



Private Equity: Rethinking Your Value Creation Playbook

In the wake of COVID-19, it's easy to assume that private-equity owned companies will automatically need to adjust their value creation targets and/or holding periods in response to unprecedented changes in market conditions. But, not so fast.



Key Takeaways:

- In many cases, value expectations can be achieved or even exceeded, as long as the right adjustments to the value creation plan are made.
- Changes to a private equity-owned company's demand, supply, and capacity resulting from COVID-19 do not automatically necessitate changes to value creation targets or holding periods.
- The same—or potentially even greater—value opportunities continue to exist for many companies, however the value may now lie in different areas of the business.
- Private equity firms must take a proactive approach to helping portfolio companies rethink the value opportunity and adjust the value creation plan accordingly.
- It is essential to account for any new risks, specifically in the areas of human resources and supply network, that could affect the value creation plan.

7/27/20 Gary Hoover, John Ferguson, John Wynne, Jeff Klapp

For many businesses, today's reality looks nothing like it did four months ago, with the pillars of demand, supply, and capacity fundamentally altered, at least for the time being. For private equity firms, which are beholden to specific time horizons and value creation targets, it's logical to assume that the deal parameters will have to change, too. But, that's not necessarily the case. Indeed, we're finding that many PE firms don't have to move their targets. Rather, they need to adjust the paths they will follow to achieve them.

3 Steps to Recalibrating Your Value Creation Plan



Determine Where the Value Lies



Adjust the Value Creation Levers



Conduct a Risk Review and Risk Mitigation Planning

The value creation opportunity defined for a portfolio company pre-COVID likely included some combination of growth (organic, inorganic, or both) and operational improvements, such as improving cost structures or the supplier network. While the fallout from the virus may have dramatically altered that value creation opportunity, it doesn't mean that value doesn't exist at all or that portfolio companies cannot perform as well as or even better than originally anticipated. The keys are flexibility and speed when it comes to reassessing where the value now lies and making the required changes to plans in order to capitalize on the current opportunities.

TBM is helping our clients follow a three-step process to determine any directional changes to their value creation plans. In some cases, we're helping clients identify where additional, more in-depth operational assessments may be needed. At a minimum, we are recommending that all portfolio companies do the following:

1. DETERMINE WHERE THE VALUE LIES NOW

The pandemic has dramatically altered demand for many products and services—and that demand will probably fluctuate for some time to come. It may have changed the competitive landscape in some industries and geographies or affected a company's internal capabilities based on supply and labor issues. It's important to take the time to carefully consider your portfolio companies' new normal and clarify where value sits now (keeping in mind that it could be less or more than it was four months ago) and what the best opportunities are for value creation going forward.

TBM is currently working with a portfolio company that provides products and components to the recreational vehicle industry. The PE firm's value creation plan was built on exiting at the end of 2021. According to the [RV Industry Association, while RV sales have been strong as economies have reopened](#), the industry is still off from where it was a year ago and manufacturing activity was shuttered for months during the pandemic, taking a toll on performance. Despite this lost time, the PE firm is not adjusting its exit date. Rather, it's reorienting the value creation opportunity around both bottom line and top line growth. TBM has identified opportunities for designing waste out of the product, making key changes to the supply base, and improving production processes. All told, we've helped the company uncover \$10 million in realizable opportunity over the next 12 months, positioning it to mitigate the impact of any potential future downturn in demand and ensure its best performance in any economic circumstances.

2. ADJUST THE VALUE CREATION LEVERS ACCORDINGLY

Whatever the new normal looks like for your portfolio companies, the levers you are pulling, and the degree to which you are relying on each, may be different than they were before. For example, a company that was planning to grow by leveraging contract manufacturing opportunities in China may no longer have that option available. But it could find similar opportunities in another region of the world. Conversely, some companies will have to rely less on organic top line growth and look instead for significant opportunities to increase internal capacity or strengthen the bottom line.

As an example, one TBM client, a plastic bottle manufacturing company, has seen its automotive-related business go down while demand for water bottles and cleaning product bottles has soared. Many of the value creation levers have changed – the company is facing new variability in production, which has exacerbated many of the recruiting and staffing challenges it faced even before the pandemic started. TBM is helping the organization identify opportunities for cost take out to drive bottom line value, especially in areas where demand is weak and may be for some time. And, we're conducting a thorough human capital assessment to help the business find ways to attract and retain workers needed to achieve production goals for high demand products and fill difficult roles like maintenance technicians.

3. CONDUCT A RISK REVIEW AND RISK MITIGATION PLANNING

For many manufacturing businesses, the pandemic has clearly illustrated vulnerabilities, particularly in their staffing models and supply chains. As part of any revised go-forward value creation plan, it will be important to carefully consider all the areas where risk is inherent and how you can reduce any risks that stand in the way of your portfolio company's ability to deliver on its plan.

In a recent article on [proactively managing the human capital impact of COVID-19](#), TBM discussed the importance of planning for various human capital scenarios, such as a loss of leadership or how to keep the employees you need safe on the job. In addition, [reconciling the supply chain for a post-COVID world](#) will be an important part of keeping your value creation plan on track. This may include geographically diversifying the supply chain footprint and/or looking for opportunities to bring some work in house to help de-risk and boost the resiliency of the supply chain.

Both of these tactics were part of our recommendations to a private equity-owned consumer products company. As the company was gearing up for a spike in demand and exponential growth in the United States, TBM conducted a supply network risk assessment to validate if the manufacturer's Asia-based suppliers could keep pace at the right quality and lead times. After carefully evaluating the tier one supplier's equipment capacity, people capacity, testing, and capabilities, TBM recommended that the portfolio company develop an internal assembly location in the U.S. in order to reduce risk with the single supplier. Ultimately, the company leveraged space in an existing warehouse to establish this capability, adding redundancy to its supply chain and creating more reliable operational capability to better meet the growing demand for its products.

Don't stop pursuing the value you want.

While value creation is certainly going to look different in today's world, PE firms do not automatically have to lower their expectations for returns or extend their timelines. But they do need to act quickly to resize the opportunity and implement any alterations to their value creation plans. With quick action and a healthy dose of flexibility and agility, companies can continue to thrive in a COVID-19 world.

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