USC CONSULTING GROUP

PRIVATE EQUITY VALUE CREATION:

INCREASE YIELD AND EBITDA THROUGH LEVERAGING CONSULTANTS

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DEAL COMPETITION IS FORCING CREATIVE APPROACHES

Available financing and an abundance of dry powder has recently increased the volume of deals and generated the highest amount of buyouts ever. This environment has not only sustained high average EV/EBITDA multiples in the mid 11s, but the related yield pressure has caused GPs to look at creative approaches to winning asset competitions as well as value creation.

These dynamics also caused a predictably large number of exits taking advantage of high valuations with a record amount to other PE firms (i.e. secondary buyouts). To be sure, the variables in place make generating attractive return on investment via traditional PE strategies challenging.

This is why an increasingly large number of firms have evaluated their strategy and models, including debt versus equity relationships, add on activity, integration plans, and operational improvement approaches.

Business management consultancies are being leveraged as an important tool in the PE value creation toolkit due to their vast industry experience crossing the supply chain. PE firms are seeing benefit from leveraging these outside resources across the deal cycle.

OPPORTUNITIES WITHIN THE PRIVATE EQUITY LIFECYCLE

While there are variations in approach across PE firms, most generally navigate the same private equity lifecycle and the overarching operational workflow wherein they receive potential acquisition candidates, perform evaluations, cull the candidates, perform due diligence, manage the closing process, and ultimately acquire. Then, they manage, optimize and realize the value in assets. This process can involve a firm reviewing over 300, and for some as many as 1,000, target potentials per year.

1. **INITIAL REVIEW:** PEs review the core industry, the offering, financial and operational information for the potential holding, and perhaps a CIM or equivalent all to determine portfolio fit.

2. **DATA ROOM EVALUATION:** With interest established, the PE gains access to the data room or some form of the business's centralized information hub and conducts a more thorough assessment.

3. LETTER OF INTENT AND DUE DILIGENCE: The sequence can vary, but PEs often participate in management meetings, begin cursory diligence, achieve a meeting of the minds, executes a letter of intent, and continues its analysis including thorough due diligence which will include some form of quality of earnings and detailed legal review.

4. CLOSING: Here, the PE executes the transaction with their investment hypothesis in hand including the integration plan and strategy for driving short-term and long-term value creation—and officially acquires the organization.

5. INTEGRATION: The PE leverages a 100-day plan or similar mechanism to fold the acquisition into its portfolio and establish a governance cadence.

6. OPTIMIZE AND EXIT: After monitoring performance of the integrated asset, the PE decides when and where to apply additional operational improvement and commercial levers to realize the value creation hypothesis or further improve results. Often, corrective measures are needed either due to flawed execution or adverse external dynamics. Ultimately, the asset value is realized through an effective marketing and sales approach.

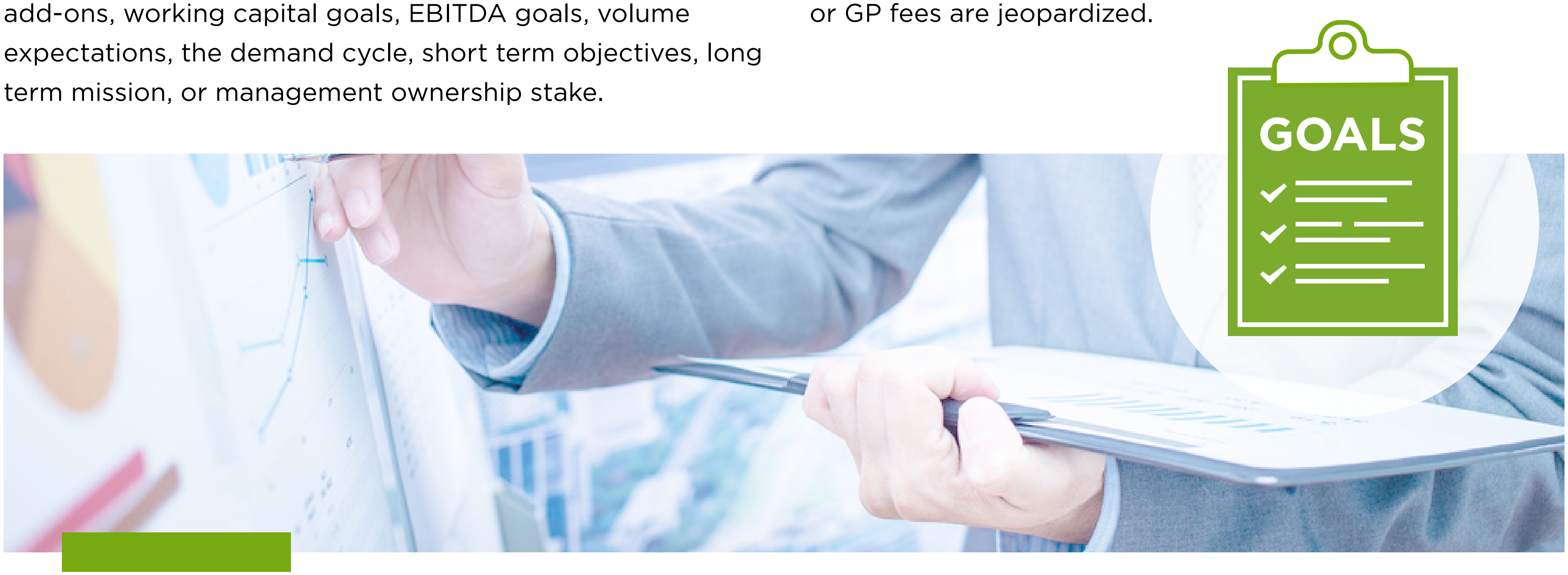
PE firms utilize outside expertise from management consultants throughout each of these steps in the private equity lifecycle and realize how additional insight can increase their competitiveness, the value proposition, and yield.

