

Once savings plans have been identified, the challenge is to implement strategies effectively, which requires not only careful monitoring but also comprehensive buy-in at all levels of the companies involved. In our experience, a top-down imposition of new arrangements is rarely welcomed, and each category may well require a different approach if it is to achieve the support and implementation required to truly boost the bottom line in an accelerated way.

Procurement spend and savings potential; indexed client example



Tracking implementation

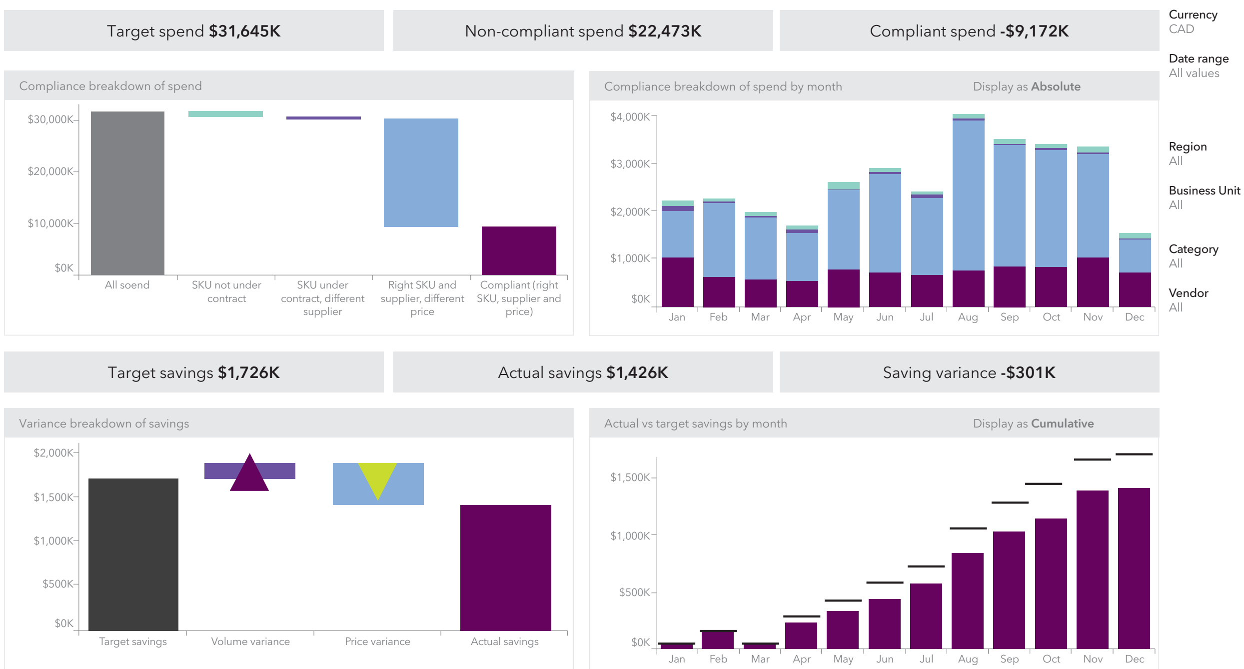
Making sure that savings actually materialise following a process of opportunity assessment, strategic sourcing and new contract signing requires a total commitment to implementation that has not always been evident in the procurement industry. The value of a procurement function is enhanced not by the identification of savings, but by an ongoing process of managing implementation, supplier performance and compliance. Maximising the value of the savings delivered and continuing to identify additional savings opportunities as the market develops are also key.

Savings tracking is notoriously difficult because data has tended to be fragmented and unreliable, with little or no information on project risks or actions. If a multinational manufacturing business signs up to reduce the number of vendors it is purchasing parts from down to 20 from 200, huge savings can be promised. However, if buyers on the ground do not change purchasing habits, target savings will not materialise, or if purchased volumes deviate from that expected, savings can be hard to quantify.

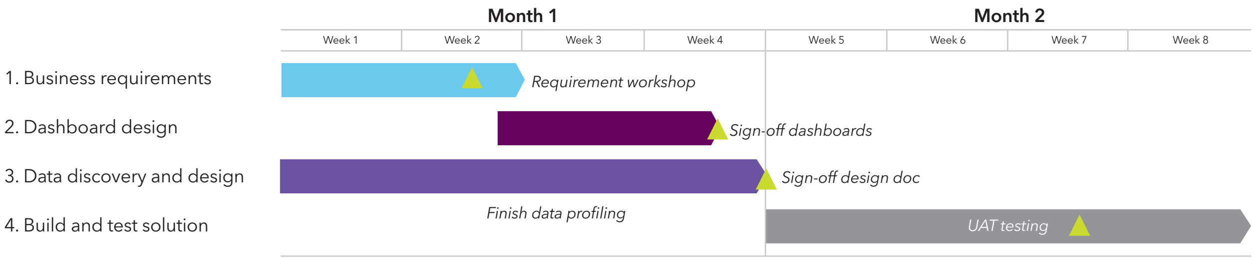
Despite these challenges, effective savings tracking is critical to any procurement function, because it is the only way to ensure that value is being created as expected and that corrections to strategies can be made if required. At Efficio, we have developed enhanced savings tracking tools as part of our broader eFlow technology platform, giving firms access to the latest methodologies and dashboards created for each client to track their own unique categories and scope.

We have supported clients facing complex challenges as they work to implement proper savings tracking as part of procurement initiatives, whether those revolved around orders not being captured properly by systems, manufacturing part numbers not being adequately recorded, or complex vendor structures agreed during contracting. Often the key to successful tracking lies in the automation of data inputs so that monthly reports are not arduous or time consuming to produce and analyse.

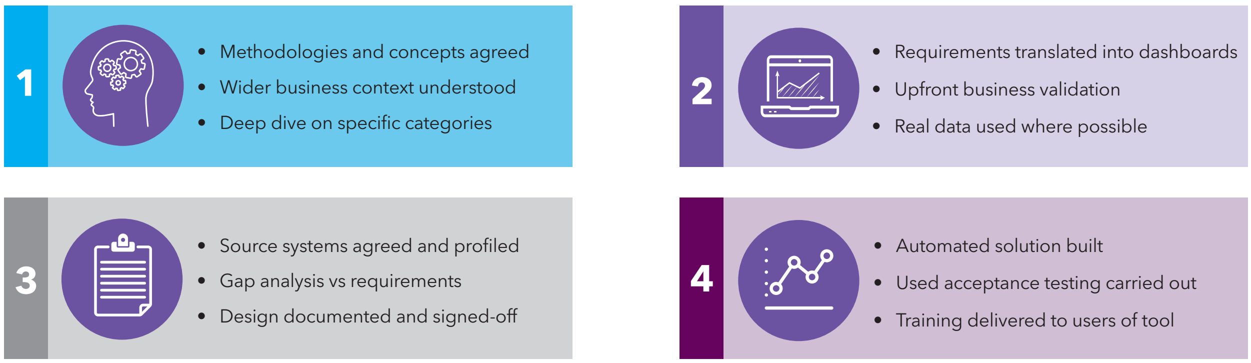
The savings tracking tool monitors compliance and savings from the bottom up, providing detailed analysis



eFlow: Efficio's procurement technology platform



Delivery time varies depending on number of categories, complexity of saving types and number of systems



It typically takes us two months to develop a tool, conducted in parallel with our savings sourcing work, that will track savings in an efficient and cost-effective manner and ultimately deliver sustainable improvements.

Delivering measurable results

Where we see procurement strategies truly delivering is where cost reductions are identified and strategic sourcing initiatives are rolled out hand-in-hand with a well-developed savings tracking and implementation strategy. This approach means working with the whole business to encourage and enhance compliance. It also provides status reporting through regular snapshots on progress that give CFOs and private equity owners clear visibility on how savings targets are being achieved and an early warning if actions need to be taken to address any issues.

Efficio recently completed a programme of work for a global private equity-owned packaging company that has grown by acquisition and now has revenues in excess of $1 billion. Procurement had historically been done on a local level with limited strategic capability and a focus on keeping the plants running, such that purchasing decisions were often dictated by ingrained local manager relationships. In an initial wave of sourcing, we addressed approximately $100 million of spend across 10 categories and over 20 divisions including several complex direct spend areas.

