THE OPERATING PARTNER IN PRIVATE EQUITY

VOLUME 2

Advanced strategies for value creators

Edited by
Tony Ecock, Welsh, Carson, Anderson & Stowe
Contents

Figures and tables vii
About the editor xi

Introduction xiii
By Tony Ecock, Welsh, Carson, Anderson & Stowe

1 Operational value creation at the portfolio level 1
By Tony Ecock, Welsh, Carson, Anderson & Stowe
Introduction 1
Operational value creation at the portfolio level: 6 must dos for private equity firms 3
1. Start with a broad view of operational value add 3
2. Implement a systematic, repeatable process starting pre-closing 4
3. Resource the approach sufficiently for the mission 9
4. Apply the approach consistently 12
5. Continuously prioritise work with the companies 14
6. Measure the results and adapt over time 15
Conclusion: Operating value in context 16

2 Operational approaches: The limited partner perspective 17
By Jay Bartlett, Parthenon-EY
Introduction 17
LPs’ level of awareness and understanding of operating resources 17
Operating models available and their prominence 18
Do LPs believe there is a superior approach to leveraging operating resources? 20
Conclusion: Key takeaways for GPs 23

3 A day in the life of an operating partner 25
By Mike Kohlsdorf, Francisco Partners
Introduction 25
The dance: A typical day 25
The ticket to the dance: Importance of User Interface (UI) 33
Conclusion: Save the last dance 34

4 Smooth operators: How Riverside built and refined its operating approach 35
By Dan Colbert, The Riverside Company (2007-2014)
Introduction 35
# The Operating Partner in Private Equity

The birth of the Riverside operating model 36
The early years of Riverside Micro-Cap Fund (RMCF) 39
Growing pains 40
Key lessons from failed deals 41
Finding operating partners 42
Refining the approach 43
Riverside University: Operations are part of Riverside’s DNA 44
Conclusion 44

## 5 Leveraging operational due diligence to enhance outcomes for equity and credit investors 47

*By Shahriyar Rahmati, The Gores Group*

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Introduction</td>
<td>47</td>
</tr>
<tr>
<td>Operating due diligence used for determining credit</td>
<td>47</td>
</tr>
<tr>
<td>Transaction types: How they relate to financing scenarios</td>
<td>48</td>
</tr>
<tr>
<td>A primer on LBO financing, and its reliance on borrower operations</td>
<td>50</td>
</tr>
<tr>
<td>Credit agreement: Elements that an operating executive can inform and should be knowledgeable about</td>
<td>55</td>
</tr>
<tr>
<td>Focusing on the concept of liquidity vs. the notion of ‘cash’</td>
<td>55</td>
</tr>
<tr>
<td>Operating executive’s role during a default period/when the sponsor has taken ownership through debt ownership</td>
<td>56</td>
</tr>
<tr>
<td>Conclusion</td>
<td>58</td>
</tr>
</tbody>
</table>

## 6 Driving risk mitigation in private equity portfolio companies 59

*By Scott Glickman, Dan Soroka and Sara Boyd, Graham Partners*

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Introduction</td>
<td>59</td>
</tr>
<tr>
<td>Business controls risk</td>
<td>59</td>
</tr>
<tr>
<td>Business model risk</td>
<td>67</td>
</tr>
<tr>
<td>Case study: The Atlas Group</td>
<td>69</td>
</tr>
<tr>
<td>Case study: Infiltrator Systems</td>
<td>70</td>
</tr>
<tr>
<td>Conclusion</td>
<td>71</td>
</tr>
</tbody>
</table>

