PRIVATE EQUITY

Knowing the next move.

1	DEMYSTIFY	2	NAVIGATE
3	ACCELERATE	4	REALISE

BDO

BDO – DEMYSTIFY

Private Equity investment enables entrepreneurial businesses to expand at speed, and clears the way for skilled and ambitious people to step up a gear. If managed in the right way, Private Equity can be an exceptionally positive route to growth.

Using Private Equity should be a positive and exhilarating experience, especially for those doing it for the first time. It can help growth orientated businesses and their leaders professionalise, grow and achieve transformation in their business. In fact, taking on Private Equity can help an entrepreneur become more entrepreneurial.

Private Equity houses are often tarnished by the headlines of a rogue few, making it difficult for some business owners to distinguish fact from fiction. However, there are very few real predators out there looking for an opportunity to take advantage.

We believe there is a more balanced truth for those with a clear purpose, an ambition to embark on the next phase of growth and the stamina for this transformational change over a relatively short period of time.

Deciding that Private Equity is the right choice and finding the right partner for our clients is very important to BDO. Our knowledge and understanding of this market is deep-rooted in the heritage of our business.

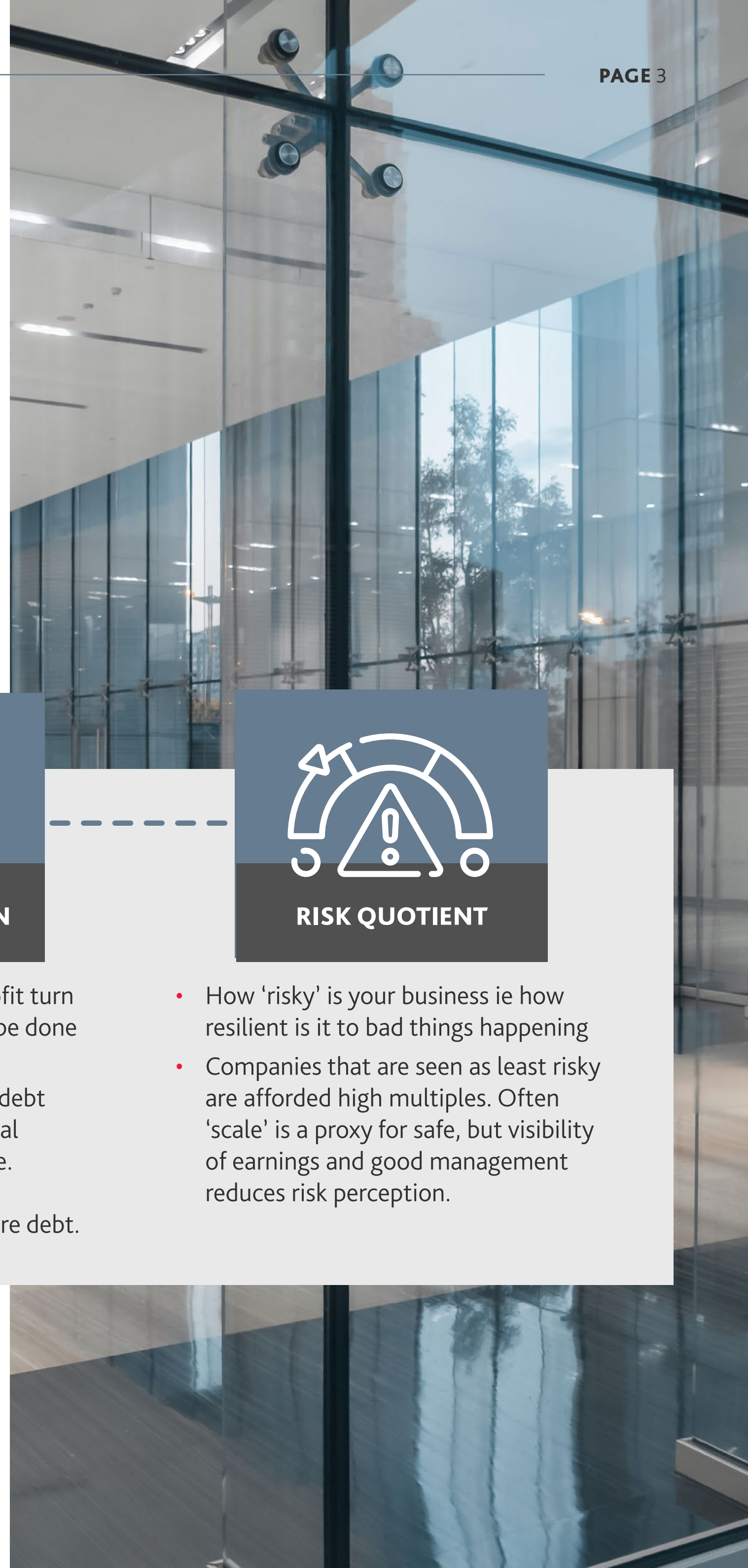
Through our relationships with and understanding of Private Equity, we help business owners assess the opportunity, avoid conflict and find the right solution for maximum effect.

