How Private Equity Deal Teams can underwrite Management

What can be done in diligence and post close to align Human Capital Strategy to Value Creation Playbook execution? Deal Teams need to broaden their trusted advisors group during the diligence process. This can be the earlier integration of Operating Partners and use of trusted advisors and technology and analytics to have an edge.

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We are operating in a PE deal and value creation environment where two long held views that have been long discussed and analyzed are now crushing up against each other. One, is the view that time kills all deals. The IOI to LOI to lock up period to close should be a short as possible. Second is that misaligned leadership to the value creation plan execution probably is the reason that success is not achieved post close. Like many diligence processes, it can be strengthened via a rapid dive into data to validate the executive team composition and alignment . Senior executive experience alone will not be the complete predictor is management can drive value. While a radical step (or deal delay event) at diligence or lock up, it sounds logical to dive deep into Human Capital as a value driver to explore. Regrettably it tends not to happen based

on the desire to keep the deal process short and focus on close with the stakeholders. That same desire for speed and agility to outcomes is not executed upon by deal teams and executives to speed to the Value Creation Plan (VCP). Time may kill deals but lack of action on the post close contribution of Human Capital to value creation is a very evident marker of value creation leakage.

Are there actually options in place to better underwrite management? Is there a broader PE Human Capital Strategy that needs to be constantly fed and developed independent of a "deal requirement"? How can the use of objective data be introduced into a diligence or assessment process (and when in the deal time line) in order for the PE Firm's Deal Team to know the knowable faster and make changes earlier in the ownership life cycle. Ultimately the Deal Team must own the VCP and the need to have that leadership team in place executing earlier is the best predictor of a high return on the investment.

Having all the key CXO roles in place and with a clear validated understanding if this team can execute is critical. The evolution of leadership team dynamics can be tested and can be retested on a cadence to ensure the leadership development is on track. The use of such analytics should be fully considered by Private Equity versus the choice of not knowing this key indicator of success. The organizational maturity and tracking its development is critical. Teams need to be a functional transparent communicating force that drives alignment to strategic clear priorities. This will change a culture. Leadership always needs to ensure they are driving the change and that the culture is evolving.

In the absence of longer LOI to close the deal teams will be the closest to the management team for the longest period of the transaction. Could a deal team leader be leveraged with tools and resources to underwrite human capital better until close?

The underwriting process should have two goals.

1. The Human Capital Strategy that folds into the VCP needs to be done and actioned within 30-40 days of deal close.

2. Core areas that could be prioritized in diligence to accelerate the value creation plan:

    - The PE Deal Team would have a stronger post close first meeting and pivot to 100 day plan if more was known per the skills and upside of the functional capabilities. If this is growth thesis; is the Commercial Leader using RevOps? What alignment does Commercial have with Financial and Operations? How well does that executive team work together? Could we develop a pre-close measure of cohesiveness of the current

executive team? Who were part of recent executive departures and what risks exist from those moves in year one of ownership?

- Have key hires for success been identified and what steps have been taken to fully assess the hard and culture communication skills that would go with the position?

- What is the executive team motivations and alignment to the PE firm look like? Could red flags be identified earlier in the hold to bring resources, analytics and paths of remediation earlier in the hold.

Building a team that will be on the project through close needs to remain consistent. That needs to include the Deal Team Leader and the Associates. The addition of an Operating Resource/Partner or Industry Executive depending on the PE Fund's programs, model and approach to executive evaluation and development should be included.

The first management meeting should be organized to uncover the CXOs tenure, backgrounds, and functional area experience (Sales, Marketing, Engineering, Operations, etc.). Can the team see the executive group executing the VCP with KPIs. This is a new approach to management measurement and evaluation, and some will do well , others will need coaching, and others will not make it. This visioning of the team should be discussed by deal teams and trusted advisors. In visioning the team, the Deal Team needs to answer after one or perhaps two management teams interactions if there is a mission critical role to the VCP and thesis that is not in place with the executive team currently.

Some other probing and process areas to be considered in management meeting preparation:

- How long has the team been together as a unit?
- Is it a Sales Culture, is it an Engineering Culture, is it micro managed through a very centralized model of an all-powerful CEO ?
- How do the management team members define culture?
- How concise does the management team explain the reason for being in the market place they are in?
- Do the numbers as presented provide indications of how they manage growth, costs, low grow periods, executive changes, loss of largest customers, etc.
- Can you vision the CFO building a 13-week cash flow, could they use the data in the data room to structure a month end package at a PE standard within 2-3 months and would there be comfort in having the CFO lead an audit?

- Is there consistency across all executive members in how the value proposition of the firm is articulated?

Two actions to come out of the first management meeting should be;

1. Ensuring the sellers and sellers advisors will allow 1 to 2 more meetings with specific areas of focus so greater depth and answers can evolve and be clearly known and articulated.

2. Write the job descriptions of the core CXO functions and any other mission critical roles needed and how does the team measure against the description of the needs to execute a VCP.

Ultimately this will provide an underwriting of post close costs and actions for the first 30-40 days post close. Can after 2-3 management meetings provide comfort, clarity for action or not. Are the core questions fully answered and can the dynamic of the culture be exposed to understand the estimated costs of CXO replacement(s) and other key hires more fully. This number should be built fully considering the needs or executive recruiting fees, severance, onboarding costs and potential impact to the VCP measurement milestones for each quarter the full team is not in place.

Deal teams and advisors can underwrite management and accessing actional data insights for measuring value should be a fund priority.

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