## 7 Effecting and leading transformational change 73

*By Mark Gillett, Silver Lake and David Moss*

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Introduction – identifying the nature of change</td>
<td>73</td>
</tr>
<tr>
<td>Defining transformation</td>
<td>74</td>
</tr>
<tr>
<td>The transformation process</td>
<td>74</td>
</tr>
<tr>
<td>Considerations</td>
<td>80</td>
</tr>
<tr>
<td>Step 1: Prepare</td>
<td>81</td>
</tr>
<tr>
<td>Step 2: Frame and establish the transformation</td>
<td>82</td>
</tr>
<tr>
<td>Step 3: Implement and iterate</td>
<td>85</td>
</tr>
<tr>
<td>Step 4: Embed and sustain the change</td>
<td>88</td>
</tr>
<tr>
<td>Step 5: Finishing the transformation</td>
<td>89</td>
</tr>
<tr>
<td>Conclusion</td>
<td>90</td>
</tr>
<tr>
<td>Glossary</td>
<td>92</td>
</tr>
</tbody>
</table>
Contents

8 Transformational value creation in the middle market: Picking your spots to maximise portfolio returns 93
By Christopher Springer, Alliance Holdings Inc
Introduction 93
Picking your spots for transformational change 94
The must haves 95
The must dos 99
Conclusion 103

9 Connecting CEO talent to value 105
By Sandy Ogg, The Blackstone Group
Introduction 105
Disconnects: Set up to fail 107
Connect: Set up to succeed 110
Conclusion 113

10 The drive for improved organic growth in private equity portfolio companies 115
By Steve Larned, Welsh, Carson, Anderson & Stowe, and James R. Corey and André Martinelli, Blue Ridge Partners
Introduction 115
Growth objectives by deal type 115
Shaping the context to engage in growth 116
Strategies for improving growth basics 123
Prioritising and pursuing high-impact actions 127
Creating and sustaining impact with implementation excellence:
- Critical actions for operating partners 131
Conclusion 132

11 Managing pricing with intention: A practical guide to getting started 135
By Stephan M. Liozu, Value Innorruption Advisors and Chatham University
Introduction 135
Reasons to pay attention to pricing now 136
Ten considerations to get pricing right 137
Five ways to get started tomorrow 144
The secret is in the execution 146
Conclusions 146

12 Carve-outs 2.0: Next generation carve-out management 147
By Nick Alvarez, Markus Lahrkamp, Ajay Raina and Jeff Shaffer, Alvarez & Marsal
Introduction 147
Complex, yet increasingly popular 147
The multi-phase carve-out process 149
13 **Information technology for operating partners**

*By Matt Sondag, Keith Campbell and Kyle Sarausky, West Monroe Partners*

- Introduction: 161
- IT operating partners: How to select one and how to optimise the role: 161
- IT due diligence: Uncovering the good, the bad and the ugly: 165
- Breaking up is hard to do: Lessons from the trenches that increase carve-out success: 171
- Conclusion: 178

14 **Implementing key performance indicators in portfolio companies**

*By Kristoffer Nino, Orbis Invest*

- Introduction: 179
- Lessons: 179
- Guide to implementing KPIs: 182
- Solidifying the system: 193
- Conclusion: 194

15 **Mind your step! Avoiding the legal pitfalls of being an operating partner**

*By Othon Prounis, Eva Carman and Amanda Raad, Ropes & Gray*

- Introduction: 195
- Today’s enforcement climate: 195
- Transparency and risk-based regulations: 195
- Enforcement activities relevant to operating partners: 197
- Potential liabilities beyond the regulatory context: 204
- Conclusion: 207

