IDEAS | PEOPLE | TRUST

Private Equity

How to grow with Private Equity investment

DEMYSTIFY | NAVIGATE | ACCELERATE | REALISE

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BDO – Navigate

Private Equity investment enables entrepreneurially spirited businesses to accelerate their growth, and clears the way for skilled and ambitious people to step up a gear. If managed in the right way, Private Equity can be an exceptionally positive route to growth.

But there are no guarantees. Engaging with Private Equity always brings change to a business, sometimes revolutionary change, and if the process isn't carefully handled it can cause turbulence, disruption and disappointment.

Following on from Demystify and Navigate, the Accelerate phase represents the chapter of Private Equity ownership where businesses are challenged to achieve demanding value growth at an increased rate.

For the right business and the right reasons, managed in the right way, we see Private Equity as a hugely positive driver for growth.

This document tells you more about how it works, and why you need to prepare.

“ BDO are a valued business partner of the CH&Co Group. As advisers, they have kept pace with the growing complexity of our business postmerger, providing relevant, proactive tax and accounting advice. The ongoing joined up approach demonstrated by the audit and tax compliance teams is of significant note, ensuring timely reporting in a demanding reporting environment. ”

Nicki Tinniswood
Group Finance Director
CH&Co Group

Helping you achieve Private Equity success

Private Equity: an ambitious ownership model

Private Equity offers an exciting and intense opportunity to accelerate value growth. It achieves outperformance by super-charging growth, improving margins, enhancing cash conversions and reducing risks. Culminating in a profitable sale usually within three to five years.

Private Equity investors have a laser focus on growth during a relatively short period of time. Businesses and management teams will be tasked with achieving a completely different level of sophistication and professionalism to meet both parties expectations – this will often lead to unprecedented pace and breadth of change.

Today, Private Equity investors are much more demanding and hands on. They use a range of tools that they often promote, to help grow the value of their investment:

- Incentivisation
- Leverage
- M&A
- Operational improvements
- New market entry
- R&D and digital transformation
- Risk management
- Investment in management.

Whatever the investment plan, it's certain that management will find themselves under increased pressure in running the business while they implement new strategies and report on a demanding growth plan. The challenge is to make sure the interests of the stakeholders – company and investor – stay aligned throughout the process. That's where BDO comes in.

BDO: the home of the entrepreneur

BDO's ambition is to help our clients grow and succeed. We use our expertise, energy and the power of collaboration across our firm to help businesses realise their full potential.

As the leading adviser to entrepreneurially spirited businesses and people, we're in the perfect position to understand the needs of ambitious businesses. We've always had a deep empathy with the passion of entrepreneurial leaders, and we thrive on working with management teams who are on a journey to build something bold and unique.

Our people know the value of long-term business relationships, trust and credibility. We understand that every business is different, and we invest in getting to know our clients and what really matters to them. We use that knowledge to anticipate and support our clients across all aspects of strategic decision-making.

This approach is at the heart of our offering, and it's why for four years running we've been named the top firm for exceptional client service. As a result, more of our clients would recommend us than any other firm.

But personal relationships would count for nothing without technical excellence and a rock-solid infrastructure behind them. At BDO we have both – and they give us a strong base to help companies manage the particular challenges and issues they face when working with Private Equity.

Bridging the gap

When businesses first start to work with their Private Equity backers, they undergo an enormous change. While it's often an exhilarating period for all concerned, the needs of the investors mean there will be a relentless and demanding focus on growth, with targets and reporting requirements to match.

The two sides must start by sharing a common understanding and vision, and it's essential that this remains solid: it's particularly important in the early days when the impact of the change will be at its most intense.

That's what Accelerate is about – helping management teams and businesses get the most out of Private Equity. We know and understand both the entrepreneur and Private Equity, and we're well positioned to mediate, facilitate and advise management teams on driving value into their businesses.

Agenda alignment

Every business is different, and no two Private Equity deals are the same. However, we have observed four fundamental areas that set the tone for every Private Equity relationship. If expertly managed so that both parties can stay aligned, the chances of realising full potential will be improved.

The four pillars
of a strong aligned relationship

Purpose and intent + **Execution** + **Constant/Effective communication** = **Trust**

The first step is to define and clearly communicate what success looks like to all stakeholders.

As well as the investors and the business owners, this includes management and workforce. If everyone agrees on a common purpose and intent, the all-important collective direction of travel is much more clear.

Putting purpose and intent into practice.

This is perhaps the single most demanding aspect of a Private Equity relationship. Management must be prepared for the profound and intense transformation that is about to take place. Collaboration to implement all aspects of the plan will support the overarching goals:

- Cascading your action plan throughout your team, driving collective responsibilities
- Incentivising more than just your top team.

