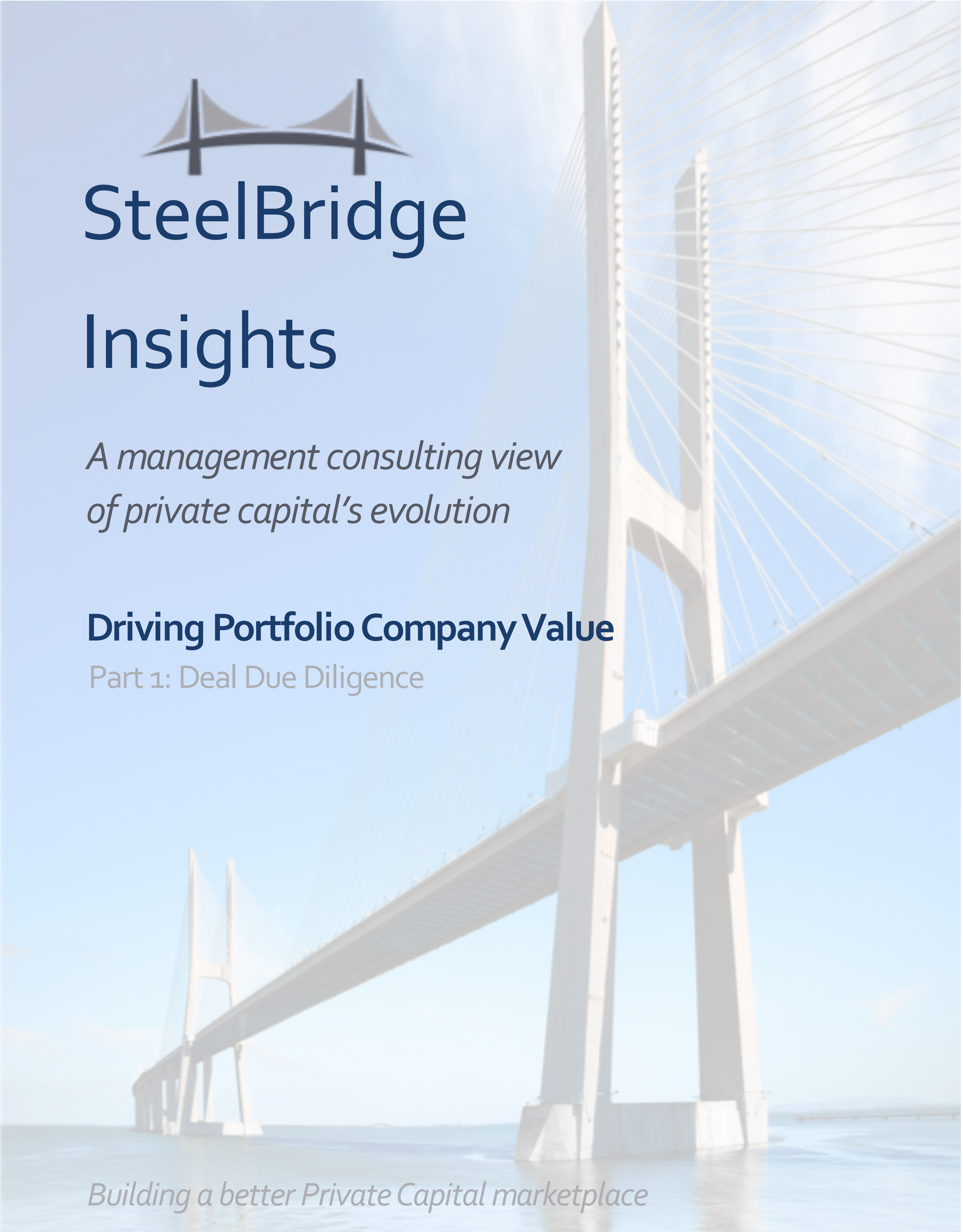


# SteelBridge

# Insights

*A management consulting view of private capital's evolution*

## Driving Portfolio Company Value

Part 1: Deal Due Diligence

*Building a better Private Capital marketplace*

## Key Highlights:

- Assessing and supporting portfolio companies has become far more complex and multi-faceted
- Construct a good model for the "before," the "during," and the "after"
- Robust due diligence can avoid risky deals and enable positive outcomes

### "How Can We Increase ROI?"

The answer to this question is rapidly evolving when it comes to private capital. Asset managers of all sizes have traditionally viewed this question through leverage, equity multiples, and other "industry" lenses.