**About PEI**

208
## Figures and tables

### Figures

<table>
<thead>
<tr>
<th>Figure</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Figure 1.1</td>
<td>A systematic and repeatable approach for long-term investors: Key success factors and WCAS reinforcing mechanisms</td>
<td>6</td>
</tr>
<tr>
<td>Figure 1.2</td>
<td>Welsh, Carson, Anderson &amp; Stowe (WCAS) Operating Cycle</td>
<td>7</td>
</tr>
<tr>
<td>Figure 2.1</td>
<td>Continuum of private equity firm structure and integration of operating resources</td>
<td>19</td>
</tr>
<tr>
<td>Figure 2.2</td>
<td>The six private equity firm operating models</td>
<td>20</td>
</tr>
<tr>
<td>Figure 2.3</td>
<td>Linking private equity firm strategy to operating structure</td>
<td>21</td>
</tr>
<tr>
<td>Figure 2.4</td>
<td>The five levers private equity firms use to align operating resources</td>
<td>22</td>
</tr>
<tr>
<td>Figure 3.1</td>
<td>Value-creation drivers</td>
<td>32</td>
</tr>
<tr>
<td>Figure 6.1</td>
<td>Graham Partners’ layered property programme</td>
<td>62</td>
</tr>
<tr>
<td>Figure 6.2</td>
<td>Graham Partners' value-creation process</td>
<td>69</td>
</tr>
<tr>
<td>Figure 6.3</td>
<td>Atlas sales end user segment diversification shift over time, 2008-2014</td>
<td>70</td>
</tr>
<tr>
<td>Figure 6.4</td>
<td>Infiltrator acquisition and 2014 sales by product category</td>
<td>71</td>
</tr>
<tr>
<td>Figure 7.1</td>
<td>Incremental change vs Transformation</td>
<td>74</td>
</tr>
<tr>
<td>Figure 7.2</td>
<td>Illustration of a simplified transformation process</td>
<td>76</td>
</tr>
<tr>
<td>Figure 10.1</td>
<td>Growth driver matrix</td>
<td>119</td>
</tr>
<tr>
<td>Figure 10.2</td>
<td>Mapping the growth process</td>
<td>125</td>
</tr>
<tr>
<td>Figure 11.1</td>
<td>Five components of a pricing due diligence process</td>
<td>142</td>
</tr>
<tr>
<td>Figure 12.1</td>
<td>Sample of completed deals by private equity buyers, by sector, 2009-14</td>
<td>148</td>
</tr>
<tr>
<td>Figure 12.2</td>
<td>Breakdown of transaction size – for disclosed deals, 2009-14</td>
<td>149</td>
</tr>
</tbody>
</table>
The Operating Partner in Private Equity

**Figure 12.3:** Illustrative cost structure of a carve-out  
**Figure 12.4:** Typical Project Management Organisation (PMO) during a carve-out  
**Figure 13.1:** IT carve-out lifecycle  
**Figure 13.2:** IT carve-out due diligence: Focus areas and questions  
**Figure 13.3:** Pre-packaged IT provider framework  
**Figure 14.1:** Sample management reporting system  
**Figure 14.2:** Sample meeting agenda  
**Figure 14.3:** Sample KPI tree  
**Figure 15.1:** Areas of SEC inquiry on the use of operating partners  
**Figure 15.2:** Active UK and US bribery investigations by industry  
**Figure 15.3:** Active UK and US bribery investigations by geography  

**Tables**

**Table 3.1:** Operating partner activities  
**Table 3.2:** Calendar extract – a typical day for an operating partner  
**Table 3.3:** An operating partner’s situational analysis report  
**Table 5.1:** Examples of synergy between equity sponsors and lender DD  
**Table 6.1:** Excerpt from Graham Partners’ standard human resources audit questionnaire  
**Table 6.2:** Graham Partners’ standard processes to mitigate business execution risk  
**Table 7.1:** The five steps in the transformation process  
**Table 7.2:** Key takeaways for the operating partner  
**Table 10.1:** Growth sources  
**Table 11.1:** Five consequences of informal price management
Figures and tables

