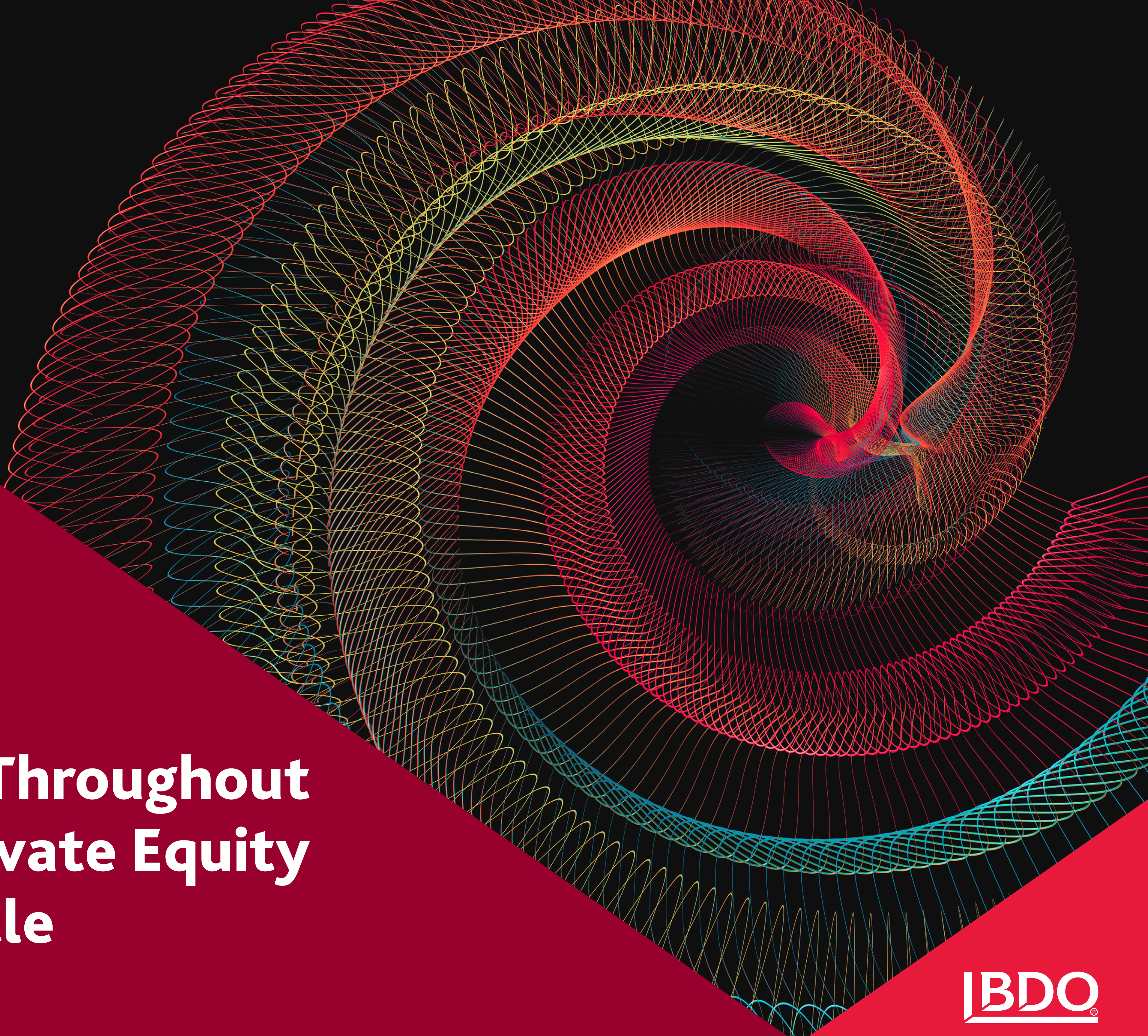


Value Throughout the Private Equity Lifecycle

BDO

Contents

Introduction

For much of the last decade, private equity enjoyed the fruits of a low-cost capital environment and buoyant equity markets, which culminated in a record-setting 2021. Following [BDO's 2023 Private Capital Survey](), fund managers adjusted to the new economic reality that set in in 2022, deprioritizing new deals in favor of triaging their portfolio companies. Yet, there is still much dry powder left to deploy and funds will be under pressure from their limited partners (LPs) to deploy that capital, particularly once economic conditions stabilize as many expect them to in 2024.

This e-book examines how to approach and maximize deal value at each stage of the acquisition lifecycle. Chapter 1 addresses the deal, Chapter 2 the holding period, and Chapter 3 the exit strategy.