CONSULTING and PEs:

UNDERSTANDING THE FINANCIAL DYNAMICS

Management Consulting firms with experience working with PE firms can adapt their approach to meet the specific financial needs of the PE firm and the portfolio company. Variations exist across different firms and even specific deals within the same PE firm. Different situations may require different approaches based on myriad aspects including: degree of leverage, financial governance, sponsor intrusiveness, portfolio company autonomy, appetite for add-ons, working capital goals, EBITDA goals, volume expectations, the demand cycle, short term objectives, long term mission, or management ownership stake.

Adept consulting firms collaborate with PE firms and portfolio company management to design operational improvement approaches respectful of those aspects to generate the greatest value creation for owners. As mentioned, that toolkit best includes a restructuring mindset in turnaround situations where either flawed execution or external dynamics have created tension when financial goals, debt coverage, lender covenants or GP fees are jeopardized.



STRATEGY VERSUS EXECUTION

Different consultancies help PE firms in different ways. Some management consultants provide outstanding philosophical and strategic guidance leaving it to PE firms and portfolio companies to execute change. Some are experts in commercial aspects where driving top line growth and increasing markets or share are a competency. There are too few that provide boots-on-the-ground evaluation of shortcomings, devise line level solutions, create detailed project plans for change, and then implement sustainable operational change with measurable financial results, all while working hand in hand with the workforce. Similarly, PE firms typically employ a cadre of expertise that encompasses all three areas (i.e. strategy, commercial growth, and operational improvement). Often, the operational expertise in PE firms includes experienced C-level executives who have realized they can greatly benefit from the collaboration with these boots-on-the-ground implementers of sustainable operational improvement. This is where PE firms are finding great value in this tight market driving differentiation in performance.

POTENTIAL AREAS OF IMPROVEMENT

Operational improvement consulting firms bring the experience and skills necessary to help PEs across all phases of the private equity lifecycle, leveraging their capabilities to affect positive change in numerous ways. For instance, consultancies can validate model assumptions during the deal book analysis, data room evaluation, letter of intent issuance and move towards closing. Sometimes these reviews invalidate assumptions, uncover additional risk and opportunities, and hone realistic timelines for achievement of benefit. Pre-purchase assistance alone can have an immense impact on PE valuations which can impact success in the bidding process, or the avoidance of miscalculation.

Of course, consulting firms also offer value post-acquisition through the development and deployment of operational improvement strategies. These methodologies encompass a whole host of salient functional areas which cross the bounds of the supply chain, including planning and scheduling, ERP/MRP utilization, strategic sourcing, manufacturing execution or the make-node, manufacturing footprint strategy, capacity optimization, material handling, logistics, as well as areas like asset performance management, employee productivity, organizational design, overhead reduction, and SKU and customer rationalization.

TOOLS OF THE TRADE

How exactly can consulting firms offer such wide-ranging assistance? By leveraging a cross-sectional group of techniques and tools:

TECHNICAL STRATEGIES: Firms draw upon a body of well-known and respected strategic methodologies such as Lean Manufacturing, Six Sigma, APICS disciplines, S&OP, as well as more granular concepts like capacity planning, strategic sourcing, and work order management.

TACTICAL TECHNIQUES: This encompasses a variety of on-the-ground execution tactics, including Management Operating System diagnostics, employee involvement prototypes, steering team structures, supervisor skills development and LTA negotiation.

TECHNOLOGICAL TOOLS: A set of advanced digital tools facilitate the implementation and management of improvement efforts. These assets include automated management operating system visualization, ERP and CMMS platforms, simulation, business intelligence tools and dashboards providing timely visibility to KPIs with drill down and diagnostic functionality.

FACILITATING ACQUISITION ROI

With the competition for deals increasing the difficulty to create attractive yield from investments and the difficulties high multiple valuations have brought, today's PEs are embracing all available means to generate ROI. Leveraging the experience of external support like operational improvement consulting firms with private equity expertise at all phases of the deal cycle improves risk, increases true asset valuation insight and most importantly provides EBITDA and value improvement.

USC Consulting Group is a top-tier organization with over 50 years of experience implementing sustainable operational improvement and leverages that functional experience to help PEs get the most out of their investments. Contact us today to learn more.

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50+ YEARS of Empowering Performance

+1 800.888.8872 | info@usccg.com

3000 Bayport Drive, Suite 1010

Tampa, FL 33607