Even the strongest Private Equity relationship will never be entirely plain sailing.

Key to navigating this is communication: management must be prepared to keep their private equity partners up to speed with whats going on, whether or good or bad. Therefore it's critical to establish strong channels and reporting mechanisms with the investors.

There's a balance to strike between management team autonomy and Private Equity stakeholder involvement and different arrangements will suit different businesses.

However, every successful relationship shares one essential element: trust.

Accelerating value growth

On page 4 we outlined eight tools that PE investors do to grow the value of their investment. But what do they mean to you?

1 Incentivisation

PE houses seek to disproportionately incentivise key people to deliver growth in the equity value of an investee company. This is managed through the investment structure (how much and what type of leverage there is) and the all-important Sweet Equity and the terms attaching to it. These include the notorious 'Leaver Provisions'. As well as Sweet Equity, key people can also benefit from bonuses and option schemes. Senior management must ensure that each member of the team has clear objectives which, when aggregated, support the overall goals. Getting this right is essential as it drives alignment throughout the senior team.

2 Leverage

Using debt lowers the cost of capital. Lowering the cost of capital helps all shareholders make a bigger return. However, this must be balanced with the risk of adding third party debt to an investment structure: 'cheaper' debt brings covenants that become disproportionately painful in underperformance. Management teams should also be mindful of the split between ordinary shares and preference shares/loan note instruments. If not 'pari passu' management teams might be more incentivised but also carry greater risk which could challenge alignment.

3 M&A

'Buy & build' is becoming more prevalent as a value growth tool. There is a great attraction to 'following your money' if you are a PE investor. This means putting more funding behind a proven management team in a sector or setting that is already well known. This reduces the perceived risk. Equally, there is the allure of synergies, reducing the average entry multiple (if bolt-on or add-on acquisitions can be purchased at a lower multiple that the original investment), new market entry and a simple premium for scale all of which will provide shareholders with the benefits of potential multiple arbitrage (where the exit multiple is higher than the entry multiple).

4 Operational Improvements

Similar to adding value through a buy-and-build programme, operational Improvements are strongly sought by PE investors. If margin can be tweaked up through reorganisation or the investment in slicker processes for instance, or risks can be diluted by reducing fixed costs or working capital can be managed more efficiently making the business more cash generative, all shareholders will benefit. Often operational improvements are incremental and subtle, but they can be profound, for instance outsourcing manufacturing in its entirety or switching a business model to being on-line. There is an enormous array of help available in this area these days and you will be surprised how far you can go if you are open minded and prepared to put in the work.

5 New market entry

Teaming up with PE brings two things in abundance (if you have picked the right PE house). Firstly, the power and wherewithal to invest; and secondly, experience. All business plans should look at new market entry on top of doing more of the same. This can be adjacent products or services, new territories or new customer areas or sectors. Each needs to be evaluated against the cost of capital, expertise, management bandwidth and timeframe. The classic strategy for UK businesses is to open up in the US or to the US marketplace. This can be extremely lucrative when it goes right but care and planning is required especially in respect of the human capital that is needed: it is often the difficulty of finding the right leadership or team in the US that hampers success. Your PE investor should be able to fund such activities and provide guidance from their own investing experience.

6 R&D and digital transformation

Contrary to what people might think, PE is interested in the longer term prospects of a business. They know that the visibility of further future growth will help eventual buyers pay more. Therefore, investors are constantly looking to evaluate potential returns from new product development, process automation, tech-enablement as well as the conditions and processes that are needed to build more innovation into an investee company from ideation to execution. It is probably not silly to say that all businesses should be spending some time looking at how they can embrace the opportunities that the internet, digital analytics, digital marketing, digital communication and clever software can provide. No business model is immune.

7 Risk management

The overall area of risk management affords a massive array of value enhancement opportunities. Having said that, it is an area that is often overlooked as teams strive for more glorious achievements (see above!). Simple activities like running through the details of the due diligence from the investment and talking to the providers can remind investor and management alike of areas that can be tightened and improved: where warranties and indemnities were sought, could work be undertaken to dial entry risks out when it comes to exit? Also, can customer dependency be worked on; and how can revenues be made more 'sticky', that reduces risk? There may be tactical and strategic work streams to ultimately improve the quality of earnings, the diversity of revenue, address bandwidth issues etc.

