



Technology

Private Equity Calls in Experts to Fix Firms They Can't Sell

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(Bloomberg)

(Bloomberg) — Buyout heavyweights are increasingly resorting to the old-fashioned way of making money — actually running the companies they've bought.

Financial engineering just isn't working as well as it once did for private equity shops. Some of the biggest, including Goldman Sachs Group Inc. and Blackstone Inc., have added veterans with operations experience from industry giants like Walmart Inc. and Honeywell International Inc. Others like Brookfield Asset Management Ltd. and Partners Group are leaning even more into their roots as operators.

They're looking for tangible results such as wider margins and higher cash flow instead of gauzy "multiple expansion." It's a more hands-on approach that includes building five- and 10-year strategic growth plans for the companies they own, and sometimes helping them market and sell their products. Goldman, without being specific, said its efforts have yielded hundreds of millions of dollars in extra revenue.

"Helping companies operate well should always be an important initiative," said Lou D'Ambrosio, the former CEO of Sears Holdings who leads Goldman's unit devoted to boosting growth at the firm's private holdings. "But if several years ago it was a 'nice to have,' now it's a 'need to have.'"

They need it because private equity firms are contending with a drought in the deals market and holding periods as much as three years longer than historical averages. Acquisitions that seemed like a good idea when interest rates were at rock bottom are stuck shoveling cash into debt payments, and meanwhile, private equity clients are clamoring to receive long-delayed payouts.

Other firms are hamstrung by higher interest rates that have drastically changed the economics of transacting, holding and exiting portfolio companies. They're bringing in experts to help boost cash flows so they can meet minimums set by lenders and head off a default, according to Gary Hoover, TBM's vice president for global private equity.

"Many of our clients have come to us very specifically and said, we need to find Ebitda improvements immediately," said Hoover, referring to a key measure of earnings in loan agreements.

Brookfield, the world's second-largest alternative-asset manager, brought on Adrian Letts in 2022 to become head of business operations for the private equity group and put the former energy and supermarket executive to work on Modulaire Group. The business, acquired in 2021, specializes in building energy-efficient and sustainable modular infrastructure, from temporary offices at construction sites to children's day-care centers.

Letts said he's creating value by "standardizing technology and procurement processes" across the Modulaire's brands so that it has growth "whatever the weather."

Basic Approach

Without the tailwind of low rates and tame inflation, private equity firms will have to concentrate on basics like margin expansion that make companies better, Anuj Ranjan, Brookfield's head of private equity, said at the firm's investor day this month.

Goldman Sachs, which oversees some \$140 billion in private equity assets with more than 300 portfolio companies, recently hired Darius Adamczyk, Honeywell's former leader, to parachute into firms to fix industrial operation issues and decide what to invest in next.

They're working with a benefits management firm on deploying artificial intelligence to speed up decisions on whether health claims are covered, D'Ambrosio said. The effort combines a large language model with elements such as treatment codes, coverage terms and identifying the person who's contacting the call center.

Similarly, Walmart's artificial intelligence whiz Prakhar Mehrotra joined Blackstone in April to bring the emerging technology to its portfolio of more than 240 companies. Mehrotra said via email that AI has been put to work with significant impact in education, logistics, consumer products and recommendation systems.

As for future deals, operating partners are gaining influence, with some firms bringing an industry executive into pre-deal discussions to explain just how hard it will be to extract value from the investment.

"The ability to financially re-engineer a company is no longer a competitive edge," said Smith, the Leathwaite recruiter. "They've had to revamp their expectations, their timeline to exit, and the way they are going to exit. That also means they just have to work hard to make money."

—With assistance from Sridhar Natarajan.

(Updates with Brookfield's headquarters under "Different Mindset" subhead)

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Frothy Phenomenon

"That's created a lot of challenges for that cohort of investments made in 2021, and you can't assume multiples expansion," said Andrea Auerbach, head of global private investments at Cambridge Associates, whose team allocates nearly \$15 billion to private market managers every year on behalf of pension funds, endowments and other investors.

Multiples expansion, in private equity parlance, is when a firm's value rises far more than the underlying fundamentals. Investors can't count on that to continue — a McKinsey & Co. study found multiples were shrinking as of last year. So they're asking private equity managers if they can consistently improve profitability with better operations, or as Auerbach put it, "Have you added people that know what to do?"

It's not like private equity is discovering the idea for the first time — they've been tinkering with operations for years — but the data that's available shows there's good reason to try.

CAIS Group, which consults on alternative investments, sorted through figures on deals from the Institute for Private Capital and found that boosting revenue growth and margins added almost twice as much value than multiple expansion during the decade following the 2008 financial crisis. Preqin's examination of deals under \$1 billion from 2006 through 2019 also found that gains from improving revenue and margins beat out multiple expansion.

It's too early to gauge the full impact of the latest hires because their plans can take years to create and execute. But demand for operational help more than doubled in the first half of the year from a year earlier, according to TBM Consulting, which advises manufacturers and distributors.

In practice, this doesn't mean hiring someone who already knows a lot about the widget a company makes, or sleeps on the factory floor like Elon Musk or cost-cuts their way to prosperity with mass firings. Instead, the recruits are expected to look deep into a company's technology, digital data, human capital and finances, said Chris Smith, a partner at recruiting firm Leathwaite International.

Different Mindset

It's a playbook that Partners Group and Toronto-based Brookfield started out with, and others are now seeing the merits.

"The prior era was a bit more transactional and about finding investment opportunities," said Partners Group's David Layton, chief executive of the Swiss private equity firm. "Our industry is changing. You don't have the same tailwinds."

Sensing the turn, Partners Group brought on Wolf-Henning Scheider a year ago as its private equity head. He's an unusual choice — "our head of private equity has never done a private equity transaction," Layton said. But Scheider has "the mindset of an operator, not the mindset of a deal-doer."

He fits in partly because the \$150 billion firm sees itself more like an industrial conglomerate than a finance firm with portfolio holdings. Scheider spent 36 years working at Robert Bosch GmbH and Mahle GmbH, two enormous German engineering multinationals best known for automotive parts.

Within months, Scheider had the firm expand its existing homemade system that tracks progress in the strategic growth plan of each portfolio company. He leans on the information gleaned to track milestones and performance, and keep projects on track when meeting with management teams and boards of the portfolio companies.

Cash Flows

Kate Romanowicz, a senior client partner at headhunting firm Korn Ferry, just finished a search for an executive with commercial experience to help portfolio companies at a big private equity firm boost sales. In the over-stimulated post-pandemic economy, where consumers snapped up goods with abandon, companies "never had to sell a thing," Romanowicz said. "Now you really need to hustle. You need to create a sales force, so firms are trying to rebuild that capability, because that muscle was kind of lost."