AlixPartners

Private Equity

MAXIMIZING VALUE CREATION WHEN THE END IS IN SIGHT

In the private equity world, finding an attractive asset, acquiring it at the right price, and successfully executing a value creation plan post-acquisition are all critical components to success, but the true test comes in realizing the value and returns upon exit.

The current market has become increasingly difficult for successfully exiting investments and realizing internal rate-of-return targets—let alone exceeding them. **The same economic and competitive factors that make finding attractive deals tougher** are now making exits more complex than ever.

Portfolio companies being prepared for sale today were typically acquired in markets with very different economic outlooks from today's. It was a market with readily available and cheap capital. Buyers today not only have to pay more for debt; they also find fewer lenders because credit investors have tightened their standards by requiring buyers to put up more equity before deals can happen; according to PitchBook, equity contributions to leveraged buyouts are the highest they've been in 15 years, reaching close to an average of 58% in the third quarter of 2023 compared with an average of closer to 40% since 2007. In more and more cases, deal financing involves a consortium of alternative capital providers, each with its own set of goals, standards, and conditions.

Yet while M&A activity has reduced from the peaks of 2021 to 2022, assets are still coming to market as funds look to harvest their portfolios. And an attractive asset can expect to generate considerable interest from a diverse set of potential buyers. To overcome the structural challenges on the buy-side, private equity firms and portfolio companies must work together closely to craft a compelling equity narrative as the exit approaches, proactively addressing potential obstacles for buyers and preparing—and in some cases, replacing—the portfolio company management team to showcase the asset and gain confidence from buyers that there remains further upside in the next ownership cycle.

Evaluating the interests of diverse stakeholders and applying a buy-side lens to the asset, investors and portfolio companies can attract more bidders, build higher levels of confidence about the strategic options the asset presents, and ultimately achieve higher valuations and returns for the company, its employees, and its new owners.

Potential buyers evaluate **management capabilities, market attractiveness, competitive landscape, financial performance,** and **potential upsides and value creation opportunities.** It is critical that a management team be ready with a narrative and supporting evidence that can capture investor attention and nurture confidence in all of those areas. To make that happen, portfolio company executives and their investor-partners should take the following steps:

1. CONDUCT A THOROUGH EXIT READINESS ASSESSMENT

The exit phase holds significant influence over total return on investment. A business acquired five years ago is likely to be sold in a markedly different environment from the original one and is likely potentially operating in different way from its original way. Consequently, refreshing and recalibrating a potential deal thesis and economics becomes necessary to attract prospective buyers.

From our experience, it is vital to perform an exit readiness assessment 12 to 18 months before the intended exit. Such timing for the assessment is near enough to the exit to be relevant, yet far enough to enable management to correct issues that need fixing before buyers come to look at the company, such as a material revenue decline in a strategic customer segment or a cybersecurity breach.

Another important aspect of the exit readiness assessment involves considering the profiles of potential buyers. Financial buyers focus on aligning cost and revenue upside, while strategic buyers tend to put significant emphasis on both tangible and intangible considerations like cultural compatibility, talent retention, and integration complexity.