COMPREHENSIVE VALUE ENHANCEMENT

INVESTMENT LIFECYCLE

PRE-PURCHASE	HOLDING PERIOD			VALUE REALIZATION
Mitigate transactional and transitional risk	Identify opportunities to profitably grow the top line, reduce expenses, improve capital management and mitigate risk to support sustainable improvements			Maximize return on Investment
Risk Mitigation & Synergy Assessment	Revenue Enhancement	Margin & Efficiency Improvement	Capital Efficiency and Risk Mitigation	Exit Readiness

Once interest rates and inflation stabilize, which seems likely, I expect private equity dealmaking to return in 2024. For now, fund managers will likely continue to focus on adding incremental scale to their portfolio companies through tuck-in deals to create value during elongated holding periods. Funds that can effectively execute deals in today's environment will be best positioned to return value to their LPs when exit markets improve.

PATRICK DONOGHUE
National Corporate Finance Practice Leader

Chapter One: Evolving the Deal

Private equity firms are looking to deploy their record amount of capital ("dry powder"), and competition for quality assets remains high. To win bids, private equity deal makers have been evolving their deal processes — from investing in their teams having deep industry knowledge to coordinating more closely with investment banks on potential deals that may come to market. Fund managers are finding new ways to get an edge on the competition — even as new competitors enter the market — and having a deep understanding of the issues and challenges unique to each transaction, among other factors, has proved critical for an acquisition's success.

With more economic uncertainty in the market, deals are happening on elongated timelines as buyers face less pressure to close the gap on price with sellers. This dynamic places greater emphasis on the due diligence team's ability to assess whether a target's risks are short-term and can be overcome or are more ingrained and present a long-term threat.

At the same time, they are facing more questions around what comprises a reasonable valuation. Fund managers that deploy robust due diligence processes will have an edge in valuing companies that can overcome this current period of economic volatility and be positioned for long-term success once conditions improve.

As the industry evolves, the need to have a due diligence process that evolves with it becomes more crucial. The results of the due diligence process lay the foundation for a sound value creation strategy and, ultimately, a successful and lucrative exit.

With increased pressure on the due diligence process, fund managers' pain points include:

- The need to sift through large amounts of data and pull out relevant and actionable insights
- Data that has been incorrectly managed or consolidated
- Disparate diligence streams that need to be reconciled and coordinated
- M&A processes that happen in a vacuum, resulting in post-integration inefficiencies
- Integration issues pertaining to technology, internal systems, and company culture
- Uncertainty as to whether valuations are correct

Does Your Due Diligence Process Reflect Market Demands?

The approach to due diligence and Quality of Earnings (QofE) analysis has changed on both the buy- and sell-side as deal makers look to transact amid dynamic market conditions.

BDO's due diligence approach evaluates a spectrum of inputs — from financial to insurance-related issues — and synthesizes them into a holistic view of a target's business and growth potential.

Our approach offers private equity funds:

- Deal advisors with extensive M&A experience, a technical understanding of due diligence, and an informed perspective on the deal
- The ability to identify hidden risks and opportunities through advanced data analytics
- A true value assessment of a target's potential
- Deal-related data that enables deal makers to make decisions with confidence
- Trained analytics teams who can put data into context

HOW IS DUE DILIGENCE CHANGING?

The due diligence process has undergone some significant changes in the past few years. After the global pandemic hit in 2020, due diligence timelines lengthened as buyers and sellers spent more time conducting it remotely. When deal making rebounded later that year and hit new records the following year, due diligence began to receive lighter treatment in favor of meeting sellers' desire to get a deal closed more quickly. As economic conditions deteriorated once more in the second half of 2022 and into 2023, due diligence periods extended as buyers and sellers negotiated their gap on price and financing terms. Firms adjusted their approach to due diligence in response to a variety of influences, including:

- Shifting leverage between buyers and sellers
- Economic, geopolitical, and market fluctuations
- Limited partner (LP) values or demands
- The amount of competition
- Internal resources available
- Access to and cost of capital

Due diligence is arguably the most critical component of the investment process. An effective due diligence process identifies risks and opportunities while creating a solid foundation for value creation during the holding period and through to exit. It encompasses not just the process of identifying targets but assessing risk adequately and mapping synergies. Truncating the due diligence process can result in the need to address unfinished diligence work post-close, which, in turn, comprises a risk within itself: Potentially leading to undiscovered risks that might have been uncovered and mitigated pre-close.

Private equity is heeding the risks found in deal due diligence processes: 34% of fund managers in BDO's 2023 Private Capital Survey cited risk exposure uncovered during due diligence as the number one challenge to closing deals.

DUE DILIGENCE SELF-ASSESSMENT

Whether working on an elongated or compressed timeline, making sure your due diligence process hits on key evaluators across the Financial & Tax, IT & Cyber, Human Capital & Workforce, and Operational spectrum can help mitigate post-close risks.

Ask Yourself These Questions:

Financial & Tax:

- [ ] Am I confident the data available to me is complete and supports my intended assessment?
- [ ] Do I have all the information needed to assess key performance indicators and risk, conduct my Quality of Earnings analysis, and identify strategic paths forward?

IT & Cyber:

- [ ] Do I have a clear picture of the value of the information assets, the level of cyber threat, and the vulnerability of the target company?
- [ ] How certain is the target company's compliance with industry cyber security risk management? Is the cyber liability insurance coverage adequate?