We identified more than $15 million in savings, with all key decisions made by the business units, driving accountability to the end users. Through a systematic and focused approach, a large portion of the savings was implemented within the first two months followed by a prioritised approach to part and supplier changes.

In another project for a global waste management company with over 200 operational centres, we were able to take savings tracking to an advanced level post the sourcing programme. This allowed the business to track compliance against spend and actual savings against target savings.

Management can easily see if the right items are being bought from the right suppliers at the right price, as well as monitoring any variance against expected volumes. When sourcing categories like maintenance, there is little benefit in agreeing a reduced hourly labour rate if repair times increase as a result, and such nuances need to be captured by the system.

For on-contract transactions, forecast and actual savings can be compared, and the difference between these can be explained by price and volume variations. This helps the CFO and private equity owners immediately see where and why savings differ from expectations. For such a complex business, where there are hundreds of suppliers and parts, a sophisticated tracking tool is required and the business case to develop the tool is more than justified.

Sustainable results

What is apparent in every business that we work in is that there are some quick wins to be gained from simple renegotiation or bulk purchasing, but there are also other more high-value gains to be made in more complex categories.

Half of our business derives from private equity and we know that every portfolio company is different and requires a bespoke approach. We believe the key to delivering lasting sustainable cost reductions that drive EBITDA growth lies not only in creating a savings plan and delivering savings in an implementation programme, but in employing the best tools for savings tracking, data analysis and implementation and to keep driving for further improvements over time. ■

Declan Feeney is a private equity advisor at Efficio, managing the firm's activity in the sector. He has two decades of experience in private equity, having previously worked at Permira and Fondinvest.

Waldo Saville is a principal at Efficio. He holds a Masters from Oxford University and has been working at the firm since 2011.

Asia-Pacific

Fresh thinking

The victorious entries from Asia-Pacific consist of Japanese high-tech manufacturers, one of the largest exits in Indian private equity history and a particularly fruitful ESG strategy for a New Zealand-based honey producer. All three significantly revamped the company leadership.

When Advantage Partners sold Fasford Technology, manufacturer of die-bonding equipment for semiconductor fabrication, it achieved a very impressive 10x money multiple, having doubled EBITDA during its ownership. It is a strong example of carving out a company and setting it up to stand on its own.

Advantage turned Fasford into a market leader by overhauling the management and introducing a string of key hires. Blackstone achieved its remarkable success with Intelenet Global Services by following a similar game plan: significantly strengthening the management as well as the sales teams in the US and Europe.

"The value-creation programme included both top-line and bottom-line initiatives: hiring a capable senior management team that institutionalised the sales process and created metrics-driven incentives in driving the top-line growth and launching its profit improvement programme, which achieved significant and immediate bottom-line results. The investment in digital technologies will help Intelenet Global Services grow in the long-term," says awards judge Jian Li.

New management was also brought into Manuka Health by Pacific Equity Partners, with new hires chosen for their expertise in food products, agribusiness and social responsibility. ESG played a central role in the company's strategy.

Awards judge Veronique Lafon-Vinais says: "The interesting part is the development of standards for the product, although how much it contributed to the growth is hard to gauge. The ESG strategy in this case is closely linked to the business core." ■

WINNER

Advantage Partners

Carving Fasford Technology out from Hitachi High-Technologies helped cement its position as a dominant leader in its field

Advantage Partners acquired Hitachi High-Technologies' Japan-headquartered die-bonder division in a closed-bid process in 2015. The business manufactures and sells die-bonding equipment for semiconductor fabrication. It is the market leader for high-performance flash memory used in both smartphones and PCs.

Immediately following the deal, Advantage embarked on a process of carving the company out from its former parent and establishing its own independent operational platform under the new name of Fasford Technology.

Advantage then set about transforming the understaffed and underinvested company by creating an independent management platform and introducing several key hires in year one. The firm also undertook a holistic review of all costs and directed fresh investment to new growth product categories so that the company could better weather the cyclical economic swings in the volatile semiconductor markets that it serves.

In addition, Advantage improved the underlying profitability of Fasford's existing business lines by revamping the company's pricing strategy, modifying how the company develops its software in order to enhance product quality and training the company's sales staff to actively propose services to existing customers. The company also augmented Fasford's basic accounting, development and planning functions.

As a result of Advantage's interventions, as well as the overall expansion of the semiconductor market, top-line revenue growth increased by 23 percent with EBITDA more than doubling from ¥461 million at the time of the original acquisition to ¥980 million ($9 million; €8 million) at the time of exit. EBITDA margins, meanwhile, increased from 6 percent to 11 percent and Fasford's market share grew to a dominant 78 percent.

78%

Fasford Technology's market share at exit

10x

Money multiple achieved by a sale to Fuji Technology

¥980m

EBITDA doubled on exit from ¥461 million on entry

Advantage sold the business to Fuji Technology in August 2018. Fuji is one of the largest manufacturers of industrial robots in the world, with a leading market share in the field of electric components. The acquisition of Fasford boosted its presence in semiconductor assembly as well. The company specifically referenced Fasford's ability to quickly release new products as one of the reasons behind its decision to acquire the business. "More than anything we were happy that we were able to set Fasford up for future success by helping them create a self-sufficient platform after splitting off from Hitachi High-Technologies," says Toru Indo, who led the investment for Advantage.

"More than anything we were happy that we were able to set Fasford up for future success"

TORU INDO
Advantage Partners

"We strongly believe that Fuji Corporation will be a great partner for Fasford going forward by helping them to develop new technologies and further enhancing the quality of manufacturing."

Advantage's sale of Fasford to Fuji Technology generated a gross return on investment of over 10x for the firm and an internal rate of return of close to 100 percent. ■

WINNER

Blackstone Group

Blackstone's second ownership of Intelenet Global Services was even more successful than its first and led to a record capital gain

Blackstone's 2015 investment in Intelenet Global Services resulted in one of the biggest exits in Indian private equity history, as well as Blackstone's largest-ever capital gain on an Asian deal. But this was not the first time the firm had acquired the company. It originally bought the global business process management provider in 2007, before selling it to Serco four years later.

Following the 2015 acquisition, however, Blackstone made significant changes to the senior management team, recruiting Bhupender Singh as chief executive, while former Intelenet CEO Susir Kumar became chairman.

The ex-global COO for retail and commercial banking at Barclays, David Skillen, and Mitchell Habib, formerly of GE and Nielsen, also joined the board and Blackstone created a unique metrics-driven incentive programme for the management team, to ensure they were fully aligned with shareholder value creation.

Meanwhile, Blackstone's vast global portfolio proved crucial to the company's growth. Having recruited managing director Bob Barthelmes, formerly of IBM and Misys Corp, to help identify synergy opportunities, Intelenet won 11 of Blackstone's portfolio companies as customers, equating to around 10 percent of overall revenue at exit. This revenue acceleration was similar to Blackstone's previous period of ownership when it added seven portfolio companies as customers.

Blackstone also drove revenues by strengthening the sales teams in both Europe and the US and revamping the sales organisation structure to focus on new client wins and pipeline development. It hired new heads of sales in both regions, as well as industry experts to help accelerate global business development.

A focus on the next generation of digital offerings was also key to Blackstone's value creation strategy. The firm created a dedicated team to develop automation tools, including iPrompto, an analytics tool for unstructured data, iFare, a natural language processing tool to calculate fares, and iCAN, a robotics solution for improving customer experience.

Meanwhile, productivity improvements, pyramid optimisation and portfolio rationalisation led to an improvement in EBITDA margin of 350bps. The deployment of Blackstone's global portfolio procurement programme, which includes common shared services and IT platforms, realised significant cost savings as well.

Blackstone also institutionalised data-based decision making by putting in place robust reporting systems and monthly review dashboards, and designed and implemented a sophisticated foreign exchange hedging policy which helped the company improve its margins and mitigate the severe blow of Brexit. Around 30 percent of Intelenet's revenues stem from Europe and despite the fact the pound depreciated by around 11 percent, the company was still able to double its profitability as a result of the hedging policy that had been put in place.