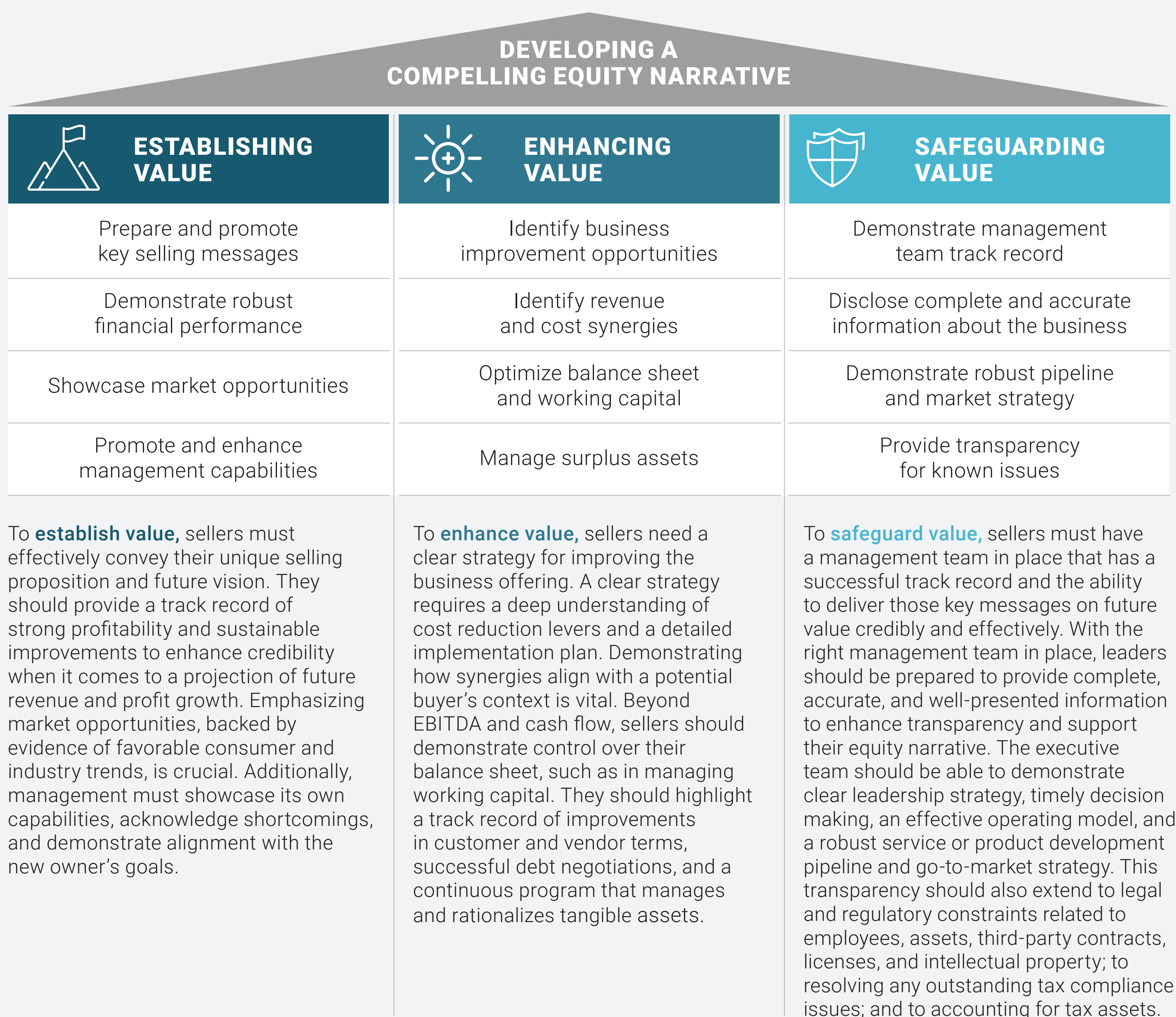
In the event that only a portion of an asset is being sold rather than the entire entity, the assessment must also account for the likely deal perimeter: which business units, assets, and product lines are likely to be included in the deal and which not. For instance, in a carve-out scenario, the deal perimeter carries implications for stranded costs and integration requirements postsale, including what kind of future transition services agreement (TSA) buyer and seller will need. Therefore, it is important to proactively define a robust deal perimeter and outline TSA services for all of the assets, personnel, contracts, and operations involved in the sale. The assessment of a prospective operating model directly impacts deal valuation and feasibility.

2. DEVELOP A COMPELLING EQUITY NARRATIVE

Sellers must develop a logical and attractive equity narrative that explains why the asset can create more value under new ownership and management. The narrative should align to the long-term strategy followed throughout the ownership period and is complimented by concrete, actionable value creation levers that a new owner can execute from day one.

As a foundation to the equity narrative—and in addition to foundational facts and figures like market size, trends, growth potential, and competitive landscape—it is essential to clearly demonstrate the value proposition, competitive advantage, growth, and the ways the target company can create value during the new-ownership period. To motivate buyers, sellers must show strategic options and performance-improvement opportunities that can be captured starting on day one.

A successful equity narrative typically revolves around three key pillars: **establishing, enhancing,** and **safeguarding** equity value as shown in the following graphic.



To **establish value,** sellers must effectively convey their unique selling proposition and future vision. They should provide a track record of strong profitability and sustainable improvements to enhance credibility when it comes to a projection of future revenue and profit growth. Emphasizing market opportunities, backed by evidence of favorable consumer and industry trends, is crucial. Additionally, management must showcase its own capabilities, acknowledge shortcomings, and demonstrate alignment with the new owner's goals.

To **enhance value,** sellers need a clear strategy for improving the business offering. A clear strategy requires a deep understanding of cost reduction levers and a detailed implementation plan. Demonstrating how synergies align with a potential buyer's context is vital. Beyond EBITDA and cash flow, sellers should demonstrate control over their balance sheet, such as in managing working capital. They should highlight a track record of improvements in customer and vendor terms, successful debt negotiations, and a continuous program that manages and rationalizes tangible assets.

To **safeguard value,** sellers must have a management team in place that has a successful track record and the ability to deliver those key messages on future value credibly and effectively. With the right management team in place, leaders should be prepared to provide complete, accurate, and well-presented information to enhance transparency and support their equity narrative. The executive team should be able to demonstrate clear leadership strategy, timely decision making, an effective operating model, and a robust service or product development pipeline and go-to-market strategy. This transparency should also extend to legal and regulatory constraints related to employees, assets, third-party contracts, licenses, and intellectual property; to resolving any outstanding tax compliance issues; and to accounting for tax assets.