As the home of the entrepreneur, we are founded on helping entrepreneurially-spirited clients along the whole life journey of their businesses and often, a part of that is spent in the Private Equity world.

Starting with the demystify phase, we help to dispel the misconceptions and broaden knowledge of how Private Equity works so that decisions can be made on an informed basis. We bring people together from across our business and networks to help our clients achieve their long term goals beyond their immediate Private Equity ambitions.

A BASIC VALUATION MODEL

Private Equity houses look to drive growth in value, therefore, it is useful to have a basic valuation model in mind. The one that we use looks at value through four lenses: Revenue Growth, Margin, Cash Conversion and Risk Quotient.



Rationalising this, businesses that grow the fastest, that turn their efforts into profits the most readily, where the quality of those profits are the highest (ie profits readily turn into cash) and where the risks are the lowest, will be valued the most highly. So, when thinking about taking on Private Equity, it is worthwhile looking at your business through these four lenses:

REVENUE GROWTH

- How fast has your business grown and how fast could it grow in the future
- Empirically, companies with the highest growth, or with the expectation of the highest growth attract the highest valuations.

MARGIN

- How much effort (cost) do you need to make to turn your revenues into profit and what could be done to improve that
- Similarly, but not so visibly, companies with high margins are more highly valued by investors.

CASH CONVERSION

- How readily does your profit turn into cash and what could be done to enhance that
- Private Equity houses use debt to reduce the cost of capital and help drive equity value. Companies with high cash conversion can service more debt.

RISK QUOTIENT

- How ‘risky’ is your business ie how resilient is it to bad things happening
- Companies that are seen as least risky are afforded high multiples. Often ‘scale’ is a proxy for safe, but visibility of earnings and good management reduces risk perception.

IF YOU COMBINE ALL THESE TOGETHER, YOU REACH THE HIGHEST VALUATIONS.

Companies such as Google and Apple follow the basic valuation model and as a result they’re still fast growing. When contemplating private equity, think about how you can demonstrate your prowess in these four areas.

PRIVATE EQUITY

In our experience, there are four areas which should be focused on in order to drive value and maximise your value. Some considerations in each of these areas are set out as follows:

REVENUE GROWTH

- Volume
- Pricing
- Sales mix
- Maximising brand and IP
- Business development practices and team
- Use of social media and online presence
- Leadership in a growing market.

