Portfolio management issues in Private Equity

Presentation to the AIFI Annual Symposium

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Contents

- Why institutions invest in PE
- The New Millennium: a different environment
- Looking after your businesses
- Adding value
- Critical success factors
- Looking ahead
Why institutions invest in PE

- Diversity
  - Access to sectors not covered by public markets
  - Access to emerging technologies

- Performance
  - Absolute returns
  - Superior returns - 5% premium to public markets
  - The ability to add value
### The New Millennium: a different environment

<table>
<thead>
<tr>
<th>1990’s</th>
<th>2000’s</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Money</strong></td>
<td><strong>Deal Flow</strong></td>
</tr>
<tr>
<td>Ready supply of capital</td>
<td>Accessible deal flow</td>
</tr>
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<td></td>
<td>Rising public markets</td>
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<tr>
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</tr>
</tbody>
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- **Value source**
  - Value creation
  - Valuation & business-cycle arbitrage

- **Deal Flow**
  - Accessible deal flow
  - Rising public markets
  - More competition between buyers, fewer deals
  - Vendors are more sophisticated
  - Exits more difficult
  - Realisation overhang

- **Implications**
  - Holding periods extended
  - Problems have time to surface
  - Performance depends on adding value
Looking after your businesses: 1

What is the most important factor in successfully managing your portfolio companies?

- Motivation and capability of management
- Knowing what’s happening within the business
- Knowing what’s happening in the market-place
- Understanding the sector
Looking after your businesses: 2

- Regular communication with management: 4
- Attendance at board meetings: 3
- Review of regular management accounts: 2
- Review of bespoke financial and non-financial information: 1
- On-site reviews: 1
- Non-executive directors: 0

Most important success factors:

- Regular communication with management
- Fairly high degree of importance attached to board meetings
- Less importance attached to forward indicators
Looking after your businesses: 3

- Most spend 30% to 40% of time managing/monitoring portfolio companies
- Smaller businesses require proportionately more time
- Turnaround situations require heaviest time commitment
Looking after your businesses: 4

What’s really important

- Communication and information
  - Reliable, appropriate and timely management information
  - Understanding the business

- Intervention
  - Acting early
  - Having access to the right skills

- But....
  - “We always feel we do too little too late”
  - “Changing the management team is often seen as the cure for all ills”
Adding value

What PE houses regard as important

- Guiding businesses through change
- Being a critical sounding board
- Challenging managements’ views
- Optimising financial structure
- Providing access to appropriate specialist skills
Critical success factors

Improving PE house performance

- **Before you buy**
  - Understand the business you are getting into
  - Identify the exit method and strategy
  - Evaluate the management team and identify replacements where needed

- **After the deal**
  - Good communication with several points of contact
  - Good information especially using forward looking KPIs
  - Respond quickly to problems
  - Having operationally experienced staff involved or available

“We like people with a few grey hairs”
What is considered leading edge in portfolio management?

- In house team dedicated to monitoring and developing portfolio businesses
- Having good non-executive directors available, especially chairmen
- Improved systems and real time information
- Outsourcing / provision of specialist skills
- Collective arrangements
- Portfolio secondment
“Ultimately, it must be the ability of PE houses to add value to portfolio companies during their ownership that justifies investment in the sector”

- Portfolio management is the key differentiator for PE houses and leading edge developments include:
  - Improved prospects of internal origination
  - Reducing transaction risk via in-house operational due diligence
  - Ability to undertake greater variety of transactions
    - Complex buy to build
    - Turnaround
  - More sophisticated tools to exercise control
  - Improved communication with management teams