



PRIVATE EQUITY **PERSPECTIVES** PODCAST

EPISODE 13: DIGITAL TRANSFORMATION CREATING VALUE FOR PRIVATE EQUITY

INSIGHTS FROM THE BDO PRIVATE EQUITY PRACTICE

INTRODUCTION

Todd: Hello, and welcome to another episode of BDO's Private Equity Perspectives podcast. I'm Todd Kinney, National Relationship Director with our Private Equity Practice based in New York City. I'm thrilled to have two special guests here with me today to talk about digital transformation in the private equity space. First, we have Amir Akhavan joining us from JEGI, where he is a managing director advising tech, interactive data, and marketing services companies in M&A, divestitures, recaps, and capital raises. Gosh, you're a busy guy, Amir. Thanks for joining us.

Amir: Thank you.

Todd: Next, I'd like to welcome Grant Marcks, who's a principal and head of business development at Atlantic Street Capital. At Atlantic Street, Grant focuses on transaction sourcing for new platforms and add-ons, as well as the firm's various deal source partners. Grant, thanks for joining us.

Grant: Yes.

INTRODUCTORY QUESTIONS

Todd: Excellent. Amir, why don't we have you kick things off by telling us a little bit about JEGI and your role there?

Amir: Sure. Great. Thank you, Todd. Amir Akhavan here. I'm a partner at JEGI. We're a 32-year-old investment bank focusing on marketing services, information, media, and software. We're 60 professionals on the platform across four offices; New York, London, Boston, and Sydney. And I've been part of 15 years of that journey.

TOPICS DISCUSSED INCLUDE:

[Introduction](#)

[Introductory Questions](#)

[Tech Outlook](#)

[Valuing Digital Potential](#)

[Coffee Break with
Kirstie Tiernan of BDO's
Data Analytics &
Automation Practice](#)

[Digital Transformation
Driving Deals](#)

[Artificial Intelligence](#)

[Overcoming Digital
Challenges](#)

Todd: Awesome. Grant, perhaps you could tell our listeners a bit about Atlantic Street and your role there.

Grant: Sure. Thank you. Atlantic Street is a lower middle market private equity firm that has been focused exclusively on partnering with the family and entrepreneurial community across the US and in Canada for the last 13 years. And where we really differentiate ourselves is we feel like we bring great operational value to our portfolio company partners and really act as a service provider to our various investments. And importantly, one of the things that we offer to our portfolio is a network of operating advisors that are dedicated to helping support critical back-office functions. And obviously, one of those being data analytics, business intelligence, and general support, so relevant to what we're going to talk about.

Todd: Absolutely. All right. Well, let's jump into our first topic. Amir, as I mentioned at JEGI, it's a media- and information-focused firm. Perhaps you could give us some insights on what are the most exciting trends you're seeing right now in digital?

Amir: Yeah, one of the cool things we're seeing in digital as it applies to private equity investing is the recurring nature of the relationships that are being established between kind of vendors and customers. Whereas you're seeing companies who used to just do implementation services of digital and software technology and then walk away, now you're seeing them do the implementation and you kind of do the management of those processes, the constant upgrading of those, and then pushing into other things like customer data management because there's so much data coming off of a digital experience, or doing UX and UI building. It's just a much more dynamic relationship. And opportunities for private equity firms to come in and establish a beachhead with a company that does one type of digital service and then add on a series of more recurring relationships.

Todd: Very interesting. Agree with that. Curious really to get both of your insights regarding what are some of the greatest challenges and, really, opportunities for technology as it pertains to the PE sector this year. Grant, maybe you could kick things off and then I'll throw it over to Amir to chime in with his thoughts.