Intelenet was eventually acquired by French company Teleperformance for around $1 billion, generating a money multiple of 3.8 times and an internal rate of return of 62 percent for Blackstone. ■

$1bn

Intelenet's exit enterprise value, one of the largest exits in Indian PE history

11

Blackstone portfolio companies that became Intelenet customers during the investment period

62%

IRR achieved on exit to French company Teleperformance

350bps

EBITDA margin improvement

12%

Revenue growth per annum, double the industry average

WINNER

Pacific Equity Partners

A new leadership team at Manuka Health put a strong focus on ESG and saw Pacific Equity Partners almost triple its money

Pacific Equity Partners acquired Manuka Health in a private process in December 2015. The company produces and sells Manuka honey, as well as honey-related products, foods and supplements. While its beehive and manufacturing operations are based in New Zealand, it has distribution channels extending to 45 countries and more than 11,000 retail outlets.

Following the acquisition, Pacific Equity Partners focused its attention on renewing Manuka Health's management team to ensure it was capable of managing the regulatory and ESG challenges the business faced. The firm installed a new chief executive, John Kippenberger, who had extensive experience in the consumer goods sector as the former CEO of the Australian meat and dairy division of George Weston Foods. Together with Kippenberger, Pacific Equity Partners recruited a completely new senior management team with expertise in food products, agribusiness and social responsibility.

This was important because, as Manuka honey can only be produced during six weeks of the year, strong biodiversity management is an essential feature of the company's operations and financial performance. Weather conditions and Manuka tree density also have a considerable impact on honey potency and supply.

Pacific Equity Partners therefore drove the identification of additional land suitable for regeneration; this was essential for the expansion of the business and enabled the company to internalise its honey supply. The number of in-house hives increased from 5,000 to 20,000 over the course of the investment period.

Under Pacific Equity Partners' guidance, Manuka Health also took on a leadership position in the wider industry. The company led industry engagement with regulators, both in New Zealand and key export markets and, following extensive consultation, New Zealand's Ministry of Primary Industries released a universal Manuka Definition in 2017. This development will have a significant impact on reducing counterfeit product.

In addition, Pacific Equity Partners undertook several important ESG initiatives, including pioneering the use of climate and bloom monitoring technology to enable remote monitoring of apiculture, as well as launching land regeneration initiatives to restore over 20,000 hectares of Manuka. Manuka Health has also improved bee health and reproduction through targeted population drops into remote areas during flowering periods and wintering programmes that keep hives protected out of season.

Elsewhere, Pacific Equity Partners helped corporatise the business and invested significantly to drive channel and customer expansion, brand recognition, new product development and supply chain optimisation. New product categories launched included lozenges and wound care, while new markets included China and Europe. Online sales, meanwhile, increased by more than 1,000 percent in three years.

Manuka Health was sold in an auction process that attracted interest from both private equity and trade. It was ultimately acquired by a South-East Asian trading company, almost tripling Pacific Equity Partners' money in the process. ■

20,000

In-house beehives in operation at exit, up from 5,000

1,000%

Increase in online sales over just three years

72%

Revenue growth since acquisition

31%

Market share, up from 23 percent at acquisition

6

Weeks per year in which Manuka honey can be produced

KEYNOTE INTERVIEW

The need to prepare for a downturn

To take advantage of the next downturn, companies must position themselves now, say Alvarez & Marsal managing directors Markus Lahrkamp and Jeffrey Klein

Q How imminent do you believe a downturn to be?

Jeffrey Klein: If we knew when the market would turn we would be making a killing in hedge funds, or already retired! But clients do believe a downturn is on the way and that can become a self-fulfilling prophesy.

Private equity firms and their portfolio companies are becoming more conservative and we are starting to see broken deal processes once again. That is a reflection of investor sentiment.

Q What challenges are manufacturing and distribution businesses, in particular, facing at this point in the cycle?

Markus Lahrkamp: They primarily face challenges around web-enablement and changes in consumer behaviour – the Amazon affect – as well as the demand for mass customisation. And they have to be able to respond to all these challenges, while also dealing with the prospect of a cyclical downturn.

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ALVAREZ & MARSAL

Q So, how should companies in these industries, and their private equity owners, be preparing?

ML: The emphasis needs to be on shoring up balance sheets and ensuring sufficient levels of liquidity. It is important that fixed costs are kept down and that capex plans are carefully considered and potentially deferred. It can be a tough message, but human capital costs also need to be looked at. We see a lot of companies that don't have the right HR policies in place.

Q What about managing a sales force in a downturn?

ML: Companies will often try to minimise sales force costs in a downturn, turning variable compensation into fixed. But you need a highly motivated sales force in a difficult economic environment.

JK: One of the problems we encounter in the software and business services sectors is that sales forces are not compensated on margin, but on dollars sold. That can be problematic because salespeople are often allowed to run amok and create contracts and pricing structures that are inconsistent with the company's ability to deliver. Ahead of a downturn, it's a good time to look at your quote-to-order process, and at the profitability of the deals going through.

Q How else do the challenges facing services businesses differ from those faced by the manufacturing sector?

JK: A lot of the traditional levers that exist in the manufacturing environment don't exist in software and business services. Where you have hard assets, you have inventory, the ability to throttle production and the ability to convert fixed costs to variable. Software and business services are primarily based around people and so the levers are different.

It is very important to understand the total cost to serve. A lot of these companies track significant costs in the corporate structure, rather than allocating them down to a product or customer level.

That results in the perception that services and products are profitable when they are not. It creates a vicious cycle where you are potentially renewing unprofitable or barely profitable clients, increasing the velocity of negative margin.

There is also an expectation in software and services that contracts will fall. As we enter a downturn there will be pricing pressure. It is vital, therefore, that our clients truly understand that total cost to serve.

Q Many private equity-backed businesses in these software and services sectors are still at a growth stage. Are they particularly vulnerable?

JK: When clients are buying into high-growth companies, they tend to get lazy about cost management. They don't have the visibility around cost to serve that is required to know where and when to slow down.

It's also important to get serious about which products are at scale, which might achieve scale and which are sub-scale. While it is a difficult conversation to have, you need to look at the pipeline and say, if there isn't a clear path to productivity in 12-18 months, alternatives may need to be considered.

One of the best alternatives is to monetise those assets, selling them or selling the customer base. You can then use that funding to push products that are scaling to where they need to be. The move from growth at all costs to profitability at all costs can be a difficult cultural shift.

Q What steps should businesses be taking to ensure they are investing in the right places?

JK: It's usually a function of gaining control of product development, R&D and sometimes sales. That will generally mean someone in the C-suite taking greater ownership of the roadmap.

The challenges are particularly acute for the software sector, because a lot of companies are in the process of moving into the cloud and transitioning from a purchase licence and maintenance model to a recurring 'software as a service', or SaaS, model. That creates difficulties from a cashflow perspective.

Moving into the cloud is costly, and at the same time you are losing the large capital infusions that sales of software bring. Good communication between management and sponsor is needed to avoid a cashflow crunch, which right now might be revocable but could be irreparable in a downturn.

ML: The other issue for private equity-owned companies in general is that multiples have been astronomically high over the past few years and debt has been cheap. Now, with the prospect of a downturn, as well as all the other structural challenges above, you have a perfect storm. In terms of how businesses should be approaching this, you have to look at where you are making money and what needs to be cut.

> *"Multiples have been astronomically high over the past few years and debt has been cheap"*
>
> **MARKUS LAHRKAMP**

Q Are there not litigation risks associated with cutting services?

JK: Manufacturing companies have the opportunity to choose not to ship product if clients represent a credit risk or are in arrears. But the situation is less clear cut for our SaaS clients. With so much now being run in the cloud, you can create significant economic damage by cutting service.

> *"When clients are buying into high growth companies, they tend to get lazy about cost management"*
>
> **JEFFREY KLEIN**

Most SaaS companies have not been through a downturn before and don't necessarily have well-established processes for how to escalate matters before services are terminated. The time is right, ahead of a possible recession, to review those policies and make sure the decision making is elevated to the right level.