But in a world where double-digit multiples are more the exception than the rule, managers are looking at broader opportunities to create value at the company level. These initiatives are taking multiple forms – operations, technology, and marketing to name a few.

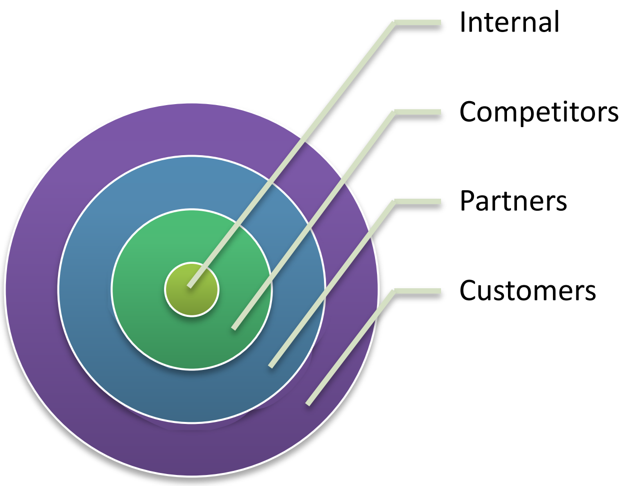
With this new perspective comes greater responsibility to plan the "before" and the "after" when taking on a portfolio company. Simultaneously starting with the end in mind means keeping an eye toward what a positive exit looks like and how planning can adapt to meet that end.

This paper is the first in a series of three, taking a "before, during, and after" look at interactions at the portfolio company level. In Part 1, we discuss some best practices in portfolio-company due diligence, some risks they help to avoid, and some benefits of getting it right the first time.

### Good Due Diligence Matters

This statement is obvious, but it bears repeating. It's important to ensure the due diligence conducted is as robust as possible. Revenue and valuation projections are good, but if the underpinnings of those projections are not examined, the company could bog down resources and drag down the entire portfolio.

We recommend looking at a portfolio company in the context of as many spheres of concern as possible.



There are a number of items to consider in each sphere.

## Internal

We recently wrote a paper discussing the importance of operational due diligence at the fund manager level. Many of those same tenets are equally applicable when a deal team evaluates a potential deal. To provide parallel perspective, we'll highlight some key areas using the same breakdown: people, process, and business.

**People**

- Identify key persons and develop/foster ways to keep them
- Find talent gaps and methods to attract top talent
- Ensure that culture fosters creativity and a team environment

**Process**

- Ensure proper levels of process documentation
- Regularly evaluate opportunities for efficiencies
- Examine where technologies can be better leveraged

**Business**

- Know the marketing and sales distribution channels
- Understand the core mission and vision
- Conduct a comprehensive financial analysis

As the checklist by which portfolio companies are evaluated grows, it's also important to bear in mind ESG factors – Environmental, Social, and Governance.

- Environmental – Impact on climate, production of hazardous waste
- Social – Diversity, human rights
- Governance – Management controls, employee relations

While ESG factors have gained more traction overseas than in the United States, their impact on domestic portfolio company value and investor decision-making has trended upward. A recent Harvard Law study focusing on application of ESG principles in Canada – specifically focusing on governance structures – saw increases in excess of 20 percent in use of clear policies such as Board voting and executive compensation among over 40 percent of S&P-traded firms. When planning to monitor a company and adjust or develop its core values, ESG factors should be clearly outlined.

