



VALUE MANAGEMENT IN PRIVATE EQUITY



Private Equity (PE) has been making a lot of headlines recently but not always for positive reasons, with concerns over debt structuring with the potential increased risk this produces, asset stripping accusations and earnings tax breaks. However in common with most businesses the end game for Private Equity (PE) firms is to increase the value of their investment and they are no doubt successful in achieving this. As they commonly invest in financial assets and companies there is something to learn from understanding how they make investment decisions.

Overvaluing a company or asset or subsequently failing to exploit value-added opportunities are two of the most significant risks any Private Equity Investor faces. When it comes to a buying decision Private Equity firms will view it from two angles: What is the current value of the asset? and How can this value be enhanced? What this means in practice is as follows:

A. Valuing the asset

The techniques and approaches employed by PE to determine the true value of the asset will include the following:

- Financial Modelling and Forecasting to model future cash flows and analyse the drivers of value.
- Assessment of the risk performance and capability of the company, including measurement of the adequacy of provisions
- Portfolio Behaviour analysis to get under the skin of an asset's performance, including, for example, utilisation rates, prepayment levels, cross sales, and segment level credit losses and how these link together to drive value.
- Operational Due Diligence to understand the capability and quality of servicing, processing and operations.

B. Identifying and Enhancing Value

The potential for creating value from an investment is a key factor in establishing its price - so reducing the risk of failing to extract that value is a critical objective for any Private Equity Investor.

To drive future value that can provide the targeted rate of return, the Private Equity firm will need assurance that the business has robust plans to leverage emerging growth opportunities and new revenue streams and that value can be built rapidly and effectively. To achieve this, they will develop the following:

- Strategy potentially using a '100-day plan' approach to develop the turnaround strategy and market positioning that maximises returns. This will be embedded in the organisation through robust execution tracking to provide real momentum and pace of change.
- Performance Improvement plans to understand investment requirements, capability development needed and risk mitigation actions
- Robust Performance Monitoring including KPI definition, MI production and exception reporting.

Clearly Private Equity have a very strong focus on value and growing value, they achieve this through using analytics and modelling to develop a deep



understanding of the drivers of value and complementing this with robust planning, processes and operations.

The approach taken and tools used are aligned to those expert risk & value portfolio managers will be using on a daily basis. If risk managers in financial services businesses do not have a true view of the current or potential future value of their portfolios they should consider employing a Private Equity approach to unearth the hidden value.

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