Q What would be your final piece of advice for minimising the risk that a potential downturn may bring?

ML: It is important to remember that alongside risk, a downturn also brings opportunity. Companies that are prepared and have strong balance sheets will emerge as winners. The problem, at the moment, is that too few recognise this need for preparation. With no clear sense of when the cycle will turn, many prefer to focus on the next acquisition, or major investment, instead.

JK: You need to get serious about total cost to serve and margins. Don't spend a year trying to fix sub-scale or nominally profitable assets that will prove difficult to maintain. Liquidate them and use that cash to take advantage of weakness in the market and to buy companies as they start to fail. ■

Outstanding Achievement winners

Operational excellence takes many forms and the Outstanding Achievement winners – recognising excellence in ESG, Growth Strategy and Innovation – are a celebration of that. Far from being optional extras, these three pillars of creating value are key considerations in turning companies into leaders.

ESG has become a pressing concern across industries and our Outstanding Achievement in ESG winner – Sun European Partners for ELIX Polymers – shows that putting ESG front and centre is a winning strategy. EBITDA quadrupled over Sun's holding period.

The supplier of ABS polymers has worked hard to reduce energy consumption, greenhouse gas emissions and waste generated, while pouring funding into R&D on sustainable products and environmental risk analysis. This focus on ESG transformed the company, leading to a gross return of 8.4x on Sun's exit.

Our Outstanding Achievement in Growth Strategy winner is Partners Group, for its success building affordable housing finance company Aavas Financiers. The company added product lines, built its management team, doubled earnings and quadrupled its number of branches. The GP reaped the rewards of such strong growth when it realised a 3.8x exit multiple.

The Outstanding Achievement in Innovation – based not just on product innovation, but also innovative approaches to management, use of technology and investment in R&D – is awarded to EQT Partners, for automation and robotics firm Piab.

Digital innovation was key with Piab. As awards judge Antoon Schneider says, "at Piab, EQT used its in-house digital team to help the company on several topics, in particular around a revamped digital go-to-market approach".

All three are true examples of operational excellence. ■

WINNER

Sun European Partners

A reduction in energy used and emissions and waste produced went hand in hand with increased sales and customer satisfaction for ELIX Polymers

Sun European Partners acquired ELIX Polymers as part of a corporate carve-out in April 2012. ELIX supplies ABS polymers and products used in the manufacture of consumer goods, consumer electronics, medical devices and automotive dashboards. Those products are sold to over 300 customers in more than 40 countries.

Since the original investment, Sun European Partners has transformed the company from a production-focused division of a large conglomerate, into a standalone business focused on earnings.

In particular, the firm has driven earnings improvement by introducing continuous improvement in manufacturing operations, supply chain and procurement. It has also implemented a business intelligence system to create transparency on profitability drivers, which has led to better pricing and improved production efficiency, as well as supported the company's expansion into North America in 2016. As a result, ELIX more than quadrupled EBITDA from €5.8 million at acquisition to €25.1 million for the 12 months to June 2018.

In addition, Sun European Partners has worked hard, in partnership with ELIX, to strengthen its ESG credentials as the plastics industry faces ongoing challenges around environmental impact. The company has reduced its energy consumption by 11.4 percent; its greenhouse gas emissions by 10.26 percent; reduced the waste generated per tonne manufactured by 4.4 percent and increased R&D spending on sustainable products by 10.7 percent.

Furthermore, ELIX recently conducted a comprehensive study to analyse environmental risks in its facilities, which resulted in definitive action to achieve its future sustainability objectives. Sun European Partners itself named ELIX its own ESG Excellence winner in 2018.

11.4%

Reduction in energy consumption during Sun's ownership

4x

EBITDA quadrupled from €5.8 million to €25.1 million over the holding period

10.7%

Increased R&D spend on sustainable products

"At the core of this transformation was the company's motivation to deliver on its ESG targets and reduce its energy consumption, waste and carbon footprint"

TIM STUBBS
Sun European Partners

"ELIX was previously a manufacturing unit of a large conglomerate. During Sun's ownership, we worked with the management team to transform the business into a successful standalone company," says Tim Stubbs, senior managing director at Sun European Partners.

"At the core of this transformation was the company's motivation to deliver on its ESG targets and reduce its energy consumption, waste and carbon footprint. Leveraging the Sun transformation system, key operational changes included the introduction of lean manufacturing and commercial excellence."

Following a six-year holding period, ELIX was acquired by Chinese strategic buyer Sinochem International for €195 million, representing an acquisition multiple of 7.8x EBITDA. The sale generated a gross return of 8.4x total invested capital for Sun European Partners and an internal rate of return of 54 percent.

"Maintaining high ESG standards resulted in a considerable jump in productivity, record levels of customer satisfaction and strong sales increases, leading to a quadrupling in EBITDA and ultimately to ELIX becoming a European standalone leader in its field," says Stubbs. ■

WINNER

Partners Group

Aavas Financiers brought new products to new customers in new states as Partners Group overhauled the management and focused on digitalisation

69%

Total revenue growth (2015-19), which is the highest among housing finance companies

49%

Total disbursement (2015-19)

3.8x

Exit multiple

210

Branches as of 2018, up from 53 at entry

0.47%

Non-performing assets in 2019, down from 0.79 percent in 2017

Partners Group took Jaipur, India-based Aavas Financiers from a single-state operator to a pan-regional best-in-class business. Partners first invested in June 2016, when it acquired a controlling equity stake from parent company Au Small Finance Bank, which was carving Aavas out to comply with regulatory requirements.

When the affordable housing finance company, which focuses on low- and middle-income customers with informal sources of income, was listed on the Indian stock exchanges in October 2018, it allowed Partners Group to sell a 24 percent stake for a 3.8x return on its original investment. The stock has continued to do well post-listing and, as of July, was trading at 4.5x Partners Group's average purchase price.

Aavas' remarkable growth was achieved by pulling a series of levers: new products, branch expansion and digitalising its sourcing, rating and CRM.

Under Partners Group's ownership, Aavas expanded its product range with the introduction of a home equity product to go alongside its traditional home loan product. It also entered six new states and increased expansion into a number of new districts, which also allowed for significantly increased client sourcing.

One of the key pillars of the value creation strategy was hiring the right team. Strengthening the management was fundamental to increasing customer service and sales.

A new vice-president for operations and head of distribution were hired to drive better branch service, higher profitability and operating leverage. Heads of analytics and IT were recruited to drive a 'digital first' model, and head of HR and recovery were hired to protect the core and preserve the company's culture.

Partners Group pioneered digital efforts on data and risk management and enhanced ratings, which both improved liquidity and lowered the cost of borrowing. Aavas quadrupled its branch network between 2016 and 2019 and grew assets at 69 percent CAGR, which is the highest among housing finance companies.

The 'digital first' approach saw Partners Group rigorously assess opportunities and risks from digital solutions, and the team worked closely with management to make digitalisation a key priority and a sustainable competitive advantage for the business. A key part of the digital approach can be seen in sourcing, where new leads are now logged via a mobile app, there is a live application scorecard and predictive analytics, which has increased customer retention and upselling.

The digitalisation extends to collections as well, with real-time tracking of collections and GPS-based route optimisation. Bounce prediction models are also employed, which has contributed to a reduction in non-performing assets from 0.79 percent in 2017 to 0.47 percent in 2019 – particularly impressive for the market it serves. ■

WINNER

EQT Partners

EQT Partners' approach with robotics firm Piab relied on innovation – in both Piab's products and EQT's approach

EQT had been following Swedish automation and robotics specialist Piab for a number of years when a new CEO, Anders Lindqvist, kickstarted a phase of accelerated growth back in 2014.

EQT was attracted by the business's technological prowess, customer relationships and product design, as well as the secular megatrends around the third industrial revolution. The firm was particularly impressed by Piab's ability to continuously innovate.