Human Capital & Workforce:

- [ ] Does the target company's business strategy align with employee compensation, benefits, culture, and behaviors?
- [ ] Has HR leadership identified and disclosed all business and human capital risks that could affect the strategy and integration plan?

Operational:

- [ ] Is there sufficient transparency to identify operational changes that may need to be made post-close, including investments, product changes, or actions that support value creation?
- [ ] Do I have all the information needed to evaluate the target company's global value chain strategy and risk exposure?

As an advisor on deals across industries and asset classes, BDO can bring new perspectives to the table, asking the "What Ifs" you may not be considering.

We can help:

- Validate the deal thesis within the context of specific deal parameters as well as macro factors, such as industry-specific influences and economic and market fluctuations
- Assess and validate the deal valuation
- Identify focus areas of due diligence based on the deal thesis
- Align and coordinate cross-functional teams to enhance the identification and execution of deal synergies
- Assess and address gaps and/or overlaps in scale vs. scope deals
- Quantify deal synergies and design a value creation plan
- Identify and remediate target companies' supply chain design vulnerabilities

Ready to reach out about our holistic due diligence approach?

CONTACT US NOW ▶

MERGER INTEGRATION & IMPLEMENTATION

An effective M&A process means that upon deal close, integration and implementation are essentially already underway. Private equity fund managers don't just hit the ground running on day 1 — they have been executing their strategy along a continuum that flows according to strategies identified during the due diligence process, capturing synergies and integrating operations, finance, culture, and technology along the way.

The integration and implementation process includes:

- Executing the business and value creation plans
- Meeting with management to track progress on and make adjustments to the business and value creation plan
- Implementing the human resources strategy and integrating employees and departments
- Capturing and tracking deal synergies
- Ensuring transparent reporting and documentation

This process is only as good as its plan, and plans are tailored to the deal's thesis and strategy — buy-and-build will be different from scale integration plans, for example. In a high-valuation environment, successful integrations are critical to achieving investor returns.

Integration is where the deal thesis begins to play out. Firms that have a rigorous post-close framework that outlines well-defined roles among deal players increase their chances of maximizing value. Fund managers' responsibilities should be delineated from those of the portfolio company's management team to facilitate quick decision making; one telltale sign of a failing integration plan is slow and laborious decision making.

BDO can help:

- Develop and execute integration strategy (people, process, systems, data)
- Assess and establish synergies and value creation tactics
- Optimize revenue
- Enhance the organizational structure
- Transform and improve processes and systems

IS YOUR M&A PROCESS WORKING FOR YOU? Learn more about our merger integration capabilities ▶

Chapter Two: Tackling Value Creation in the Holding Period

Private equity value creation tactics evolve as economies and industries progress. The end of the "era of cheap capital" has forced many funds to extend their holding periods. As a result, fund managers are even more focused on generating liquidity as they pursue topline growth and reduce costs. The traditional inputs that determined a value creation strategy have grown more numerous and complex — notably, private equity funds and the CFOs they rely on have reported severe staffing challenges, presenting a major hurdle to reaching the objectives of the deal thesis.

At the same time, private equity funds have record amounts of dry powder to deploy amid a sharply competitive deal landscape. Higher interest rates place even more pressure on their ability to achieve the returns that distinguish the private from the public markets, necessitating more creativity around value creation strategy and discipline in its execution.

In this second chapter of our e-book, we discuss best practices for **creating value during the holding period.**

COMPREHENSIVE VALUE ENHANCEMENT

INVESTMENT LIFECYCLE

PRE-PURCHASE

Mitigate transactional and transitional risk

- Risk Mitigation & Synergy Assessment

HOLDING PERIOD

Identify opportunities to profitably grow the top line, reduce expenses, improve capital management and mitigate risk to support sustainable improvements

- Revenue Enhancement
- Margin & Efficiency Improvement
- Capital Efficiency and Risk Mitigation

VALUE REALIZATION

Maximize return on Investment

- Exit Readiness

> *Value creation strategies have long been a key competitive differentiator for LPs looking for funds to invest in. As competition has grown more intense funds have been increasingly focused on deploying multi-pronged initiatives that uncover value from multiple sources. Not to be overlooked, one of the biggest challenges and opportunities to value creation today lies within human capital — not just attracting and retaining talent but strategically supporting management and key personnel.*

JIM CLAYTON
Private Equity Advisory Leader

GENERATING VALUE

After closing a deal, fund managers train their focus on implementing the value creation tactics they identified during the due diligence process, including:

HUMAN CAPITAL MANAGEMENT
Retaining and attracting talent, succession planning, and interim staffing

REVENUE OPTIMIZATION
Product and service competitive positioning and revenue growth strategy

OPERATIONAL IMPROVEMENTS
Growth in sales and gross margin

PROCESS AND SYSTEMS IMPROVEMENT
Automation and modernization of technology and data systems

CASH FLOW OPTIMIZATION
Reducing overhead costs and increasing capital efficiency

SHARED SERVICES
Creating shared services, including finance and accounting services, within the companies forming a new portfolio company.