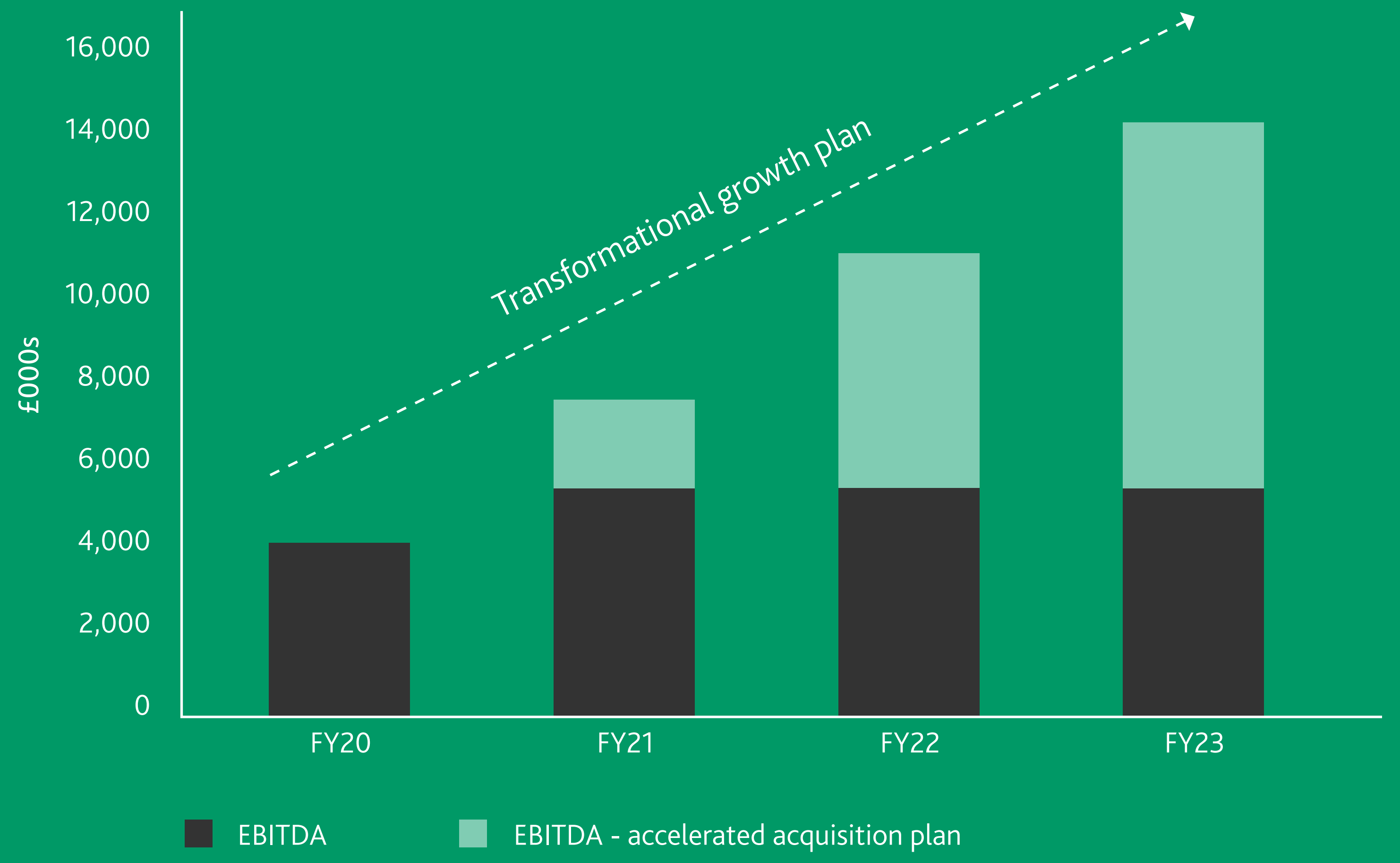
8 Investment in management

This is a potentially difficult area as people can feel vulnerable and egos can get in the way. However, it stands to reason that all shareholders benefit from a complete, rounded and effective leadership team: prospects are improved, innovation is enhanced, plans are better, and better executed, and the business can become both more strategic and sensitive to new opportunities all at the same time. Sometimes it is obvious: there is no CFO (Chief Financial Officer), but other times it is more difficult to see - should the business have a CTO (Chief Technical Officer) for instance? Other times it could be more painful as there is a weak link or dissonance in the team. Consulting help is available: but often teams already know. Having said that, beware of the PE houses with the rolodex of great people who can be 'parachuted' in: each addition to the team needs to be considered carefully avoiding the misty-eye of celebrity.