Furthermore, the decision of Peter Tell, a member of the founding family, to re-invest and remain on the board convinced EQT of the investment opportunity. The firm ended up acquiring Piab from Altor Equity Partners, in partnership with the founding Tell family, in January 2016.

Following the acquisition, EQT set about reinforcing Piab's sales team, implementing a sales excellence programme, which resulted in an increase in distribution locations from 650 to close to 1,200. In addition, EQT helped to revamp Piab's digital marketing strategy, driving a 30 percent increase in leads. It also invested significantly in innovation and product development, resulting in eight new products being launched every year and generating around 46 percent revenue growth at exit.

Furthermore, alongside this organic growth, EQT backed Piab in completing and integrating four strategic bolt-ons – Kenos, Vaculex, SAS Automation and Feba Automation – over the course of just two-and-a-half years. These acquisitions expanded the company's product offering into adjacent technologies, such as mechanical and robotic grippers, as well as ergonomic handling solutions, broadening Piab's total addressable market, as well as its value proposition for customers.

85%

Increase in sales over EQT's two-and-a-half year holding period

8

New products were launched each year

50%

Growth in employee numbers over the course of the investment

"EQT and the board worked closely with Piab to improve the operational performance of the company, while also managing its geographical expansion"

CARL JOHAN RENSTRÖM
EQT Partners

As part of its expansion strategy, EQT also targeted international growth, in particular China. The firm built a new team including a country head, three sales managers, 10 full-time sales employees and three application managers. Piab's revenues in this market accelerated to 50 percent run-rate growth, with the establishment of over 15 new distribution channel partnerships. This expansion also laid the foundation for the investment rationale for Piab's next owner.

While EQT ran an IPO-led dual track process in the second half of 2017, Piab was ultimately sold to Patricia Industries in June the following year. At this point the company's employee count had grown by 50 percent, while sales and EBITDA had increased by 85 percent.

"EQT and the board worked closely with Piab to improve the operational performance of the company, while also managing its geographical expansion, new product development and sourcing suitable strategic acquisitions," says EQT partner and investment adviser Carl Johan Renström. "Combined with a significant period of organic growth, these factors have helped Piab become the global market leader it is today." ■

KEYNOTE INTERVIEW

Rethinking data privacy

The private equity industry is aware that regulatory risks can affect the approval, success and profitability of an investment. EisnerAmper's Louis Bruno and data risk expert Matthew Bernstein discuss data privacy and how to manage the risks

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Investors are aware of cybersecurity concerns and the need to protect data, but the risks associated with data have expanded as regulators are focused on data privacy and how companies collect, use and share personally identifiable information (PII).

Compliance is challenging in today's environment, where massive amounts of data, commoditised technology infrastructure and presumed value to be extracted create incentives to keep, store and process everything. Firms that identify data privacy risks as part of the due diligence process and take the necessary steps to comply with the regulations will protect their investment and help ensure attractive exit opportunities.

New data privacy laws passed in the EU and California require that GPs not only safeguard data but know what data they possess, which requires a kind of due diligence that many firms might not be doing. Private equity firms not only have to make certain that they, as a firm, comply, but that their portfolio companies do as well.

To understand these new obligations and how to meet them, we sat down with Louis Bruno, principal at EisnerAmper, and Matthew Bernstein, who has over 20 years of experience working with major organisations on information management standards and solutions.

Q What are the key new regulations surrounding data privacy for private equity?

LB: Protecting an individual's rights to privacy continues to be a focus of lawmakers across the globe as evidenced by the European General Data Protection Regulation, the state of California's Consumer Privacy Act, draft US federal legislation and the increasing public attention to the use of data.

In addition, in the US, the SEC's Office of Compliance Inspections and Examinations issued a recent alert regarding compliance with Regulation S-P, the primary SEC rule regarding data privacy notices and safeguarding policies of investment advisors and broker-dealers.

MB: In addition, and of particular concern to PE firms, the US Treasury's Committee on Foreign Investment in the United States reviews sales to foreign entities, and now requires the consideration of personal data. If a transaction contemplates a sale to a foreign buyer, CFIUS can potentially prohibit transactions where the target firm possesses "personally identifiable information".

PE firms must assess the extent of retained PII, a counterparty's geopolitical relationship with the US, and the potential remedies when determining a buyer's qualifications. CFIUS raises the stakes for PE firms to reduce the type and scope of PII.

Q Given those new obligations, where are the risks?

LB: Compliance is certainly challenging. Although many organisations have established certain information-risk policies and mitigated some of these risks, typically with a cybersecurity programme, other risks remain unaddressed. Firms must be able to determine their obligations, identify their data, update policies and implement new procedures to accurately mitigate the risks.

MB: There are massive amounts of available data out there, but the risks associated with not governing these data are growing. Companies are more and more reliant on finding value in their data, while at the same time the public, regulators, and politicians are increasing their scrutiny of how companies use consumers' data.

Given the global focus on an individual's right to privacy, PE managers need to realise that the reputational impact associated with non-compliance can cripple a business and outweigh any regulatory fine. That reputational impact may even interfere with the successful exit of a portfolio company.

LB: Private equity firms should also be aware that data privacy risks are not limited to companies in the technology sector or those which process large volumes of sensitive PII, such as in healthcare. Businesses outside data-heavy industries may harbour hidden risks as they will have PII that has been collected over time, which may not be easily identifiable, and for which the necessary marketing and use consents are missing. In many cases, firms are not fully aware of all their business processes that capture PII and where it is stored internally.

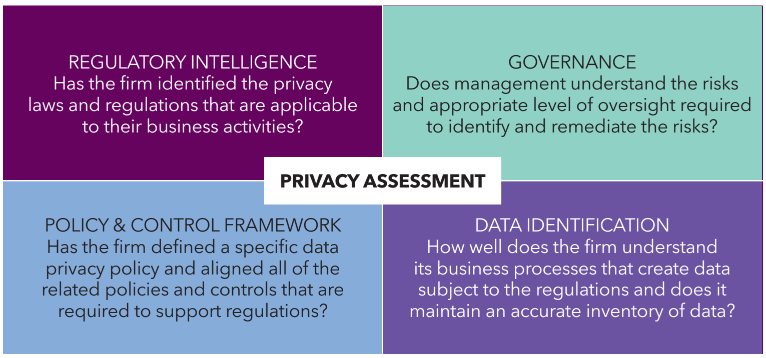
Q So how should GPs look at identifying and managing those risks?

LB: Addressing these risks involves a broader effort than just assessing a firm's cybersecurity risks; the due diligence process must identify specific data privacy risks. In addition to obvious customer-related privacy policies, an acquisition target will need to have appropriate policies covering the personal data of its employees, and much more detailed contracts with third-party processors than in the past.

In addition, firms must be able to demonstrate compliance to regulators, which requires adequate management oversight and expanded internal procedures. Increased documentation of how and why data is captured, defined processing activities, and procedures for responding to data subject access requests will be necessary. The potential vulnerabilities to data breaches will need to be identified and appropriate procedures for data breach notification and internal training implemented.

MB: To assess and quantify these risks in an acquisition target, expanded due diligence will be required. Are the appropriate technical and organisational measures in place to comply with the regulations, particularly with respect to the security and management of personal data? Are there historical compliance gaps, including data breaches?

These should be identified as part of the due diligence process, and post-acquisition remedial plans and allocation of liability for their associated costs should be defined early in the deal process. Warranties and indemnities are likely to be much more keenly negotiated, given the potential liabilities, and understanding the technical and business fundamentals will be a critical part of this process.



Q Most firms employ third parties to manage data, so could those service providers pose risks as well?

MB: This is my biggest concern. The increasing trend of 'externalisation' and outsourcing of data management poses a challenge to PE firms, given the diversity of systems and applications used by portfolio companies. Identifying third-party risks is challenging because almost every widely used communication, processing and storage platform operates outside the four walls of the company.

Portfolio companies are likely to use tools like Box, Slack, LinkedIn and Twitter to communicate both internally and externally. Enterprise management solutions like Salesforce and Workday, and cloud providers like AWS, Microsoft Azure and Google Cloud are the platforms of choice for fast developing companies.

