Private Equity: A Disciplined Management System Turns Portfolio Companies into Rock-Solid Performers

Properly prepared, solid-performing companies always command a premium of price-to-EBITDA multiples. Preparing a portfolio company for a successful sale starts early.

An Effective Management System Aligns Strategy with Daily Activities, Performance Monitoring and Corrective Actions

“Properly prepared, solid performing companies are always welcome in the M&A market and will continue to receive strong buyer interest and premium valuations.” That statement in a recent report by Prairie Capital Advisors succinctly describes what it takes for sellers to garner an even higher premium in today’s private equity market.

But what does properly prepared and solid performing actually mean?

From a financial perspective it boils down to this: General partners want to know that a target's earnings growth can be sustained and accelerated over the three- to five-year ownership period. That depends in part on what happens in the wider economy and in the company's core markets, which can't be controlled but can be anticipated and managed.

Ongoing earnings growth also depends on reaping the full benefits of any restructuring and the company's internal capabilities for sustaining gains. These can be managed and developed. When gauging a target's internal capabilities, it's important to consider if current performance levels will be sustained following any changes in management. Solid performers are much less likely to falter because of management turnover. On the seller's side the challenge for operating partners is to develop portfolio companies that will continue to perform well after management transitions.

These internal capabilities are what we evaluate when assessing acquisition targets for our private equity clients. In preparation for Private Equity International's 2018 Operating Partners Forum (Oct. 17-18, New York), I wrote about the three main areas that we evaluate.

As I noted in the article, the primary opportunities for growing EBITDA are:

1. One-time cost savings,
2. performance gains that will deliver long-term margin improvements if sustained, and
3. daily management effectiveness

The first two are familiar to everyone. The third area brings us back to the topic of what a properly prepared and solid performing portfolio company looks like. Key signs that a manufacturing company is a solid performer revolve around it's "management system."

A company's management system – regardless of its current effectiveness – is how it creates value.

It’s how orders get shipped out the door every day. An effective management system aligns the company strategy and annual objectives with daily activities, performance monitoring and corrective actions. It reduces daily firefighting and provides a foundation for managers and employees to make process improvements and sustain forward progress.

Operationally, this means few production stoppages, quick equipment changeovers, minimal rework and high initial quality and high on-time shipment rates. Institutionalizing disciplined daily management eliminates performance leaks (thereby sustaining forward progress) and improves order-to-shipment consistency.

All of this is essentially what a properly prepared and solid performing portfolio company looks like. Even in the current sellers’ market and high price-to-EBITDA multiples, quality companies are in high demand and will command a premium price that maximizes investor returns.

Last year, we moderated a panel discussion at the 2018 Private Equity International Operating Partners Conference that took a deeper dive into these topics.

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Gary has over 30 years of experience as a global leader. He rejoined TBM after working as Vice President of Operations at ESAB. Gary currently leads TBM's Global Private Equity practice.