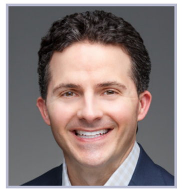
Tech Adds Value to Deal Process




West Monroe assists private equity and strategic buyers throughout the M&A lifecycle, starting with technology and operations diligence to identify risks and value creation opportunities all the way through portfolio value capture. For more information, please visit www.wmp.com.

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How would you characterize the deal making environment today?

SONDAG: The U.S. market is certainly frothy from a valuation perspective, one contributing factor being dry powder is at an all-time high. Depending on what source you look at, private equity firms have approximately $700 billion in dry powder, while strategic acquirers have about $1.7 billion earmarked for M&A. A second factor is the U.S. market remains very attractive for M&A compared to other markets. Finally, we're seeing an increase in the number of buyers – from both new U.S. private equity funds and existing Middle Eastern and Asian sovereign wealth funds coming into the U.S. marketplace.

AMIOT: Valuations are the highest in history, with multiples surpassing 20 times revenue in some cases. We predict this trend will continue since M&A has become a vehicle for growth in the current economy. Although there may be a correction down slightly, high multiples are the new norm. The second trend we see continuing is accelerated deal processes with buyers using speed-to-close as a differentiator.

What are the biggest trends you are seeing in private equity today?

SONDAG: There is more focus on value creation within the portfolio during the last 18 months. Long gone are the days of buy, plus financial engineering. Our private equity clients are set on driving value for their portfolio companies and, quite frankly, need to find operational value based on the premium they paid to win the deal. To do that, they are hiring more operating partners and getting more operationally involved. We are also seeing more divestitures, as many clients are seeing this as a favorable strategy in a competitive market. Several private equity firms that normally wouldn't touch divestitures in the past (due to high risk and high capex outlay) are now willing to execute a carveout.

Finally, we're seeing larger funds come down market in this competitive market, especially when it comes to software deals. They are willing to do smaller deals, knowing they'll need to ramp up the number of add-ons.

AMIOT: From an acquisition strategy perspective, we continue to see an increase in add-ons to bolster solution capabilities or expand geographically. Customer acquisition is also an important part of the equation. Owners are trying to make one-plus-one equal four through aggregation and creation of disruption solutions.

What technology trends are affecting due diligence in mid-market private equity?

AMIOT: Increased development of next-generation solutions to be competitive in the market. Understanding these transformational challenges are vital to deals: Where are organizations in the process? Will new solutions really differentiate the target/solutions? Do they have the right leadership to achieve their goals and deadlines?

The second big trend is in cybersecurity. We are seeing an increased focus on applying best practices across portfolio companies and measuring against industry standards and benchmarks.

SONDAG: Given the advancement in technology and the focus on digital, the amount of time and investment spent on technology diligence has gone up significantly during the last two years, especially with complex deals. It's critical because technology is having a larger impact on business strategy and operations. Also, when it comes to mergers or divestitures, technology is typically the long pole in the tent, coupled with the highest risk.

How can private equity firms use tech to drive value (not cost) over the hold period?

SONDAG: First and foremost, investing in the technology platform to ensure scalability. This is important to ensure both organic and acquisitive growth are fully enabled. The second would be ensuring a data platform to drive decision-making, analytics and business insights. Finally, using technology to make the customer experience frictionless, simple, and omni-channel for those applicable businesses. And, yes, all of those are much easier said than done.

What are some common challenges private equity firms face today and how can you help them overcome these challenges?

AMIOT: The biggest challenge we see is compiling data and leveraging insights to help portfolio companies drive decisions, especially regarding people and teams. You can learn about the competency of the team and make faster decisions with the use of data, which is important, because when a hold period is four years you don't want to spend a year to make an executive decision. Additionally, a lot of companies don't understand what digital can mean to them and where to start. It's important for private equity firms to have a conversation around what digital is and how portfolio companies can take those first steps.

As deal timelines speed up, where can private equity firms save time, and where can they never skimp?

AMIOT: From our experience, they should never skimp on evaluating the leadership and their vision. You need to have the right leadership in place to be successful. Even if you get a great asset, it can fall flat without the right leadership. For technology-based firms, you can't cut corners on understanding how scalable and extensible the technology solution is to meet growth expectations.

SONDAG: Most can save time on back-office operations and technology, but not on the front-office technology or products. It is hard to skimp on cybersecuity, data management, leadership and platform scalability. That said, every deal and investment thesis is a little different and might put emphasis on certain topics, especially if it's a platform deal vs. a tuck-in.

What value add does West Monroe bring to the private equity industry?

SONDAG: We bring a mix of business operations and technology skills to the table, which we like to call our "uncommon blend." We are also practitioners – we don't just advise, we do implementation work as well. We can help private equity and strategic buyers achieve their investment thesis, especially in a complex divesture or a merger. We like to use data and analytics to drive business insights, which are driving value for several of our clients. For example, we recently helped a client reclassify and recapture field services revenue from one-time services to recurring maintenance, which will have a direct impact on their future EBITDA multiple.

What changes do you expect in the private equity industry over the next year?

AMIOT: Buyers have become more sophisticated, doing more analysis and deeper critical thinking; therefore, sellers will have to be prepared to explain in more detail how they differentiate their solutions, what investments they need to make to do so, and what options exist to accelerate achieving their goals.

SONDAG: If you believe what most economists are saying, we won't see much of a slowdown in the next 12 months. Valuations will stay in the general vicinity and we will see private equity firms continue to focus on their portfolio. On the positive side, I think most feel, when the slowdown happens, it won't be as wide or deep as 2009. That said, you may see some private equity firms look to exit investments in 2019, earlier than originally planned if they think the economy will slow in 2020.

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