The PE firm also will bear responsibility for the management of these data, regardless of the fact that the data are external. Awareness of, and responsibility for, these data privacy risks cannot be outsourced.

LB: There's an obligation to ensure vendors are aware of and comply with relevant regulations. Service providers, especially those serving commerce generally rather than financial services firms in particular, are typically unaware of the regulations and not acting on their own to develop and implement these policies.

Solutions and services may provide safeguards and make functionality available, but it is up to the user firm to determine the rules it is subject to, identify its data subject to those rules, instruct the system or service provider to act on those rules, and ensure adherence. Safeguarding personal data is a core tenet of all data privacy laws and regulations, and the potential for a breach may be greater where the portfolio company does not directly manage its data. ■

Louis Bruno is a principal in EisnerAmper's global compliance and regulatory practice. He assists investment advisors, wealth managers and banks with strategic data and regulatory compliance-driven initiatives.

Matthew Bernstein led information practices in various financial services businesses at Deutsche Bank for more than 20 years. He works with firms to define, develop and operationalise information risk management standards and technology solutions.

Five lessons from the Operating Partners Forum

Standout themes from PEI's Operating Partners Forum: Europe 2019 included the importance of having operating partners on the team and why robots are the future. By James Linacre

PEI's Operating Partners Forum: Europe 2019 took place in May, with a focus on portfolio operational assessment and value creation. Men and women from the operational coalface discussed how to deliver value creation strategies, top-line growth and EBITDA improvement.

1 LPs want to see operating partners on the team

The perception is that LPs are increasingly focused on this function. They want to know that rubber is hitting the road and progress is being driven faster.

"LPs love to see the sharing of best practice across portfolio companies and the operating partners can be drivers of that," said Conor Boden, head of portfolio board development at Advent International.

LPs are increasingly focused on the operating partner's role, but the inclusion of an operating partner on the team comes at a cost that has to be justified. Christian Unger, partner at Partners Group, said the operating partner needs to be able to create EBITDA or otherwise generate momentum beyond what would otherwise be there.

And personality is key; you won't get far with the wrong attitude. Boden added: "It is rare that an individual does not bring the right expertise but sometimes perhaps there is a personality problem. You have to get the management team onside so there has to be a level of humility."

2 Year-one growth matters

You cannot start early enough in planning and building a transformation initiative, agreed panellists, with the sooner one can start the better. A strong and autonomous management team, with frequent, rapid communication and the early implementation of a way to track progress – and course correct if things we not going to plan – can make all the difference.

"Grow early, exit well," implored Jim Corey, managing partner at Blue Ridge Partners. He noted that the correlation between year-one growth and good exits has been clearly demonstrated. If a manager waits three or four years before starting to pull levers for value creation, then that is three or four years wasted and it is going to be tough to fundamentally reform the business.

> *"You have to get the management team onside so there has to be a level of humility"*
>
> **CONOR BODEN**
> **Advent International**

Gregg Meheriuk, senior vice-president at 24 Hour Fitness, agreed that it is impossible to start planning too early in a transformation initiative. He said: "Starting early with revenue growth is important but even just starting is vital.

"There are often pricing opportunities. If you look at where pricing sits within an organisation and see that it is two layers deep within marketing, then there is probably an opportunity there."

3 Pricing is under-invested in

A greater focus on pricing would be

broadly welcomed. Mark Billige, managing partner at Simon-Kucher & Partners, noted that his firm surveyed operating partners on value creation strategies and found that pricing is frequently overlooked.

"Value creation at the bare bones is about volume, price and cost. That is what determines profit and growth," he said. "Private equity operating partners told us that they are all interested in volume growth and taking cost out. Of the three, the largely under-focused one is pricing. When we asked where the most ROI is, interestingly there is much bigger bang for your buck on pricing."

Unfortunately, whether it is because pricing can feel technical and complex to management, or whether it seems anti-customer or just – despite the potential ROI – too expensive, pricing is not focused on enough.

4 Everything that can be automated will be automated

Anything that can be done more cheaply and more quickly, which can allow for greater growth, will be embraced. Leading companies, be they Amazon with the move towards a one-hour delivery model or Netflix as the harbinger of the end of DVD rental and associated issues such as late fees, show the benefits of going digital in removing friction and allowing for significant value creation.

"The CIO is just as responsible as the CEO for driving value and decreasing operating costs"

GEORGETTE KISER
The Carlyle Group

Automation is gaining traction and the future of the workplace is one where humans and bots work side by side, predicted Anubhav Saxena, executive vice-president at Automation Anywhere. Machines do exactly what you tell them to, so they will not make the kind of errors that humans will.

"We have clients who will talk about Melissa or talk about Susie, and these are not human employees like you and me, but bots, that do HR work. With these HR bots you do not miss payroll or miss bonuses; everything is paid on time, they are available 24/7 and you get a chance to say exactly what you want to them," said Saxena.

HR is a fairly simple area to automate, he said. Next on the list is finance, starting with backend automation before moving onto the front office. Where there were a million digital workers deployed in 2018, Saxena noted we are on course for three million or more digital assistants and colleagues in 2020.

"There are three types of people: those that think, those that do and those that analyse. We have bots that can think, that can do and that record what they are doing. Those bots can form part of your digital workforce. Your human workforce works hand in hand with your digital workforce," he said.

The question of how we structure a society that still provides meaningful work once automation has become commonplace makes robotic process automation an ESG issue, said Georgette Kiser, operating executive at The Carlyle Group. She asked: "Where do we find the balance so we don't create a society that ends up collecting welfare cheques?"

5 The CIO role has evolved into a business role

"As a company is developing, the CIO should be at the table with the other business leaders, understanding the business and where it is headed, so that they can think about what the underlying technologies are that are required for the company to move forward," asserted Kiser.

She noted that when it comes to digital transformation, "process trumps technology all day long". That means it is vital to understand the end-to-end processes and what makes that individual company make its money: what drives it, what customers are looking for and what employees want.

Kiser said every company is becoming a technology company, so the CIO's expertise is more important than ever. If the data and technology mindset is not given prominence within a firm, then that firm will get left behind.

"The CIO is just as responsible as the CEO for driving value and decreasing operating costs. It is a business role and my personal opinion is that we are going to see CIOs moving into CEO roles because that is what is needed to drive value." ■

Smooth operators: panellists dig into the issues operating partners face over how they add value

KEYNOTE INTERVIEW

Reaping the benefits of RPA

Machine learning solutions can play a key role in any firm's value creation arsenal, with a minimum investment of time and resources, says RSM's Dave Noonan

A great deal of the discussion surrounding artificial intelligence in private equity concerns its revolutionary potential, and without question that can be exciting and worth examining. But that focus can serve as a distraction from what machine learning solutions can do right now for GPs and their portfolio investments.

Those solutions might not be smart enough to replace the deal team just yet, but their ability to automate and continuously improve processes and procedures can have a real impact on the bottom line at portfolio companies.

We sat down with the head of RSM's private equity consulting practice, Dave Noonan, to discuss what Robotic Process Automation solutions can provide the industry today.

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Q How should GPs be thinking about RPA solutions?

RPA solutions are another lever of value creation GPs can pull, and one they use at various times during the investment cycle. Whether they're doing a carve-out or an add-on acquisition, or merely looking for synergies at a given target or platform, RPA solutions can drive additional cost out of the business.

In my experience, private equity firms have done a stellar job at driving operational efficiencies through various process improvements, but RPA solutions and related technologies can create even more efficiencies, and with an AI component, these technologies continue to improve all by themselves.

Q What kind of processes can these RPA technologies best automate and improve?

Any processes that are largely manually driven, that are frequently executed and require access to more than one system to complete. Any process where there are multiple iterations, such as new employee onboarding, where a new worker has to set up their ID and desktop interface so they can access all the relevant systems.

Things like accounts payable and accounts receivable, where we see a ton of activity because it's usually manually driven: an invoice hits someone's desk and has to be recorded in one system and approved through another. This process is time-consuming, repetitive and easy to automate.

Q So RPA solutions automate these functions, but beyond that, how do they improve these processes?