3. CONSIDER THE RIGHT MANAGEMENT TEAM

Building confidence that the asset has the right management team in place to take the asset to the next stage of its life cycle is an often-underlooked component of the sell-side process. Many portfolio management teams do not have direct experience in leading a company in a stressed, low-growth economic environment, and those that do command a premium in the market right now.

Having the right management team with a proven track record in place when entering a sales process can boost confidence in the equity narrative. It shows potential buyers that the business plan is ambitious yet achievable.

Private equity owners should think about the value drivers of the equity narrative—whether the drivers be commercial, operational, or technological—and consider how and where the management team can be supplemented to support a future vision for the asset.

4. PROACTIVELY ADDRESS DEAL HURDLES

Even with a great equity narrative in place, clear messaging, a strong value proposition, and a thoughtful plan, any transaction involves negotiation; and each side will look to control the process and in turn the valuation. There are many areas where the sell-side can trip up. The good thing is that not all of the hurdles are unexpected, and sellers can be proactive in controlling the process and addressing known gaps or risks proactively to increase the potential for a successful transaction by initiating comprehensive planning in advance, furnishing essential data transparently, and engaging with potential buyers actively.

Even with a compelling equity narrative, clear messaging, and a solid plan, negotiations are inevitable in any transaction. Both parties aim to influence the process and, consequently, the valuation. Even though there are several potential pitfalls for the sell side, the advantage lies in the ability to anticipate and address the challenges proactively. Sellers can enhance the chances for a successful transaction by proactively taking charge of the process, addressing known issues, and engaging actively with potential buyers. This includes initiating comprehensive planning in advance, transparently providing essential data, and maintaining active communication.

Based on our experience, the following list summarizes common deal hurdles and ways sellers can proactively address them.

Hurdle no.	Common deal hurdles	Ways sellers can proactively address them
1	**VALUATION DISCREPANCIES** Differences in valuation methods and bid–ask spread can disrupt negotiations, potentially leading to deal breakdowns.	Substantiate valuation with robust financial records, historical performance, and growth potential. Engaging a respected third-party valuation expert can further support the valuation.
2	**EMPLOYEE RETENTION** Key employees departing during acquisition can affect day-to-day operations and risk value creation and delivery.	Identify critical employees early and determine their likelihood of flight risk. Develop a robust retention strategy (e.g., bonuses and equity incentives) and plan to execute.
3	**CULTURAL DIFFERENCES** Transition from one owner to another may be difficult and lengthy due to cultural clashes between management team and investors, driven by management styles, values, and employee expectations.	Foster open dialogue on culture and values with the buyer/investor, addressing differences proactively. Develop a detailed change management and communication plan and obtain joint commitment from both leadership teams.
4	**LEGAL AND REGULATORY COMPLIANCE** Large transactions may require approvals from regulatory bodies. Delays in obtaining approvals can extend the deal timeline. The buyer will want to ensure the target company is complying with all applicable laws and regulations; pending lawsuits or compliance concerns can jeopardize the deal.	Involve legal counsel proactively to handle pending legal issues. Disclose known legal matters to the buyer early and discuss potential solutions. Work closely with the buyer to prepare and submit regulatory filings and engage legal experts for potential antitrust issues.

Preparing a company for sale is a multifaceted endeavor that demands **strategic foresight, proactive planning, and transparent communication.** By conducting an in-depth exit readiness assessment, developing actionable strategies for the new owner, and promoting transparency in communication, both investors and portfolio companies can navigate the sale process more effectively. In a landscape characterized by change, successful preparation for sale sets the stage for a seamless transition of ownership and positions the company for continued success under new leadership.

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ABOUT US

For more than 40 years, AlixPartners has helped businesses around the world respond quickly and decisively to their most critical challenges – circumstances as diverse as urgent performance improvement, accelerated transformation, complex restructuring and risk mitigation.

These are the moments when everything is on the line – a sudden shift in the market, an unexpected performance decline, a time-sensitive deal, a fork-in-the-road decision. But it's not what we do that makes a difference, it's how we do it.

Tackling situations when time is of the essence is part of our DNA – so we adopt an action-oriented approach at all times. We work in small, highly qualified teams with specific industry and functional expertise, and we operate at pace, moving quickly from analysis to implementation. We stand shoulder to shoulder with our clients until the job is done, and only measure our success in terms of the results we deliver.

Our approach enables us to help our clients confront and overcome truly future-defining challenges. We partner with you to make the right decisions and take the right actions. And we are right by your side. When it really matters.

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