Grant: Yeah, I'll take the low-hanging fruit which is, the biggest challenge in this world is really surrounding valuation and valuation expectations continuing to creep up in the category as things move from less transactional, as Amir was describing, to more recurring-based services and people really paying a premium for business models. And anything that has SaaS or ARR attached to it immediately gets a ton of private equity attention. Valuation is obviously driven by capital overhang from private equity firms and bigger firms coming down market and record corporate profits driving strategic acquisitions. But I think where, specifically in the lower middle market, we play less relevant to

kind of pure data analytics companies and technologies that are really hard for private equity firms to catch in the evolution from more venture-oriented investing through to where they just scale to a point where it no longer makes sense for a lot of private equity firms. But where there's opportunity to invest is businesses that have a great market position, a real franchise value, but are under-invested in their technology and where we can leverage technology to better improve basic back-office functions.

TECH OUTLOOK

Todd: Sure. Amir, care to add your thoughts?

Amir: Yeah. One of the things that we spend a lot of time with the private equity community talking about is kind of how do you play the technology trend? Whether it's the point solution route, an enterprise play, a verticalized solution. And what we're really seeing as an opportunity is firms that have a verticalized point of view in the marketplace and then going out and either putting together certain solutions within that vertical or buying something bigger and then building organically. So, for example, we're talking to firms around not-for-profit software or an auto-vertical or a manufacturing workflow or retail content platforms as a service where you are managing the entire workflow between manufacturers and retailers. There's just really interesting verticalizations occurring where it's a more effective way to play the software game and also has kind of a TAM [total addressable market] that you can get your hands around and then build on.

VALUING DIGITAL POTENTIAL

Todd: Great. Let's transition into really kind of valuing digital potential. And for that, I think we're basically saying the bottom line and top-line growth that can be achieved through digitization and digitalization strategies. So there's an interesting stat from BDO's recent PE survey that 57 percent of PE firms say digital potential is very important to their investment decisions. Grant, I'll throw this one to you. Would you agree that long-term digital potential is increasingly important as part of your firm's decisions?

Grant: I mean, the answer to this is definitely yes. It varies pretty widely by industry vertical and category that a firm generally is investing in. But I don't think any business into the future is going to be immune from the impact of general digitization and the globalization of the economy. So yeah, it's definitely a meaningful part of our committee process to understand the digital strategy of a business, the operational improvement opportunity that we can bring beyond what's already been done at the company. I think where there's potential to make mistakes though is actually an overvaluing digital potential into the future. And so one of the biggest questions that we ask, and we never take for granted in our

investment committee is, we almost take a look-back approach where we say, when it comes time for us to exit in three to five years down the line, will this company have a longer-term story to be able to tell about how it's going to thrive with respect to its digital strategy into the future? How will technology transform the profit pool of this business over the long term? And how can we kind of basically work our way backwards to take the steps today that's going to position the business for eventually that future and our exit?

Todd: All right. Appreciate the insight. I think we've touched on a lot of good things, but right now I'd like to switch gears momentarily for the coffee break session of this podcast and introduce Kirstie Tiernan who is a Managing Director in BDO's Data Analytics and Automation Practice. Let's hear her insights.

COFFEE BREAK WITH KIRSTIE TIERNAN OF BDO'S DATA ANALYTICS & AUTOMATION PRACTICE

Kirstie: Thanks, Todd. When it comes to implementing digital initiatives that can really ultimately lead to digital transformation in this space, opportunity is really where the friction is. And when making acquisitions, private equity firms really need to do what we call their digital due diligence. And there will be questions around whether to integrate those companies' technologies or to keep them separate. And you really need to review what they have digitally, not just the technology and the software. Addressing questions like, "What data do they have that we can monetize?" Or, "What systems do they have that will need to be integrated? What systems can you maybe get to talk to existing systems without doing an integration?" Maybe an integration really isn't necessary if you have the automation in place that can then move the data from one system to another very quickly.

For example, let's say you just purchased a firm that has maybe 10 accounts payable clerks who are pulling invoices from emails. They then key them into the system and then they push them out to the proper people for approval. What you could be doing instead is using bots to monitor that email inbox for those invoices coming through and then using machine learning algorithms and optical character recognition, or OCR, to extract the data from those invoices and automatically instead push it to the right people for approvals. There are a ton of accounts payable systems that do that, but if you have a simple bot and machine learning algorithm that's custom to your situation that can automate this process, you may not need to integrate an entire AP system. So we've developed a lot of algorithms that some of our PE firms are using almost as a service. Rather than the private equity firm having to build an algorithm in-house from scratch or develop and implement some large software tool, they ask us to build and

deploy an algorithm that they can then subscribe to on a monthly basis. And that really results in taking some of that boring work off the shoulders of employees and freeing them up to do more meaningful tasks.