The digital bots doing the work now aren't like their human predecessors; they don't take coffee breaks or leave at six to go home. They work 24/7, 365 days a year. And the AI component learns how to execute this process faster and more efficiently as it goes along. But there are limits here. If the company has a bad process at the beginning, AI won't necessarily fix it all by itself, at least at the moment.

It's why our recommendation is to take a "process first" approach, so GPs make sure they have the right process infrastructure in place, the right organisational structure to manage the function, and then apply the appropriate tools to drive and sustain efficiency. It can improve almost any process, but there has to be a base level of competence to those procedures at the start.

Q Where should GPs begin to automate? How do they evaluate where automation can have the biggest impact?

"Where do we start?" is probably the most frequently asked question that we get. And I think GPs need to look at the process attributes of particular functions, say accounts receivable. Maybe there's a big AR department and the outcomes aren't great, with DSOs being unnecessarily extended. The next question is how easily such systems can be accessed via a technology platform.

Basically, it's about deciding if it's worth doing, or even feasible to do. And we find with accounting, HR and some sales functions, there are a number of places to leverage these solutions to great effect. Say, within the sales department, we've seen RPA reduce the close cycle from 30 days down to only 18.

Q What kind of upfront investment in time and money should GPs expect to make in these kinds of RPA solutions?

Most of our clients will have glaring places where RPA solutions make sense, say the finance or HR function, and we'll get to work quickly. The complexity of the job will always influence the timing and cost, but in general they can get started on the low end, inside 45 days and for between $25,000 and $50,000.

> *"Private equity firms have done a stellar job at driving operational efficiencies through various process improvements, but RPA solutions and related technologies can create even more efficiencies"*

Our process is a four-step approach. First, there's an initial assessment of process environment, of the quantitative and qualitative aspects of a process, and whether they should do an automation project. Second, we'll do a quick pilot programme on one of those processes. Once that's completed, we will move on to the other relevant processes and as we dig into that, we train the user group so they can move it forward themselves.

Q How do you quantify the ROI on these types of investments?

Reduction of headcount is the most visible and immediate return on investment. That can prompt some scepticism among current employees. If a portfolio company has a large accounts payable team and this automation solution might remove 50 percent to 75 percent of that staff, there can be pushback.

But headcount reductions aren't the only ways these bots deliver value. They can free up the current staff to do higher level work, like strategic initiatives, which might be more interesting than those very repetitive manual processes. And those processes will continue to improve thanks to an AI component that will be looking for new efficiencies long after the last worker went home.

Q How should GPs vet service providers in this space? How important is it that a service provider has experience implementing RPA solutions within a given industry?

Industry experience can help understand the infrastructure, but with this technology, functional expertise is probably more crucial than market expertise. The work that these solutions are automating in accounting, HR, supply chain and sales are broad disciplines where the fundamental processes are very similar.

However, within those broad categories, the service provider should have specialised teams devoted to continually improving those broad categories. That's pretty much table stakes at this point. If a service provider can layer specific industry experience atop that, even better. Of course, it's also a matter of the service provider offering references and case studies to help the GP select the right fit for the firm.

Q Once a GP has begun using RPA solutions, how can they stay current to ensure they're deploying the best possible tool? Or does the AI evolve all by itself?

Those machine learning bots can improve processes all by themselves, but there's always the possibility that some other solution will prove a massive leap forward. There are some options to tap outside consultants that can provide some independent analysis and advice on whether an upgrade is warranted, but I do think GPs can do their own homework online.

The truth of the matter is today's bots are quite powerful, and do plenty without looking for the next best thing. For now, RPA solutions are still cutting edge. ■

Getting strategic about human capital

Guest comment by **Matt Brubaker**

Investments in relationship engineering and other human capital strategies are generating greater returns for evangelist firms

While not generally known for being 'touchy-feely', private equity leaders today are becoming increasingly people-focused. Why? Because it's profitable.

High acquisition costs have created immense pressure as PE firms struggle to unlock sufficient value from their portfolio companies within compressed timeframes. The once reliable three-part playbook of financial leverage, operational restructuring and investment in growth has fallen short. Firms in the vanguard have overcome this challenge by adding a fourth prong to their approach: a human capital strategy.

Demystifying human capital strategy

PE firms are still learning about the levers they can move to align and engage the people within their portfolio companies to accelerate value creation. Such efforts, widely referred to as human capital strategy, are often mistakenly considered an offshoot of human resources or an area only worthy of piecemeal investment – a function to throw some money at and then move on to more critical priorities.

Too many PE firms have approached human capital strategy in this fashion, creating a self-reinforcing cycle of scepticism when poorly conceived, one-off approaches predictably fail to generate returns.

A portfolio company human capital strategy should be a comprehensive, diligent effort – devised in close collaboration with top leaders – that engages and aligns the board, portfolio company leaders and a layer or two of management below. Its goal is to ensure these parties deeply understand the growth strategy for the portfolio company, support it wholeheartedly, and are primed to execute it in lockstep, with passion and excellence, making adjustments as needed.

> *"Relationship engineering is one component of human capital strategy, but is among the most beneficial and difficult to get right"*

This represents a major change for many PE leaders who traditionally found success meeting the human needs specific to their firm's investments with straightforward mathematical calculations. Previously, it was enough to bring in new, A-level talent and align monetary incentives such that leaders would be generously compensated upon a profitable exit.

But even the most motivated team leaders can, and often do, misunderstand priorities, focus on non-critical areas, operate in siloes and work at cross purposes. They thus fail to solve cross-functional challenges – often the greatest opportunities for accelerating economic value – and create delays that make it all but impossible to meet aggressively set targets.

A human capital strategy should employ a three-step process encompassing highly purposeful onboarding, sophisticated people assessment and ongoing monitoring and calibration. In so doing, PE firms can make certain their portfolio company leaders are strongly aligned with a growth plan and galvanised to implement it.

The most comprehensive human capital strategy today goes beyond instructing, assessing and motivating leaders, but further encompasses 'relationship engineering' – the intentional creation of productive professional relationships at and across levels of the organisation. Like financial engineering or operational engineering, relationship engineering represents a functional enhancement that serves the larger purpose of accelerating value creation.

Relationship engineering 101

Relationship engineering is one component of human capital strategy, but is among the most beneficial and difficult to get right. Done well, it establishes an early foundation of camaraderie and understanding, building trust among key personnel, even where a natural tension exists, and establishes norms for communication and protocols for how inevitable disagreements will be heard and resolved.

Most people understand that such positive relationships don't necessarily materialise on their own, especially in high-stakes business environments. It is far more common for dysfunction to take root and for organisations to normalise it, inadvertently accepting the accompanying productivity loss and missed opportunities.

The narrow distance between investors and management – compared to corporate boards overseeing numerous disparate subsidiaries – is illustrative. The close relationship is designed to provide a distinct governance advantage and primes a wider pool of experts to help solve portfolio company problems, empowering them to succeed where other business leaders might have failed.

However, this advantage is often wasted or thwarted because investors and management become adversarial. This happens for myriad reasons, such as portfolio company team members not being used to the pressures of private equity management and the speed at which change is required, or private equity leaders coming across as intimidating, especially when businesses underperform.

Relationship engineering makes it possible for difficult conversations to take place without upsetting the healthy human dynamics that keep people from splintering and losing trust. It breaks down barriers, getting PE firm and portfolio company leaders working at the same side of the table, such that empathy and mutual respect win out over intimidation, resistance and fear.

Leadership in a PE 4.0 world

In their 2015 book *Private Equity 4.0: Reinventing Value Creation*, authors Benoit Leleux, Hans van Swaay and Esmeralda Megally described four industry business models for private equity since the 1940s.

■ **PE 1.0:** from 1946 to the 1980s, a time in which PE firms used the junk bond markets to buy and split apart large conglomerates.

■ **PE 2.0:** from the 1980s to 2000, a time in which PE firms made operational improvements in their portfolio companies through technology and other means.

■ **PE 3.0:** from 2000 to 2008-09, a period in which PE firms introduced practices that generate profitable revenue growth.