STAKEHOLDER & MANAGEMENT REPORTING
Providing transparency into performance and strategy through analytics

CAPITAL STRUCTURING
Assessing the proper capital structure including restructuring and recapitalization as well as assessing valuation and IPO readiness

RISK MANAGEMENT
Identifying risks from cyber and data vulnerabilities to business continuity

There is no one-size-fits-all solution; each business added to the portfolio requires a custom-tailored suite of strategies that aims to facilitate a smooth transition and capture synergies. A strong start, however, can forecast a strong exit, so kicking off the 100-day plan on day 1 is pivotal.

Fund managers have their work cut out for them. As they grapple with longer holding periods and challenging uncertain financing, the formula they ultimately apply must include a holistic set of inputs that accounts for a growing number of operational, financial, economic, and industry influences. The successful implementation of value creation plans is key to achieving target returns, but the holding period is rife with challenges, including:

- Transition issues pertaining to technology and company culture
- Ineffective organizational structure and talent gaps
- Identifying and realizing cost synergies
- Gaps in plans/costs for transforming processes and systems
- Applying ESG criteria and reporting on ESG measures

Realizing the strategic vision for acquisitions requires a multi-pronged, comprehensive approach. For deals that close on an accelerated timeline, as mentioned in Chapter 1, there is additional urgency around ensuring a sound value creation strategy that considers risks that may not have been completely uncovered during due diligence.

VALUE CREATION'S ACCELERATED EVOLUTION

Forces are converging on private equity and compelling the industry to evolve. After emerging from the pandemic and the heady days of late 2021, private equity entered a new era. Funds and their portfolio companies are taking steps to revise their value creation strategies for today's economy.

Fund managers' approach to value creation has seen dramatic changes in the last few years. In some cases, deliberation has been replaced by action — fund managers who might have been patient with underperforming CFOs in a tight labor market quickly realized that their portfolio company CFOs needed a very specific set of skills and experience once economic conditions changed. The [2023 BDO Private Capital Survey] found that approximately three in five (60%) portfolio company CFOs started working in their current roles less than 10 years ago, meaning that most of them haven't held leadership positions in a high interest rate environment.

Talent management is a top tactic fund managers have been employing to generate value, according to our recent private capital surveys, and it's become increasingly important in a tight labor market. When capital was abundant and valuations rose alongside equity markets, fund managers could afford to nurture CFO talent or simply hire new talent. As the tight labor market collided with tough economic conditions, PE fund managers were left in a bind—with some CFO vacancies extending as long as nine months. More fund managers began taking steps to shore up their portfolio company talent with a creative mix of interim hiring, outsourcing, co-sourcing, and advanced hiring.

The quest for top talent colors the multidisciplinary approach that fund managers need to be taking toward value creation today.

Deep Industry Experience

More hands-on involvement holds true in general today. Though industry experience has long been a key quality LPs desire in their fund managers, it has emerged as a crucial differentiator in recent years, requiring fund managers to dive deeper into the sectors they target. A greater understanding of these industries translates into an ability to uncover synergies and efficiencies that those with a lesser understanding may not be able to identify.

Portfolio as Ecosystem

Fund managers are tailoring strategies to accomplish the goals of both the individual portfolio company and the portfolio as a whole. Traditionally, portfolio companies were treated as somewhat siloed investments, partly as a way to diversify risk. Today, however, fund managers are approaching the portfolio as a kind of ecosystem in which portfolio companies can mutually benefit from complementary products or services and other synergies. For example, funds containing multiple manufacturers that have overlapping purchasing requirements could potentially reduce the number of suppliers needed and thus increase supply chain efficiency.

Treating the portfolio as an ecosystem requires sophistication. It entails a complex and nuanced strategy that accounts for cross-portfolio synergies but simultaneously allows for the portfolio companies to function as standalone entities — after all, once these companies reach exit, they may not be able to exercise the same operational interdependencies they did while part of the fund. However, if these relationships can remain in place post-exit, they potentially increase exit value as the cost efficiencies and other benefits arising from these value creation strategies can continue.

PE funds and portfolio companies face a massive talent shortage:

47% of portfolio company CFOs and

49% of fund managers say they are understaffed in critical roles.

At the same time **20%** of PE funds identify talent management as a top value creation lever.

Source: 2023 BDO Private Capital Survey

How Varied Are Your Value Creation Levers?

Value creation strategy is a core differentiator for LPs considering where to commit their capital, and fund managers are keenly aware of the need for sophisticated and finely tuned strategies that maximize value.

