Private Equity International

December 2022/January 2023
privateequityinternational.com

21 years of change

Tracking the transformation of an asset class

PEI

KEYNOTE INTERVIEW

Value creation becomes a top priority

Data analytics, ESG and take-privates will all feature heavily as private equity firms seek to create value in the years ahead, say Glenn Mincey and Carole Streicher of KPMG

Q In this economic environment, creating value in the portfolio may be more important than ever. How should PE firms approach this?

Carole Streicher: Being fully focused on value creation is a priority for private equity firms right now. In the current economic environment, and with fewer platform deals on the horizon, firms must shift their energy to look at opportunities to deliver more EBITDA improvements thoughtfully and quickly within their existing portfolios.

Our work with private equity clients tackling this challenge shows that the most successful companies have a strategic and detailed approach to using data and analytics to understand and evaluate potential areas of improvement within portfolio companies. In many cases, private equity firms do not yet have robust data and analytics to drive actionable insights. For example, they are collating data from disparate sources without a single source of truth, and many are not yet using AI-based predictive analytics to conduct analyses. This next year is going to require much greater focus on analytics to understand which levers are best positioned to create value within their portfolio companies.

Private equity firms should also be asking management teams in their portfolios about the key performance indicators they are tracking to understand the health of the business, from top-line growth metrics to the assessed value of cost take-outs.

One area we frequently see room for improvement in is roll-up strategies. When portfolio companies have executed roll-up strategies, it is worth exploring whether they properly integrated those businesses and where there is room for improvement, particularly in

SPONSOR
KPMG

areas such as pricing, supply chain and their human capital strategies.

With the potential slowdown in deal volume, I expect we will also see longer hold periods in private equity, which again requires owners to really focus on medium- and longer-term growth strategies and optimisation. Given those longer hold periods, we might see more minority deals, which means private equity firms need to think about where the value might lie in such deals and whether those could allow them to bring additional capital into businesses to help drive growth.

Q How does ESG factor into PE firms' portfolio management efforts?

Glenn Mincey: With all the headwinds around higher interest rates and lending restrictions, an industry that thrives on leverage for returns will inevitably be impacted. Private equity firms are therefore actively looking for additional levers they can apply, which means value creation and ESG are key considerations right now.

Many point to the pandemic and the societal issues of the last two years as having accelerated the focus on ESG, but this is something private equity has been focused on for some time. Whereas 18 months ago ESG was a red flag risk management exercise, now it is a focus at all stages of the deal process and is seen as a means of creating value.

There is a clear belief that sustainable companies are more stable companies, and consumers in all industries seek out strong ESG criteria. Today, private equity due diligence is much more focused on ESG across the whole transaction life cycle and there is an understanding that an opportunity to make a company greener will drive better multiples on exit.

Data is also crucial when it comes to ESG. We have had clients describe ESG as a full contact sport: investors have different questionnaires, portfolio companies collect different data, in different forms and with differing levels of reliability. And everyone wants access to data immediately. There is a crucial need for quantitative data on climate risks and opportunities, as well as a uniform standard. The funds that can get this right will likely have a leg up on the competition moving forward.

Finally, reporting and regulatory requirements are becoming increasingly complex, so companies need to make sure their reporting and compliance processes are robust in order to both avoid unexpected pitfalls and to attract potential buyers.

Q What talent or skills do PE firms need to successfully navigate the next two years and drive long-term value in their portfolios?

CS: First, we are seeing a lot of private equity firms doubling down on building out their data and analytics capabilities to support value creation and performance improvement. That is about getting the data from the portfolio as well as creating a team of data scientists capable of analysing that information and drawing out valuable insights.

Second, GPs are now making significant investments in high-level ESG talent, creating senior positions to help the fund and its portfolio companies execute on their ESG agenda.

Third, we anticipate an increase in carve-outs in the market in 2023, as more corporates look to divest non-core assets. Private equity firms need to make sure they are prepared to successfully execute on those deals, which are different from typical M&A in that they need to stand up a new business that comes with a lot less support around the back office for functions such as HR and IT. Making sure firms have those skills within their existing talent structure to help work through those challenges will be important.

