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KEYNOTE INTERVIEW

Preparation is everything

An uncertain global environment means it has never been more important to start laying the foundations for exit earlier in the investment lifecycle, say KPMG's Paul Pan and Gavin Geminder

Q Why is it so important that managers focus on exit well in advance of the exit process itself?

Paul Pan: LPs are laser-focused on DPI right now. Most institutional investors we speak with indicate a commitment to hold their allocations to private equity steady, but that means they need to see cash flowing back before they can make commitments to new funds.

In this kind of environment, it is vital to form a view on exit strategy and know the options that are available early on in the lifecycle of an investment, so that how you grow and where you grow – as well as your investments in people, process and technology – align with your eventual exit strategy.

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Gavin Geminder: I would add that it is important to have more than one year's worth of outcomes to show for all the work you have done while you have owned that particular business. You need to have a clear track record of executing the bottom-line strategy. That is accretive when it comes to negotiating a better deal at exit.

Q What are some of the initiatives that managers should be prioritising ahead of an exit?

PP: What we are seeing, particularly in more growth-orientated funds, is that private equity firms are allowing management to have a two- to three-year period where they are free to chase somewhat unconstrained top-line growth.

Then, somewhere between two and three years ahead of a potential exit, the focus turns to positioning the asset as a mature company in terms of its ability to manage the bottom line and implement a sustainable cost platform to support the next tranche of growth. That tends to manifest itself in a more formalised approach to budgeting. Zero-based budgeting, for instance, is increasingly being used to manage cost structures effectively, both from a process and tools standpoint.

We are also seeing significant investment in tools and technology – not only for financial consolidation and analytics dashboards, which increase speed to

Q What kind of data do you advise tracking as you enter the exit preparation phase?

PP: I don't think this is specific to exit planning. It is something that is relevant to the entire investment journey. We increasingly see private equity firms building out their own sector and subsector databases with industry-specific metrics and KPIs that they can align to each portfolio company's value creation journey.

The key is using a set of relevant benchmarks to align portfolio company management teams to defined targets so they can track and start early in launching initiatives to improve the growth drivers of the business. I would add that it is important to not only track these metrics and KPIs and their impact on the P&L, but to align those trends with improvements to cash conversion and working capital.

visibility on numbers for decision support – but on operational systems and AI too, which drive performance improvements in the underlying business. Those kinds of investments were rare in private equity portfolio companies 10 years ago. Now, however, the focus is very much on building better businesses and on getting the foundations right for sustainable growth.

We believe that AI should be embedded everywhere in the organisation, but you need to make sure that it is implemented in use cases that you know will drive a benefit. It is also important to start testing and implementing AI solutions early on, so that you can substantiate the benefits well ahead of any exit process.

GG: We are definitely seeing more dollars being deployed against the technology backbone. Historically, private equity firms have been reluctant to spend big money on the back office unless they really had to. Now that optionality has gone. Being best in class in terms of the tech stack is critically important for helping the front office make faster, smarter decisions, which will ultimately drive better outcomes for the business.

"Implementing AI solutions early on, so that you can substantiate the benefits well ahead of any exit process, is imperative"

PAUL PAN

Q To what extent does the emphasis of the exit preparation differ depending on the sector?

PP: If you have an asset that really aligns with the profile that buyers are looking for, you will get more interest during an auction process or even a successful IPO. What that sweet spot is differs depending on the sector, or even the subsector.

For example, in consumer products, where I spend much of my time, strategic buyers want to invest in either brands with scale, that stand to significantly strengthen their existing portfolio position, or less mature brands that demonstrate growth opportunities when paired with the buyer's supply chain or commercial capabilities.

Clients are hesitant to take on incremental fixed costs or increase the complexity of their existing operating model due to an acquisition. This is ultimately about prioritising more limited investment capital and ensuring that acquisitions can be margin accretive in the short term.

GG: When it comes to exit planning, subsector knowledge and an understanding of what buyers are looking for are crucial. Yes, you need to do all the legwork to ensure that the people, process and technology are optimised, but if you don't align your value creation story with what financial or strategic players in the space really want, early on in the process, you can end up with assets that look good on paper, but that nobody wants to buy.

How should private equity owners approach the issue of alignment with management teams around an exit?

PP: This is more an art than a science. Part of the equation is ensuring that the management team is fit for purpose. You need to have the right management team in place, at the right point in the lifecycle of the portfolio company.

I would add that operating partners, in particular, need to get early clarity on what their private equity platform can provide. That could mean full-service procurement, for example, or it could mean the ability to lift out certain functions, taking them out of management's hands. There needs to be a clear understanding of what the private equity firm is bringing to the value creation story and what the management team is responsible to build and improve.

GG: It is equally crucial for the private equity firm to provide clarity regarding the proposed timeline, specifically concerning the expected exit. Alignment around objectives is vital so that there is no misunderstanding regarding what needs to be done and when.

How are geopolitical events affecting the exit environment?

PP: A number of processes have slowed down because buyers are wanting to get more clarity on scenario planning – on inputs, suppliers and vendors, and how those might be affected by various policy decisions – before they close a deal.

> *"Historically, private equity firms have been reluctant to spend big money on the back office unless they really had to. Now that optionality has gone"*
>
> **GAVIN GEMINDER**

GG: Certainty is everything in this business. I would say that the desire to transact remains high but there is undoubtedly some pull-back in terms of actually signing on the dotted line until we have greater clarity.

What steps can managers and operating partners take to optimise their exit prospects against this backdrop of extreme uncertainty?

GG: Uncertainty breeds inaction, or at least a slowdown in short-term transaction volumes. PE and portfolio companies need to focus on what they can control and directly impact.

PP: There are three clear steps that private equity firms need to be thinking about. The first is to get visibility on your value chain in terms of where your various inputs and outputs are coming from. That might mean considering tax carefully, or mapping commodity codes and sub-commodity codes in a way that results in real data.

The second step involves scenario planning. Once you have visibility on your inputs and outputs, you then need to assess the overall impact of different tariff scenarios on the overall cost of goods and services.

The final step involves a mitigation plan. At some point, someone is going to be left holding the bag in terms of increased costs. You need to understand what levers are available to you with respect to passing through those costs to end customers in the form of price increases, or else working with vendors and suppliers to make sure they are sharing the burden. That involves getting into the details of contract terms.

Essentially, this is a multidisciplinary exercise involving tax, legal services, strategy and supply chain. Everyone needs to come together. ■

Paul Pan is private equity leader at KPMG Strategy, and Gavin Geminder is global head of private equity at KPMG International