And this raises another issue, one that's on the minds of a lot of employees when they hear their company is going digital. People are fearful of what that means. Are their jobs at stake? Are their jobs going to change? And as you start thinking about automation, rather than inviting employees to the table and saying, "Okay. Explain your job to me. We want to automate it," we really want to frame it as an opportunity to upskill and grow them. So, instead, consider positioning the shift differently and saying, "We really want to give you the opportunity to do something that lines up with your career goals and your interests. And here's the training we're going to give you to do that. And, oh, by the way, to help you move to that level, we're going to automate this process that you used to do." So coming to them with training opportunities and what's really going to replace that manual work, that's a key part of upskilling employees to get to the adoption of digital technologies like this. And now these employees can learn to do what they now need to do, which is maybe reviewing exceptions, doing research, or just monitoring the bot that's doing the keying for them.

A very simple example, we recently had a client that had 10 people on their tax team who were working really late nights and weekends. And the tax director came to us and said his goal was to get them home more quickly so they could have dinner with their families. No more weekend work. No more being there until 7 p.m. And one of the tasks that we helped automate for them was a regular updated PowerPoint deck that they would create for the CFO monthly. Automating the creation of that deck reduced errors and allowed the employees to focus on doing tasks that were more value add.

So those are just two considerations for the digital transformation of private equity. Of course, digital transformation is way more than just the adoption of new technologies. It's a tactic employed, ideally, within the infrastructure of a longer-term strategy. In isolation, a digital product should deliver immediate ROI—you really want those quick hits to be able to prove the value—but achieving that transformation that we're talking about requires a shift in mindset that really hinges on the adoption of those digital capabilities by the end users, which are the employees and the customers.

Todd: Thanks for sharing, Kirstie. Really appreciate it. And now, let's jump back to our conversation with Grant and Amir.

DIGITAL TRANSFORMATION DRIVING DEALS

Todd: So, Kirstie has shared some of her insights on digital transformation creating value in private equity. I'd like to hear both of your perspectives on the topic. Are you seeing more companies seeking deals and partnerships in order to secure the operational efficiencies and capital needed for digital transformation? I'll throw it to Amir first this time and then we'll go to Grant.

Amir: I think we see a tremendous amount of opportunity for private equity firms to invest in solutions and software that help drive digital transformation. We're working, for example, with one company right now. They're a data-driven B2B company that helps software and technology companies ultimately do customer acquisition better and transform the way they go to market around their digital channels, both from an account-based marketing standpoint and from an omnichannel standpoint. And when you look at them, they started as just a B2B data company. They then added a customer data platform, because they needed to bring in all the various sources of unstructured data that their clients were touching, make sense of it, do some hygiene work off of it, de-dupe it against the CRM to make sure that they understood who were their customers that they can actually go out and acquire on behalf of their sales team. So that's a great example of point solution going one step further in the digital value chain and creating more products and solutions to more effectively help their end customers, and private equity is driving a lot of that kind of thinking as these companies get bigger and then ultimately end up at some of the larger technology and digital transformation companies out there.

Todd: Interesting. Grant, as the as PE guy on the podcast, what do you think?

Grant: It's funny. Amir took a lot of the things that I was going to talk about us doing in our portfolio companies right out of my mouth. But given where we play, lower end of the middle market and family entrepreneur-focused, it's really common for us to find partnership opportunities with that community that obviously, a part of their goal is liquidity. But a big part of it also is wanting to better understand how to grow their business and how to leverage their data in order to do it. And it's just categorically a space where they may not have been comfortable investing in the past or adding resources to invest in the past. And so, by way of example, we've worked with entrepreneurs on the exact same basis that Amir was describing, where we will take a set of unstructured data that they've been capturing but not kind of realizing. We'll help them clean it, we'll help them create a structure around it and a path to monetizing it and add business intelligence tools around it, all of which is to help create leverage for that business owner and allow the management teams and the employees to focus on the work that they should be focused on, which is

building a differentiated product or service, creating real franchise value, and selling to more customers, and selling more to their existing customers.