As such, they are using more value creation tactics and combinations of these tactics to extract value from their investments and achieve their desired returns. According to our BDO Private Equity Pulse Surveys, some tactics that are growing in prominence include:

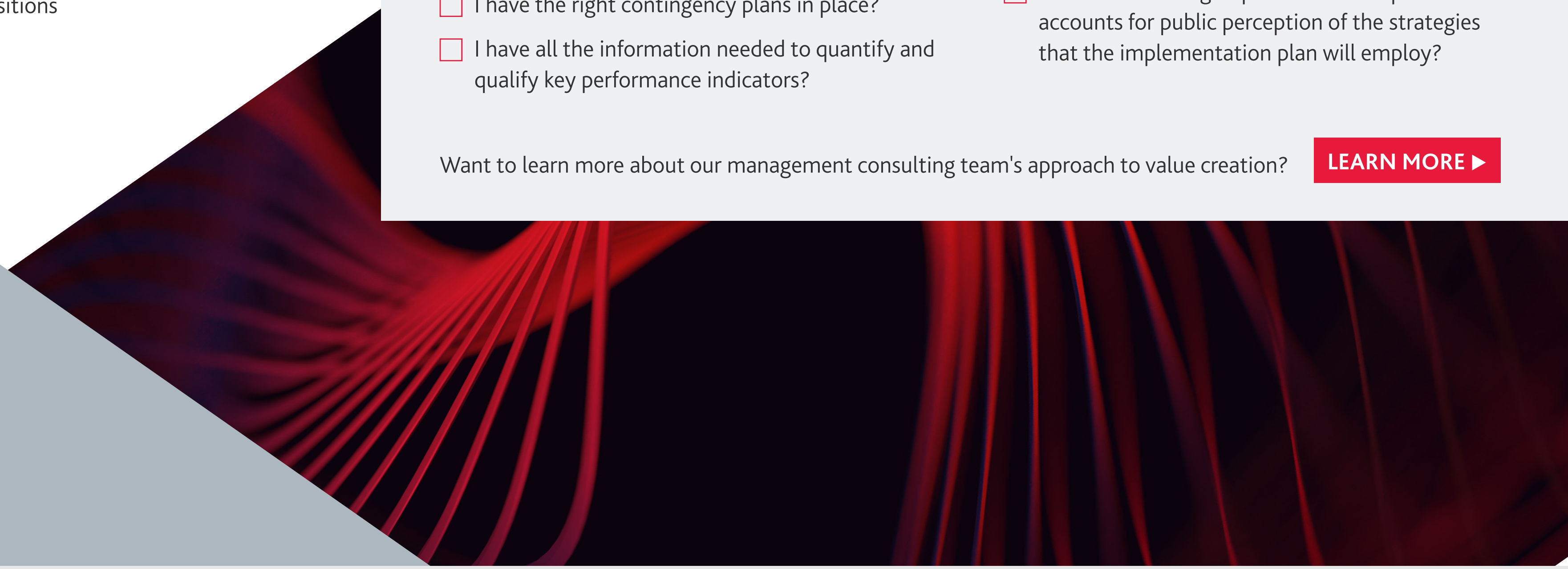
- Attracting and retaining talent
- Implementing new technologies and digital capabilities
- Adopting more sophisticated pricing strategies
- Managing cash flow more creatively so as to unlock cash from working capital
- Identifying supply chain efficiencies
- Amplifying pre-deal due diligence to identify additional value propositions

DE-RISKING YOUR VALUE CREATION STRATEGY

Ask yourself, "How confident am I that..."

- [ ] I have implemented a project governance structure to manage the transaction effectively?
- [ ] My sales growth plan accurately reflects consumer and market conditions?
- [ ] My projected DCF assessment reflects a correct valuation?
- [ ] I have a 360-degree view of the competitive landscape, including new market entrants and products or services?
- [ ] The market is willing to absorb planned price increases?
- [ ] I'm getting real-time supply chain data?
- [ ] My G&A expense analysis accounts for fluctuations in wages and salaries?
- [ ] I have the right contingency plans in place?
- [ ] I have all the information needed to quantify and qualify key performance indicators?
- [ ] The assumptions that underpin my strategies can adapt to market developments?
- [ ] These assumptions are the right ones for achieving the returns I'm targeting?
- [ ] I have identified key talent and ensured appropriate contingencies are in place?
- [ ] I understand all business and human capital risks that could affect the strategy and integration plan?
- [ ] All stakeholders are aligned with how to roll out the implementation plan and understand their respective roles and responsibilities?
- [ ] The implementation plan is not too complex to execute in an organized and logical way?
- [ ] I have a marketing or public relations plan that accounts for public perception of the strategies that the implementation plan will employ?

Want to learn more about our management consulting team's approach to value creation? LEARN MORE ▶



VALUE CREATION: HOW BDO CAN HELP

The ultimate goal of creating value during the holding period is to achieve or exceed target returns at exit. In today's market, doing so is becoming more difficult—especially because holding periods are getting longer. Fund managers who have a comprehensive understanding of the tactics available to them are better positioned to succeed and thus attract LP investment in successive funds.