**Table 11.2:** CEO perceptions of pricing 138

**Table 11.3:** Key predictors of pricing power 139

**Table 11.4:** Specific pricing initiatives by sector 140

**Table 13.1:** IT security: What to ask for and what to look for during due diligence 166

**Table 13.2:** IT organisation: What to ask for and what to look for during due diligence 168

**Table 13.3:** Proprietary systems: What to ask for and what to look for during due diligence 170

**Table 13.4:** Business application carve-out migration options 174

**Table 14.1:** Sample management team dashboard 186

**Table 14.2:** Sample action log 188
About the editor

**Anthony Ecock** is a General Partner with the private equity investment firm Welsh, Carson, Anderson & Stowe (WCAS) in New York, which he joined in 2007. At WCAS, Tony leads the Resources Group, a team of generalists and specialists responsible for helping portfolio companies improve growth, EBITDA and cash flow. From 2003 until joining WCAS, Tony served as vice president and general manager of Enterprise Sales for General Electric (GE) Healthcare, a $17 billion division of the General Electric Company. Prior to joining GE Healthcare, he was senior vice president and global general manager, Patient Monitoring at Philips Electronics, Agilent Technologies and Hewlett Packard. Tony spent 12 years at the consulting firm Bain & Company, where he was a partner, practice leader for Information Technology and programme director for Consultant Training. Tony has an MBA from Harvard University, where he was a Baker Scholar, and a BS in Economics with majors in Finance and Accounting, with honours, from The Wharton School of the University of Pennsylvania.

Tony is the founder and leader of the Private Equity Operating Partner Executive Network (PEOPEN™). Founded in 2008, PEOPEN™ serves as a networking forum for the sharing of non-proprietary best practices and proven external resources related to private equity portfolio company management, operations and value creation. Membership now consists of over 350 full-time, in-house operating partner members globally.

For more information on PEOPEN™, visit www.peoperatingpartners.com. Qualified applicants may request to join the PEOPEN™ community through LinkedIn at www.peopen.org.
Introduction

By Tony Ecock, Welsh, Carson, Anderson & Stowe

Enhancing private equity returns through better due diligence and post-close operational improvements has only become more important since we published our first book on the topic, The Operating Partner in Private Equity, in 2011. Valuation multiples are currently at all-time highs and there is more competition among private equity firms than ever. To prevail in a competitive process requires a clear view not only of the asset you are buying but also how you are going to improve its value over time and exit successfully. Firms that make good investments will do well; firms that make good investments and enhance their value will do better and attract more capital. It is safe to say that no matter what the future holds for valuation multiples, debt availability, interest rates or the global economy, the importance of adding operating value to private equity portfolio company investments has been well established.

Naturally, the field of private equity operational diligence and value enhancement has progressed to address this need. Whether we, as operating partners, are ahead or behind the curve is a matter of debate. Clearly the resources dedicated to the task have grown. There are now over 500 members in PEOPEN<sup>TM</sup>, the Private Equity Operating Partner Executive Network<sup>TM</sup> for full-time, on-staff operating partners. There are many times that number of part-time operating partners, advisors, individual consultants and board members focused on improving the value of private equity portfolio companies. There are also hundreds of successful generalist and niche consulting firms, service providers and vendors that serve just about any need. As a result, the tools available to assess companies and add value to them have progressed steadily over time.

In this context, we investigated whether enough progress has been made to warrant a second book on the topic. I was pleased that it was easy to identify a few dozen potential topics of which we chose the most relevant 15 for the content of this book. While the first book laid a strong foundation of core skills with topics such as setting up an operating group, driving revenue growth and effective cost management, this book hopes to complement the first and go a step further with more focus on advanced topics requiring judgement such as value addition at the portfolio level, company and opportunity prioritisation, risk assessment, debt and CEO talent.

I am particularly proud of the group of authors we have assembled. They are all senior people in the field who have brought thoughtful views to their topics based on years of experience and reflection. We have tried to recognise the breadth of private equity investing around the world, across different sectors and from small early-stage investments to large mega-buyouts. While the need for private equity owners to perform insightful diligence, grow revenues, cut costs and accelerate cash flows may be similar, the solutions will be different based on the sector, the size of company, the resources.
The Operating Partner in Private Equity

at hand and the risk profile of the investors. The authors as a group have worked in all such investing environments and come from all different types of firms and we aim to reflect this broad perspective throughout this publication.