Fourth, if a private equity firm has take-privates in its strategy, then it needs to make sure it has talent in-house that understands how to take a business out of public ownership and create value by doing so. Those skills are not easy to come by, and in the current tight labour market, sourcing the talent necessary to drive long-term value in portfolios should be a key consideration.

Q What is the outlook for PE firms investing over the next year?

CS: The deal market may be slowing, but it's not stopping. It's important to put the current slowdown into context – deal activity is down from last year but 2021 was a record year. We also need to look at the amount of dry powder out there, which stood at about $1.2 trillion for private equity as of 30 June, per PitchBook data.

Clearly the headwinds of inflation, rising interest rates and expectations of an economic slowdown are a concern, but there is a lot of capital to put to work and we don't expect private equity firms to sit on the side lines.

However, the current slowdown gives dealmakers an opportunity to be more judicious. Firms can undertake more robust due diligence as the investment thesis comes under greater scrutiny. Greater confidence in a deal and focus on driving value quickly will ultimately accelerate returns for sponsors. Assets purchased in recessionary times often have returns multiples higher than normal market conditions.

I'd also note that not all sectors are going to be impacted in the same way. There are some industries that we anticipate will be more active, such as healthcare, and particularly healthcare IT. Utilities is another sector where we expect to see more deals.

GM: We are also seeing significant levels of activity around the energy transition. Some forecasters have put the price tag for the global transition to a low-carbon economy at $100 trillion over the next 30 years. The clear winner by volume is renewable energy, but energy storage and transport are areas of tremendous growth. Energy storage is an area where there is a clear need for further development given the intermittent nature in production of wind and solar power. The industry has a particular need to find ways to store the energy (and store it for a longer time) in order to transition to cleaner, more affordable, reliable energy systems. In addition, we also see private equity looking at tangential sub-sectors, with cleantech, waste management and transport being additional focus areas.

"This next year is going to require much greater focus on analytics to understand which levers are best positioned to create value"

CAROLE STREICHER

"There is a clear belief that sustainable companies are more stable companies, and consumers in all industries seek out strong ESG criteria"

GLENN MINCEY

Q As PE funds look to maximise portfolio value, what role will take-private deals play?

CS: It will be interesting to see what happens next with take-privates, following a few years of healthy activity. In 2021 there were 46 take-privates in the US with a combined value of $118 billion, while in 2022, through Q3, there were 35 deals valued at around $113 billion, according to PitchBook data.

As we look ahead to 2023, we will likely be in a scenario that is more robust for take-privates. Given what is happening in equity markets, many assets could effectively be on sale, trading at a lower price. The technology, media and telecoms sector in particular has been hit hard in terms of public market valuations, so that is an area where we might see more take-privates.

We collaborate with our private equity clients to evaluate and pursue take-private opportunities. With rigour behind value creation, these businesses can be sold for a strong return a few years later. The key is to keep an eye on potential assets to find the right time and then to have a playbook ready to drive value creation and execute quickly to maximise returns. Public company carve-outs (in addition to take-privates) accelerate in these market conditions and also represent a significant opportunity for the PE market over the next six to 18 months.

GM: When it comes to take-privates involving 'brown' assets, you will often find concerns in the media that larger strategics and corporates are offloading these assets to private equity funds, which have less of a duty to provide public disclosure and may be perceived to continue with business as usual. However, fossil fuels are going to be vital to the world economy for decades to come. For now, there is an opportunity for private equity to use innovation and solid management techniques to make 'brown' companies greener and really do some good. ■

Glenn Mincey is global and US head of private equity at KPMG and Carole Streicher is US deal advisory and strategy leader at KPMG US and Americas regional head of deal advisory


KPMG
Transforming insights into opportunities
Insights illuminate better choices, allowing us to see differently and do more. When we act on insight with the right people by our side, opportunity is everywhere. With KPMG, you have the people and technologies to uncover insights and turn them into action.
Learn more at read.kpmg.us/Opportunities
© 2022 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. NDP397083-1A