Case study - why BDO

Acora

Acora is one of the leading IT managed services and technology providers to the UK mid-market, offering a comprehensive range of IT support, business software and cloud solutions to over 300 customers nationally. The Company established itself as a quality services provider and was seeking an investment partner to provide the financial firepower to upscale and accelerate the growth plan, both organically and through acquisition.



Client Quote

“Following a number of years of consultative guidance whilst building towards an investor event, Paul Russell and the BDO team provided the key market insights in identifying the potential investment partners that matched both the ambition and culture of Acora.

From launch to exclusivity and completion – the deal was executed to timetable at high speed and efficiency. We were delighted with the BDO team's appetite to support Acora at all hours throughout the process and I would not hesitate in recommending them.”

David Rabson,
CEO, Acora Holdings Limited

Dedicated to supporting entrepreneurial and high growth businesses, BDO developed a strong relationship with Acora's CEO, spanning a period of 15 years. An intimate understanding of the business, its management and investment requirements resulted in consultative guidance in the years leading up to sale, with BDO subsequently appointed to manage the sell-side process.

At the time of the capital event Acora was highly investable, demonstrating attributes of a business with revenues in excess of £100m. The Company **had assembled a high quality senior management team** and strong annuity-based customer roster, **whilst upfront investment in its operational platform meant the business was highly automated and already delivering strong profit margin**.

Acora had also developed **a dedicated internal M&A function**, responsible for identifying and executing opportunities which would deliver **additional scale or capability**. This is led by the Company's Chief Acquisition Officer and already demonstrated a proven track record of efficient execution and integration through three successful acquisitions. The acquisitions were completed at competitive prices, with **Acora able to take advantage of synergies as well as multiple arbitrage when going through sale**.

Leveraging strong relationships within the PE mid-market, BDO supported in identifying a shortlist of credible investors that were deliverable and culturally aligned to Acora. With the asset in high demand, BDO ran a highly competitive process, **strategically running vendor due diligence procedures, legal and completion mark-ups before selecting the preferred party. This ensured potential risks were identified and mitigated early**, facilitating efficient execution through a condensed exclusivity period.

Palatine Private Equity were selected as the investment partner based on sector expertise, fit and ambition. Competitive tension was used to maximise value and negotiate seller-friendly terms, which ensured management retained a controlling stake in the business, **with access to an attractive sweet equity pot incentivising the team through the next phase of growth**. Completion of the transaction within the timetable was key to vendors, with **Palatine also agreeing to equity underwrite the deal. This successfully mitigated any funding risk**, with Newco subsequently re-financing post completion.

Overall the transaction represented an excellent outcome for all parties and was truly transformative for the business. Acora now has the firepower to super charge its growth plan and achieve the objective of becoming the provider of choice for the UK mid-market. BDO looks forward to watching the business go from strength to strength and will continue to support the growth story.

Private Equity in numbers

Private Equity specialists: the BDO team

BDO's Private Equity group is a highly collaborative network of more than 400 experienced advisers from all disciplines across the firm including audit, tax, M&A, transaction services and corporate advisory. This practical team has a profound understanding of the Private Equity industry, particularly in the mid market. Our people are part of the process at every level, interacting with funds, advising on deals, and working closely with portfolio companies to help them realise their goals.

>1,200 Private Equity backed companies work with us

We audit **>500** Private Equity backed companies

We work with **>300** Private Equity houses

In 2023 we completed **205** deals worth **£10.5bn**

53% of our deals involved Private Equity

Globally BDO's 2023 network revenues were **US$14bn** generated by **115,700** people across **166** countries

The investments we've made in infrastructure, resources and talent mean that we offer a powerful combination of service, scale and expertise; and through our deep working relationship with each client we can focus on their unique needs and deliver practical individual solutions.

We've never lost our agility and personal approach. We understand the intense pressure that comes with the challenge of entrepreneurial growth, and we work strategically alongside our clients. Private Equity can offer huge rewards to businesses, but knowing how to manage it effectively makes all the difference. That's where our team comes to the fore.

Contact us

we want to hear **from you**

The reasons for embarking on Private Equity investment may be complex, but whatever your motivation, we are searching for ambitious businesses to champion through this chapter and enhance future growth.

Contact **Jamie Austin** on +44(0)77 7192 8208 for more information.
We look forward to meeting you and learning about your business.

Read the next in **our series**:

REALISE

For Private Equity backed businesses when moving to the end of their current Private Equity ownership cycle to learn how to manage next steps.

Definitions in this document have been sourced from industry bodies BVCA and ICAEW ('A Guide to Private Equity'; 'Private Equity Demystified').

Our **PE blog** series covers a number of topics that might be relevant for your business.

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