MARGIN

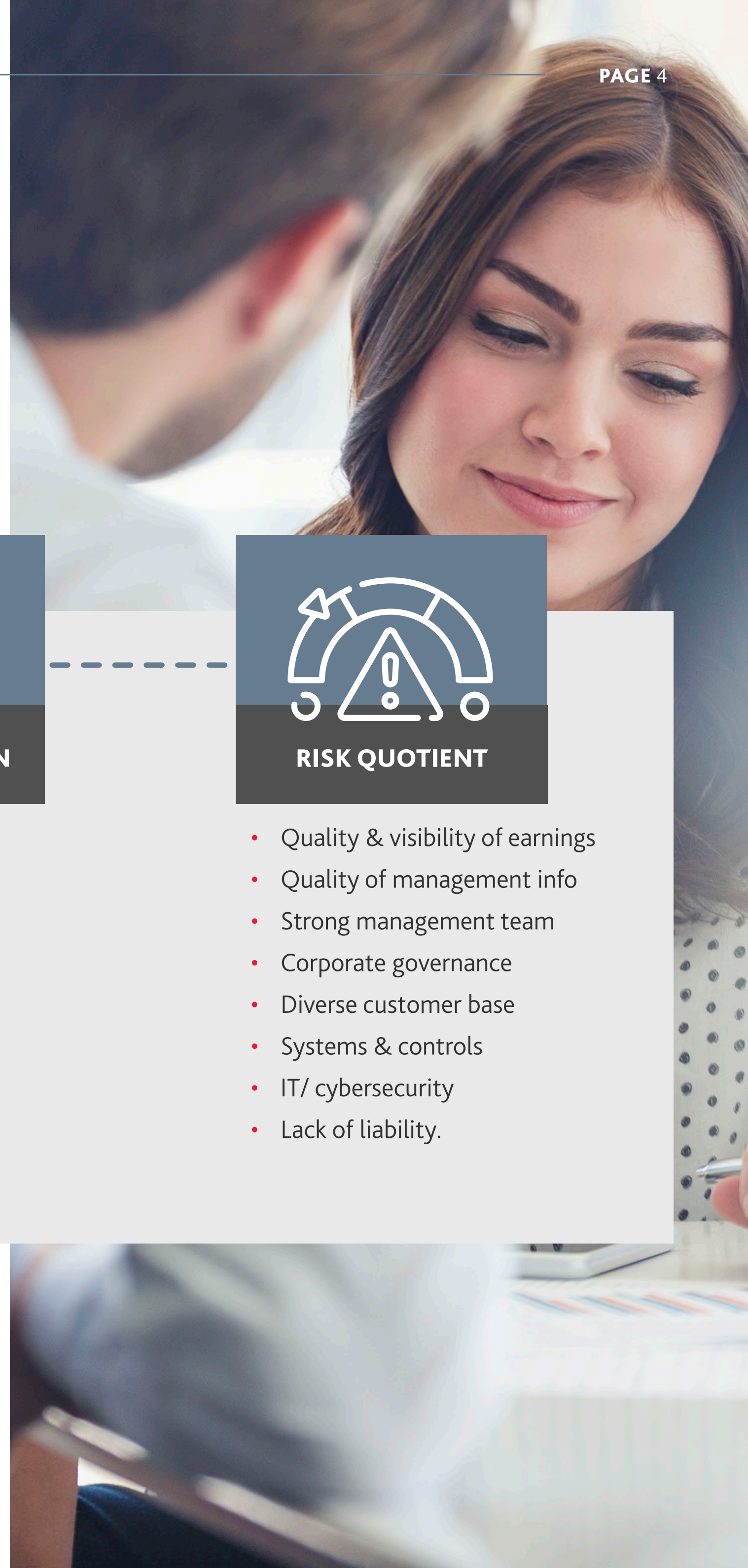
- Efficiency / productivity
- Scale
- Cost control.

CASH CONVERSION

- Working capital
- Capex
- Tax
- Financing.

RISK QUOTIENT

- Quality & visibility of earnings
- Quality of management info
- Strong management team
- Corporate governance
- Diverse customer base
- Systems & controls
- IT/ cybersecurity
- Lack of liability.



HOW PRIVATE EQUITY WORKS

PRIVATE EQUITY: THE ANATOMY OF A DEAL

Private Equity is the term used to describe a collective industry of specialised fund manager's that invest in acquiring equity stakes in potentially high-growth businesses, both control and non-control positions. These investment may take the form of a purchase of shares from an existing shareholder (a 'buy-out' if control is acquired) or an investment in new shares providing fresh capital to the investee company (development or growth capital). Often both types of funding are provided in a PE transaction.

At the same time that a private equity fund makes an investment in a private company there is usually some bank debt or other debt capital raised to meet part of the capital required to fund the investment. As time progresses and the business and EBITDA grows, bank debt is paid off or amortised and enterprise value increases, driving value into the ordinary shares, provided that the value growth outstrips the cost of debt.

The ultimate goal of Private Equity is to drive transformational growth during a relatively short period (typically 3-5 years) resulting in significant returns. To put a number on it, the normal Private Equity rule of thumb metric is 'double your money in 3 years', although that metric is under pressure in current markets.

AGENDA ALIGNMENT

Most entrepreneurial management teams are well aware of the importance of agenda alignment amongst the leaders of the business. This comes into sharp focus when a Private Equity investor joins the board. The investor's agenda is likely to be simply to drive value. Altruistic objectives of management may not be shared by investors, although there is considerable growth in impact investing.

Real success in a relationship with Private Equity comes where there is significant alignment, and non-aligned factors can be clearly de-prioritised.

In our experience it's important to have absolute clarity about your own objectives and those of your team.

QUESTIONS YOU MIGHT FIND USEFUL TO POSE INCLUDE:

- What is your definition of success for yourself over the medium & long term?
- What is your business plan to achieve this?
- How much investment do you require to fund your business plan?
- What alternatives are there?
- What are your 'non-negotiables'? ie the terms you would never sign up to
- How could you accelerate your plans and grow your business faster?

We typically help business owners to identify and prioritise their objectives and understand how they can be aligned with those of the Private Equity investor.

WHERE WE CAN HELP

We bring value in two areas. Firstly, we have a vast wealth of experience for our clients considering Private Equity. Secondly, we care that our clients have a positive experience with Private Equity. In our experience:

- Most scenarios can be modelled
- Most legal constructions have been seen before
- Most tax issues and structures have been encountered elsewhere already
- Most behaviours can be predicted.

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