ARTIFICIAL INTELLIGENCE

Todd: Makes a lot of sense. So, I'm sure most of our listeners tuned in hoping to hear something about our perspectives on artificial intelligence, so why don't we jump into that topic? A report by Intertrust says that over 90 percent of PE firms think that by 2024, AI will really disrupt the industry. For both of you, and we'll go to Amir first, does that statistic on AI technology surprise you at all?

Amir: I think because it's so topical, I'm not surprised to hear that. My question really is are folks really understanding what AI is today and what the opportunity is? There's machine learning, which is all about automating processes that humans do, and creating more efficiencies in a process, and that's absolutely coming—it's really ready for primetime now. We're seeing business models accelerate because of that. Whether it's you're walking into a McDonald's and you're interacting with a screen instead of a person and their ability to kind of show you the right offers—and that's really machine intelligence. True AI, where you're actually not having to train a system to make decisions and those decisions happen in different forms based on prior behavior, that's really, really hard to do and its early days. And the biggest tech companies, frankly, haven't figured it out, so we think it's coming, but the question is kind of what is the ultimate impact, and how is it going to be applied? And the fact that you still need human intelligence to drive a lot of the training that occurs, we think it's going to be hybrid for the next five years and then some real transformation from then on.

Todd: Grant?

Grant: That's definitely right. I mean, so we own a bunch of retail businesses, but that's probably the most relevant setting, and it's not true AI. To your point, Amir, it is kind of machine-learning-oriented, but there's a real problem in broad retail, from QSR to bank retail to fitness to you name the category, where it's high-turnover workforce, conflated by low unemployment levels, and increasing minimum wage, and just a prevalence of alternatives creating, in some cases, 150 percent churn of employee basis. And the thing that does to our businesses is there's a cost of training, there's a cost of hiring, there's a cost associated with it, and these are businesses in retail that already are typically operating at the margins. So, I think that's probably going to be one of the first sectors that starts to see evolution into machine-oriented learning through digital signage products that displace cashiers or people.

OVERCOMING DIGITAL CHALLENGES

Todd: All right, guys. Well, appreciate that. Both very interesting perspectives on AI. For our last topic, Grant, I'm going to throw this one to you. We'd like to talk about overcoming digital challenges. According to BDO's Middle Market Digital Transformation Survey, in 2019, lack of skills or insufficient training is a top barrier to digital adoption. So, from your perspective, do you think this is an issue in private equity, and if so, how can it be overcome?

Grant: Yeah. I think about it in two contexts. The first is how we look to overcome it at our portfolio companies, and then the second is how we look to ourselves and how we try to overcome it, as an investor, and how we evolve our own model. I think the best way to do it in both contexts is to obviously provide thorough training upfront, but I think the piece that's often overlooked is you have to create incentives that encourage technology adoption. And I think the best way to do that is to set operational benchmarks you measure, you report against, but probably, more

importantly, it's to tie compensation in some way, shape, or form to utilizing and leveraging technology. And strategies like that are really going to be a way to grow this in importance over time.

Todd: Great. Well, I appreciate the insight, boys. We are at the end of another exciting podcast. So, Amir, with JEGI, Grant with Atlantic Street Capital, BDO appreciates our relationships with both of you and your firms, so thank you much for joining us today. I know our listeners are going to enjoy hearing all your insights. Appreciate you guys being here.

Amir: Thanks.

Grant: Thank you.

Todd: To our listeners, thanks so much for tuning in. If you haven't already, we'd love for you to subscribe, rate, and leave a review of the show on iTunes. Until next time, this is BDO's Private Equity PERSpectives.

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