Our approach includes:

Operational due diligence insights

Execute the full value of the investment thesis through actionable insights — including identification and realization of pricing, margin, capital expenditures, and working capital synergies — developed with data analytics and business monitoring tools.

Buyside operational due diligence

Identify value creation opportunities, including uncovering hidden value and quantifying EBITDA, as well as cash flow improvement opportunities that can be implemented and realized post-close. We also help identify and mitigate operational and integration risks.

Sell-side operational due diligence

Identify opportunities to enhance value that can be implemented prior to the sale or potential areas of synergies that can be marketed to the buyer. We also help companies identify operational risks that would need to be mitigated to minimize value erosion during sale.

Value creation strategy

Develop a nuanced strategy that addresses individual portfolio company and cross-portfolio synergies, efficiencies, and revenue generators.

100-Day Plan and Exit Readiness

Define the most urgent value creation steps that private equity firms can take as soon as the deal closes.

In addition, we can help:

- Identify the right combination of value creation levers based on the verified investment thesis
- Assess and validate divesting noncore businesses
- Assess and validate scale vs scope opportunities
- Provide you with effective guidance and management tactics throughout the transaction

HOW RELIABLE IS YOUR VALUE CREATION STRATEGY?
Talk to our management consulting team to learn more. ▶

Chapter Three: Executing a Successful Exit

In a stark reversal from 2021 and early 2022, exits took a turn for the worst in 2023. Through the year's first three quarters, there were 688 exits totaling $182.9 billion in enterprise value, according to PitchBook's 2023 US PE Breakdown, putting 2023 on pace for a worse finish than 2022 and a far cry from the record-setting 2021.

While exits might not be top of mind for private equity funds right now given the state of the market, funds that miss this opportunity to prepare their portfolio companies for an exit might be out of luck when conditions become more favorable. Whether selling to a strategic buyer, another financial sponsor, or taking the portfolio company public, preparing for an IPO—the path that generates maximum value at exit—can provide funds crucial intelligence on how long a given exit path might take and which ones are viable.

In this third chapter of our e-book, we discuss best practices for [exit planning and value realization] at the end of an investment, with consideration given to changes that have occurred since the outset of the pandemic.

COMPREHENSIVE VALUE ENHANCEMENT

INVESTMENT LIFECYCLE

PRE-PURCHASE

Mitigate transactional and transitional risk

- Risk Mitigation & Synergy Assessment

HOLDING PERIOD

Identify opportunities to profitably grow the top line, reduce expenses, improve capital management and mitigate risk to support sustainable improvements

- Revenue Enhancement
- Margin & Efficiency Improvement
- Capital Efficiency and Risk Mitigation

VALUE REALIZATION

Maximize return on Investment

- Exit Readiness

> *Most funds that I speak with are looking at Q3 2024 as their earliest opportunity to exit an investment via an IPO, which means they are already behind in terms of preparation. There is no telling how long a given exit window will last and with all the uncertainty ahead in 2024—including an election—the window might close very quickly. Whether they sell their portfolio company to a corporate buyer or enter the public markets, funds that take steps to determine viable exit paths now will reap the rewards later.*

JIM CLAYTON
Private Equity Advisory Leader

PREPARING FOR EXIT

After navigating an investment through the holding period, and pulling every value creation lever in the book, it all comes down to the exit. Given the subdued state of the exit market, the stakes are higher than ever. LPs are eager to see distributions, especially as elongated holding periods threaten to dilute returns.

Whichever route a fund manager decides to take when considering an exit, there are several reasons a deal falls apart — political and economic turbulence, poor strategic planning, non-disclosure of material changes or events, inconsistent internal controls, and culture disparities between the buyer and the target, among others.

The last few years have created changes in the way private equity exit strategies have occurred, and portfolio managers need to be aware of them to set themselves up for the highest level of success.

That said, portfolio managers have ways to mitigate these issues and uncertainties, and it all begins with preparation, well before the sale process starts. Here are some factors to consider when preparing a portfolio company for an exit.

SETTING THE SCENE

Over the past few years, there have been several notable changes in the world of private equity. Private equity firms have changed their timelines for the exit planning process, for example. While fund managers began the exit process approximately two years in advance of a projected exit date, firms are giving themselves up to five years now. In a dynamic economy that is experiencing expansion and contraction in short time frames, starting sooner provides fund managers ample time to ensure they can troubleshoot the effects of market changes on their portfolio companies' operations and financials.

Value creation strategies have also gotten more complex. While traditional approaches to value creation, such as cost management, may help drive up value, new strategies that leverage technological and digital solutions are required. Digital transformation has both changed the way businesses function and accelerated the speed at which transactions take place. Digital tools have taken hold in the private equity space as well, enabling firms to bring products to market sooner and perform due diligence tasks more quickly. Additionally, added emphasis on data and analytics gives both the buy- and sell-side more transparency and background on the fundamentals of an asset.