■ **PE 4.0:** from 2009 to present day, this has been about value creation via operational and profitable revenue growth initiatives.

We believe human capital strategies are now an indispensable part of PE 4.0. For portfolio companies to thrive amid higher acquisition prices and compressed timeframes to generate higher returns on them, the previous playbooks are grossly incomplete. Relationship engineering is now a vital part of the modern-day PE playbook.

The result is that investors and management work in closer partnership, even amid disagreements and setbacks, to more quickly and constructively solve problems and meet goals. It also reduces turnover and creates a more pleasant work environment. The benefits of relationship engineering can also extend beyond board-management dynamics, helping sync portfolio company C-suites and the next few levels of management.

PE evangelists for human capital strategy

While relationship engineering and other human capital strategy components might sound outlandish to some, a growing number of evangelists have emerged. Vista Equity, which manages $31 billion in buyout, credit and hedge funds, has a 100-person consulting group that administers lengthy exams for all current and potential employees, measuring for social, technical, analytical and leadership skills, with six- to nine-month boot camps for new hires that provide big-picture insight on how the company makes money, how customers use its products, and best practices across company functions.

Alpine Investors, the software and services-focused firm, has changed its strategy such that it now recruits a CEO prior to identifying its next acquisition, allowing the new leader to participate in the due diligence process, thus putting talent first and foremost. Gryphon Investors tells us that human capital strategy is the foundation of their value creation toolkit.

Despite private equity's interest in human capital strategy trending upwards, many other firms remain resistant. They demonstrate an unwillingness to dedicate necessary time and resources to human capital issues, which they often dismiss or deem unavoidable.

These firms are entering an increasingly precarious landscape in which their competitors are more expediently solving the human-oriented challenges of their portfolio companies at the earliest possible opportunity. They thus risk creating significantly less value over the life of their investments, or the even more calamitous scenario of ill-fitting leadership and/or toxic professional relationships eroding their ability to generate a turnaround. ■

Matt Brubaker is CEO of FMG Leading and an expert on organisational assessment and change. A frequent advisor to private equity firms, he serves as an operating partner at Windrose Health Investors and is a board member at JM Search.

KEYNOTE INTERVIEW

Choosing the right outsourcing partner

Every private equity firm has its own reasons for outsourcing back office functions to external service providers. TMF Group's Ramón van Heusden and Thomas Erichsen share some tips on identifying the right provider

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Q Why do fund managers typically choose to outsource to external providers?

Thomas Erichsen: There are many reasons for outsourcing and every circumstance is different. A lot of the time, the outsourcing is to meet regulatory requirements, so it is fund administration or fund-related work. There are advantages to having a clear separation between the investment manager doing the investment and someone else doing the books and records of what has taken place with that particular investment. When firms are doing all of that themselves, investors want a great deal of transparency on what is happening to see that returns are legitimate.

The other issue is the technology and employing people with the right skills to do the fund accounting work. Investment managers should not be investing heavily into their back office, but there is a lot of automation that can happen to eliminate menial efforts now, streamlining checks and processes to make sure everything is done as efficiently as possible.

Investment managers should be focused on generating returns and there are external providers who can benefit from considerable economies of scale by investing in the technology to service the middle and back office.

Ramón van Heusden: I am based in Luxembourg, and the largest players here have the scale to keep these functions in-house. But for the newer entrants and the fund manager that has just launched their first fund, perhaps up to €2 billion in assets under management, there is not the time or the resources to handle everything, so they prefer to work with a partner. We can then grow with them as they develop.

Q What should managers think about before making a decision on a provider?

TE: We try to be open and transparent and we always invite an investment manager to visit their local TMF Group office and have a good look around before they make a decision about working with us. We spend either a full or a half day with them on due diligence, allowing them to get to know our team and the service we provide – every manager should look that closely at a potential outsourcing provider.

The three things that really differentiate providers are people, process and technology, and those are what managers need to make a judgment on. People and processes have to be viewed and got to know throughout the proposal process, which means trying to understand the company ethos and getting a glimpse of the way it works.

RH: The cultural fit is really important, and equally important is the technology fit. When it comes to investor communications, certain players have the most sophisticated investor protocols and an outsourcing partner has to be able to support those, for example.

TE: Investment and reinvestment into technology is always going to be critical, because there are always going to be new systems and it is important to understand which are the best ones and which ones different providers are using. If they are using a system that appears less sophisticated than others, then why is that? At TMF, we use FIS Global's Investran – we have good reasons for that and we are happy to go through those with potential clients.

The other aspects are the processes and the way the technology is delivered through applications for clients, and that is where there is currently a fantastic opportunity for providers to create bespoke offerings to meet specific client needs.

"The cultural fit is really important, and equally important is the technology fit"

RAMÓN VAN HEUSDEN

Q What should be the decision-making process when identifying an outsourcing partner?

RH: It is a good idea to seek out proposals from at least four or five providers, and then whittle those down to three, to give a good basis for comparison. It is really important to visit those final three and get a good feel for their processes and cultures, before conducting final due diligence and making the final pick.

TE: We like to do a lot of listening during a proposal process, getting to understand the overall goal of the investment manager and treating each individual client as unique to look at ways that we can effectively help them grow. We want people to have a full experience of what we have to offer, and during due diligence we take them through the whole process of what everything would look like, including the handover.

Q What are the risks of outsourcing, and how can they be mitigated?

TE: There are a number of different risks, one of which is the risk of choosing a provider that subsequently gets acquired, leaving the manager with a provider they did not pick. There is a lot of consolidation in the market at the moment and a lot of aggressive buying. We are in a very strong position where we could be buying, but we prefer to grow organically.

Furthermore, a manager is not going to want to go with a shop that has not done a lot of investment and does not exhibit a culture of innovation. You want to see a proper structure in place, continual reinvestment into the business and a genuine commitment to the fund services industry.

RH: We have seen providers that, over a long period of time, have suffered a high level of staff turnover, such that at certain points the teams were completely wiped out after being taken over by competitors or leaving at short notice. That is a key performance indicator that any party looking to outsource should prioritise – the culture, foundation and commitment of the staff towards the company.

Q What are the regulatory aspects that need to be taken into account?

RH: To a large extent, outsourcing is driven by regulatory requirements and so we all need to work hard to keep pace with regulatory developments. Any fund manager who wants to establish themselves in Luxembourg, for example, has to invest in the necessary infrastructure and knowledge to meet local regulatory requirements if they are going to do the work in-house. External providers are often better geared up to meet those requirements, which have increased exponentially over the last few years.

TE: When it comes to the regulatory side, the main thing is to have the right people who understand the local regulatory requirements. We have those capabilities in every jurisdiction where we look after regulated funds. We have that substance at the local level to be able to adhere to local requirements, including when it comes to reporting. There is a lot that we go through with clients to make sure we can give them a strong amount of comfort that we are able to provide a very strong service against the current regulatory backdrop, and managers should certainly demand that before working with any external provider. ■

Ramón van Heusden is a senior relationship management director in TMF Group's fund services team. He has 25 years of experience within international real estate and private equity asset managers and service providers.

Thomas Erichsen is a senior business development director, with a focus on private equity and real estate. He has spent his entire career in banking and capital markets, largely focused on alternative investments, fund administration and prime brokerage.

On the market's mind

"Over the past decade, I have seen the role of operating partner evolve to be more systematic, more focused on value creation, and more specialised"

CORY EAVES

"Arbor brought in big company know-how and resources that small companies like ours could only ever dream of"

KENT HAYDEN
Rise Baking Company

"The previous playbooks are grossly incomplete. Relationship engineering is now a vital part of the modern-day PE playbook"

MATT BRUBAKER

"The old way of doing things – the pay and pray strategy – does not work anymore in private equity. Firms are having to be highly creative"

FRIEDERICH VON HURTER
PwC

"ESG continues to rapidly rise up the agenda in terms of its importance. Operational efficiency means achieving maximum productivity and minimum waste"

GEOFF TOMLINSON
LDC

"The working culture and having an engaged, enthused and incentivised workforce with the right organisational design is critical to success"

JAMES MARKHAM
Graphite Capital