The book begins with my advice for adding operating value at the portfolio level, then Jay Bartlett at Parthenon-EY shares his perspective on what LPs look for in operating approaches.

We then explore specific examples and best practices from our team of operating partner experts:

- Mike Kohlsdorf at Francisco Partners provides a behind the scenes look at the role of a typical operating partner and the consistent focus on value creation.
- Dan Colbert discusses how The Riverside Company built and refined its operating approach with key lessons for achieving success.
- Shahriyar Rahmati at The Gores Group provides advice for dealing with the debt component of private equity and the role the operating partner can play in maximising the value of investments.
- Scott Glickman, Dan Soroka and Sara Boyd at Graham Partners outline a programme for proactively identifying and reducing business model risks.
- Mark Gillett of Silver Lake, and David Moss, independent advisor, provide a framework for assessing and addressing transformational versus incremental change.
- Christopher Springer at Alliance Holdings illustrates the importance of picking your spots – how situational factors dictate how aggressive an approach you should take.
- Sandy Ogg at The Blackstone Group proposes three action points for ensuring the portfolio company CEO search and selection process is successful.
- My colleague Steve Larned at Welsh, Carson, Anderson & Stowe (WCAS) teamed up with James Corey and André Martinelli, experts at Blue Ridge Partners, to provide advice on how to drive organic growth in a high valuation environment within a short time frame.
- Kristoffer Nino of Orbis Invest offers a comprehensive guide to implementing KPIs in a portfolio company with best practice examples tailored to private equity.

We also called upon third-party resources with extensive private equity practices to share their expertise:

- Stephan Liozu, Founder of Value Innoruption Advisors, identifies the critical issues that operating executives should consider in order to capture value through greater price realisation.
- A team of experts at Alvarez & Marsal – Nick Alvarez, Markus Lahrkamp, Ajay Raina and Jeff Shaffer - share advice for navigating the challenges of carve-outs, exploring potential risks and outlining key factors that can determine or undermine success throughout the deal lifecycle.
- Matt Sondag, Keith Campbell and Kyle Sarausky at West Monroe Partners provide useful tips for how to select and optimise the emerging role of the IT operating partner.
Introduction

- Othon Prounis, Eva Carman and Amanda Raad, partners at the law firm Ropes & Gray provide an overview of recent hot-button regulatory issues facing the private equity industry and how these issues affect operating partners.

I would also like to thank the following people who have been instrumental: Paul Queally and Tony de Nicola, Co-presidents of WCAS, who provided me with the opportunity to start the WCAS Resources Group and infinite support along the way. My colleagues in the WCAS Resources Group who make it all happen along with everyone else at WCAS and in our portfolio companies who have been receptive to our team and work.

In particular I would like to thank Kate Seward, Senior Program Director at WCAS for her assistance in keeping the project on track and editing my work for this book. Kate has been instrumental over the last seven years in building the Resources Group and the collaborative relationships we enjoy with our portfolio companies.

I also thank my colleagues in PEOPEN™ who have shared so many of their own insights with me and the private equity and consulting firms for generously sharing their wisdom and intellectual property with us.

Helen Lewer and Wanching Leong of PEI who initiated the second book and patiently brought it to fruition.

Finally, of course I would like to thank and recognise the outstanding group of authors without whom such a book would not be possible. As senior people they are all very busy, typically travelling every week and responding to urgent deal opportunities and operational challenges. I would like to acknowledge their tireless work, often on late nights and weekends, over the past nine months and the sacrifices they and their families and friends have made.

Private equity is ultimately about building and growing great businesses. Operating partners play just one role in the process along with everyone else who works with portfolio companies. I hope that everyone who reads this book learns something that helps them and, as always, I welcome feedback so that we can continue to learn from one another and improve our collective capabilities.

Tony Ecock
New York 2015