DUE DILIGENCE

In any sale process, due diligence is of the utmost importance. Prospective buyers want sellers to be transparent about any potential risks, so it is incumbent on sellers to have an accurate and comprehensive picture of an asset's risk profile. Prioritizing this allows the sell-side to strengthen a portfolio company's financials and operations and present the most attractive deal. With proper due diligence, fund managers may also accelerate the deal timeline, an essential advantage in a competitive marketplace. In a buyer's market, fund managers may look for ways to shorten the due diligence process without increasing risks.

SPEED TO MARKET AND EXIT READINESS

Getting a portfolio company up to speed and fully prepared for a sale quickly is a must for any firm. Private equity firms can optimize their exit readiness process by:

- Providing an objective perspective around the performance of the company ahead of the exit to maximize value before a sale.
- Demonstrating robust results for at least three years ahead of a sale. This will help put the buyer at ease and simplify the process of bringing the sale to completion.

QUALITY OF EARNINGS

Although it's always been part of the exit planning process, in recent years, quality of earnings (QofE) has become an even bigger focal point of the exit process. A critically important part of the due diligence process, when done correctly, a good QofE report can help facilitate an exit by providing the buyer with exactly the financials they're walking away with.

There are numerous benefits to a sell-side QofE report. Providing the buyer with as many details as possible reduces any uncertainty that may have come up while putting the deal together. The report can also help build credibility for the sellers, which can be helpful going forward. A holistic approach to due diligence before a sale through data and analytics can set the wheels in motion properly for any potential sale. A methodology that accounts for tax, financial, and operational issues concurrently will give both the buy and sell-side a complete vision of the deal ahead.

Experience BDO's holistic approach to due diligence.

Our approach introduces a better way for you to get a holistic view of the business being acquired. This transaction approach enables a broad look at the entire business, across the spectrum of financial, tax, accounting, operational, IT, HR, and insurance-related issues.

LEARN MORE ▶

FINANCIALS AND DETAILS AHEAD OF A SALE

Private equity firms should emphasize the details of a portfolio company's monthly budgeting and financials as a part of any exit strategy. When the time comes to sell, these details need to be fine-tuned. This will provide a defined roadmap that both sides can refer to during the exit process. By having a process that emphasizes discipline when it comes to budgeting, the sell-side can provide potential buyers with a sense of comfort regarding the accuracy of the portfolio company's estimates. This is of particular importance in economies in which products come to market faster than ever before.

REPS AND WARRANTIES INSURANCE

Reps and warranties (R&W) insurance has become a must-have for both buyers and sellers. This type of insurance typically lessens or eliminates the need for purchase price escrows and other holdbacks. With sellers typically having to wait one or two years before proceeds are released, R&W insurance is a welcome development in the deal world. In general, this is a benefit for both parties involved, as it helps move the process along more smoothly.

For private equity firms selling portfolio companies, R&W insurance can cap sellers' exposure to post-close issues and provide two additional benefits:

- A cleaner exit and the opportunity to maximize the proceeds distributed to limited partners at closing
- Less risk of post-closing clawbacks by shifting indemnification risk from the seller to the insurer.

Furthermore, the insurance premium is relatively small compared to the purchase price and is often paid for by the buyer.

It is worth noting that R&W insurance has its limits and is not a substitute for due diligence. In fact, it will often include a blanket exclusion from coverage when due diligence is not performed at all. Even when sufficient due diligence is performed by a reputable firm, specific exclusions are still made for any known issues that are discovered during the due diligence process.

These exclusions from insurance coverage force buyers and sellers to negotiate risks through different mechanisms such as purchase price adjustments or escrows. For this reason, it is recommended that financial and tax due diligence is performed by sellers to identify those items that are expected to be excluded from coverage. Sellers will then be better positioned to point out any mitigating factors or remediation options that could help them retain as much value as possible.

POTENTIAL RISKS AND MITIGATION

No private equity exit process is without its risks. But there are a few factors that the sell-side can look out for during an exit plan. Fund managers should ask themselves:

- **Do I have the right reporting systems in place?** Portfolio managers should consider whether they have the right reports and details for a potential buyer. An effective firm will be able to provide detailed assessments of the portfolio company's performance. This will minimize friction ahead of a sale.
- **Do I have a strong value narrative?** The sell-side needs to ensure they have a strong enough value story to court prospective buyers. In an incredibly active market, sellers must ensure the portfolio company stands out from the crowd, which can be achieved through creative strategies that maximize value ahead of a sale.
- **How can I ensure the deal closes in the current climate?** Portfolio managers need to be certain they can finalize a sale in any market climate. The best way to do this is by drawing up and executing a strategic plan that allows for dynamic real-time changes that reflect current market conditions.

STRUCTURING A TAX REVIEW AND A TAX-EFFICIENT EXIT STRATEGY

While it is important to review and disclose any potential tax liabilities the portfolio company itself may have, it is also crucial to study the tax implications of various exit paths and how they may affect the private equity fund's returns upon sale. This review should include tax assessments and should be conducted well in advance of the anticipated exit. This is extremely important in years where there may be potential tax policy changes at the global, federal, or local levels, as companies should be scenario planning for the business impacts of such changes.