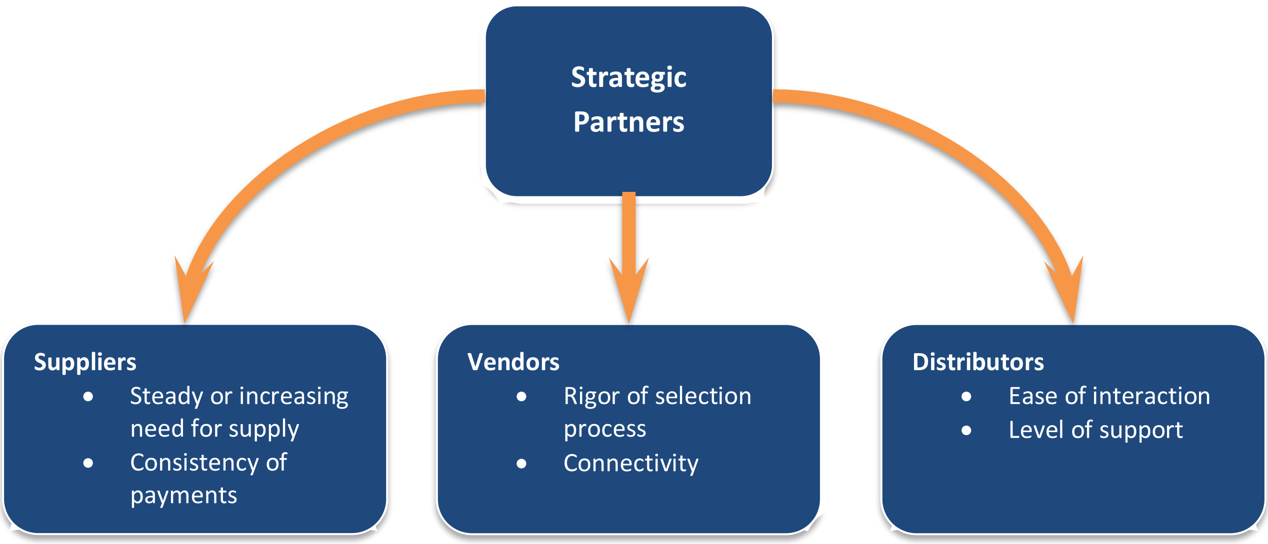
## Competitive

Properly assessing the competitive landscape can be difficult. Industries overlap, and competition is unlikely to reveal its "secret sauce." That being said, we strongly recommend conducting secondary research and, if possible, first person interviews with competitors to truly understand the market's landscape. There are a number of questions to consider here:

- **Is the company identifying with the right market?** A possible scenario here is that a Fintech firm is identifying itself more with the financial services industry when, in reality, its real competition is in software.
- **Are competitors *really* competitors?** Acting as or engaging a third-party perspective is helpful here. The company could be viewing other entities as competitors who are actually potential strategic partners.
- **Where do competitors stand?** Here it is important to evaluate the competition's progress on a number of levels – Product Development, Market Development and Penetration, and Talent Acquisition to name a few.

## Partner and Channel

Assessment of strategic partners – including but not limited to suppliers, vendors, and distribution channels – provides helpful insight. First, it gives a picture of market development and, perhaps more importantly, the *quality* of relationships a company has cultivated. Some variables to consider are highlighted below.




Second, in talking with partners, fund managers get the added benefit of multiple entities' views of the potential portfolio company. For example, if a software company's middleware provider or data storage vendor identifies significant issues with systems talking to each other, deal teams may want to reassess the deal's valuation or viability.

## Customer

Fund managers should spend additional time to evaluate the real driver of company value: the customers! While the engagement of an independent third party can prove most useful, particularly in conducting primary research, hiring a consulting firm to conduct interviews or surveys at the customer level lends additional validity to the manager and objectivity when using customer insights to evaluate a potential deal. Some variables to consider, both in primary and secondary research, include:

| | |
|---|---|
| **Demographics (B2C)** | Age ranges |
| | Income levels |
| | Marital status |
| | Household sizes |
| **Psychographics (B2C)** | Typical activities (e.g., sports, arts) |
| | Purchasing behaviors (e.g., location, frequency) |
| | Product/service types purchased |
| **Markets (B2B)** | Number of employees |
| | Industry sector(s) |
| | Geographic footprints |
| | Operating models (e.g., level of technology reliance) |

## Conclusion

Failure to conduct robust due diligence of a potential deal can carry significant consequences for a fund manager and its investors. Current trends indicate an increase in the number of variables to be considered, but they carry with them the added benefit of more robust deal valuations and the potential of increased returns. It's important in the due diligence process, though, to engage the right parties to conduct due diligence in an objective and efficient manner.

In Part 2 of this series, we move beyond the transaction itself to the "during" phase of a fund manager's relationship with a company. Once a deal is closed, we examine how managers should monitor their portfolio companies and plan – for the first 100 days and then beyond – to foster improvements and growth. Look for **Driving Portfolio Company Value Part 2: Planning and Monitoring**.

## About SteelBridge

SteelBridge is an independent boutique fund advisory service provider offering customized services and solutions to the global private capital industry. We were founded on the principle that we can affect “smart” change within our clients’ organizations. Our people are industry experts, with a common passion to facilitate change and improve performance for private capital firms.

To learn more, call us at 646.737.7960 x1001, visit us at www.steelbridgeconsulting.com, or join us on our Facebook and LinkedIn pages for more information:

***Let us show you why we are the leading boutique advisory services firm in the private capital space.***

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