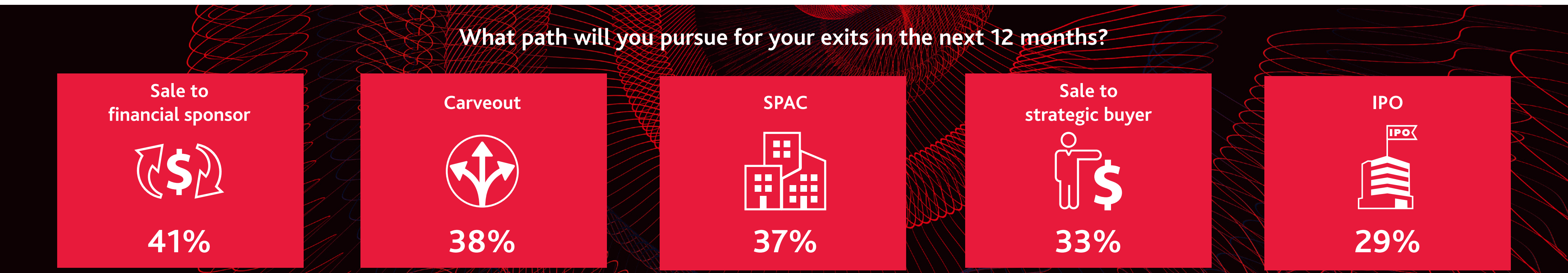
It's never too early to begin preparing portfolio companies for sale. The earlier firms begin the process, the better prepared the company will be for an exit, and the greater the opportunity to maximize returns and distributions for both limited partners and general partners alike. With changes in how quickly the market moves, firms can stay ahead of the curve by being prepared well in advance of a sale.

DECIDING ON THE EXIT ROUTE

The market for deal-making in private equity changed dramatically throughout 2022 and into 2023 as interest rates continued to rise and equity markets sagged. Despite a recent reopening of the IPO window, most market participants aren't expecting big changes until 2024.

Private equity funds are prioritizing routes that can provide immediate liquidity. According to BDO's 2023 Private Capital Pulse Survey, fund managers favor sales to fellow sponsors and carveouts as their top exit options.

2024 should provide for an interesting year in exits. Despite all the uncertainty presented by the upcoming election, our webinar poll of private equity fund managers found that many expect to see a return to optimal IPO conditions in the second half of next year. No matter the exit option, all funds could benefit from kicking the tires on their exit planning sooner rather than later.



Source: BDO 2023 Private Capital Survey

EXIT STRATEGY & PLANNING: HOW BDO CAN HELP

The exit is where the portfolio manager and the fund are essentially graded for years of hard work. The market of the last year or so has been a challenge for funds, but markets always change. Preparation and process can ensure that goals are met regardless of external factors.

Our approach to Exit Strategy and Support includes:

EXIT PREPARATION

Full exit strategy and pre-sale planning, including exit readiness assessments; sale process design; deal marketing; CIM preparation; buyer identification; SOX readiness; carve-out financial statement preparation; financial, operational, HR, and IT separation and Day 1 readiness; investigative due diligence, sell-side due diligence; tax exit planning; IPO/capital markets services; SPAC and de-SPAC services; and transition service agreement (TSA) development and execution. Creation of a top-level quality-of-earnings report to give a full financial picture to both sides of the transaction.

EXIT EXECUTION

Support around overarching exit strategy and execution, including board advisory and sell-side advisory. Determining the path of exit (financial sponsor, strategic buyer, IPO, SPAC, carveout, etc.). Ensure proper reporting processes are in place for the implementation of exit. Determine R&W insurance needs for both sides ahead of implementation.

EXIT IMPLEMENTATION

Day-to-day support on exit strategy implementation, including: divestiture and/or carve-out management officer; interim management; interim talent; tax liability review; technical accounting; and post-transaction financial and accounting support.

BDO offers comprehensive exit planning and value realization services to help private equity funds capture more value with successful exits of their portfolio companies. From readiness assessments to divestiture services to tax services, BDO can help you maximize investment return by getting the most out of the exit — whether it is through a sale to a strategic buyer, a secondary transaction, a de-SPAC transaction, or an IPO.

WHAT'S YOUR 2024 EXIT STRATEGY? Prepare one with our Management Consulting team. ▶

People who know Private Equity, know BDO.

www.bdo.com/private-equity

PATRICK DONOGHUE
Corporate Finance & Transaction Advisory
Services Managing Principal
Private Equity Industry Leader
pdonoghue@bdo.com

NATE COLLINS
Tax Transaction Advisory Leader
Private Equity Tax
bcollins@bdo.com

ERNIE SAUMELL
Principal
Private Equity Assurance
esaumell@bdo.com

JIM CLAYTON
Management Consulting Principal
Private Equity Advisory
jclayton@bdo.com