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How to Exit as a PE CEO

Leading a private equity-backed business to a successful sale will test the mettle of any CEO. **Mary-Anne Baldwin** finds out how it can be done

The key to planning a successful exit is to focus on the potential buyer, says **Adam Hodges**, former CEO of gaming company Playnation. He advises: "Work backwards. Ask who's going to buy the business. What do they want it to look like? What would make it interesting to them?"

Adam should know. After conducting a private equity-backed management buy-out in 2013, he recently sold the business – which operates 20,000 amusement and entertainment machines over 1,700 UK sites – to Austrian gaming company Novomatic Group.

But like many PE-backed CEOs, during the two years before the sale, **Adam** had to rethink his exit strategy, draw up new plans and adapt as the circumstances for potential buyers changed.

It's important to do your research. Assess whether a trade sale, secondary buyout or even an IPO is right for your business, but don't be afraid to adapt if that alters.

Study the market

Although the global IPO market cooled in 2015, exits via trade sales and secondaries remain strong. >

According to research by Big Four firm EY, PE houses sold 625 companies via M&A in 2015, with an aggregate value of $262 billion (£174 billion), which is roughly in line with 2014. Strategic M&A has been particularly active, accounting for 72 per cent of PE sales, the highest proportion in more than a decade.

Charlie Johnstone, Partner at PE firm ECI, notes: "There's a lot of money globally and that's feeding into higher prices across all sectors, from houses through to companies."

Unsurprisingly, he says the tech sector continues to attract the highest multiples and that the three tech businesses ECI sold in the last 18 months – CarTrawler, Fourth and Wireless Logic – each attracted a premium pricing of 17 to 20x their profit.

As ever, buyers want to see the magic combination of predictable income and scale.

Ewa Bielecka Rigby, Investment Director at LDC, says: "Management need to understand the size of their addressable market and where future growth will come from. A track record of sales and profit will be vital for potential buyers, together with predictable, high-recurring revenue and a forward pipeline of earnings, preferably backed by long-term contracts."

Tell your growth story

When **Roger Taylor** took the CEO role at PE-backed Quadriga Worldwide in 2011, it was two years into the Great Recession, annual new contract signings had fallen from €120 million (£85 million) to €30 million (£21 million), and the business, which provides technology to hotels, had no product roadmap.

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"We realised we had to come up with the growth story because my top line was falling away and the rationale for the product and business was dying," **Roger** explains.

It was also his first operational role after a career in M&A advisory and PE investment. He recommends the first point in any exit strategy is to understand the reality of the business. In the case of Quadriga, this meant determining the company's mission so that it could be easily communicated to staff, customers and potential buyers.

"If I were going into another situation, that would be the first thing I'd look to create. It's the anchor by which you can align your vision with the board," says **Roger**, who left when the company was sold earlier this year to software development and professional services organisation Exceptional Innovation.

Ewa agrees with his advice, adding: "In an exit situation, the same story delivered in a consistent way by different management team members builds trust with potential buyers, especially when backed by facts and a good track record for the delivery of results."

Right-size the business

When **Adam** was told his initial exit route for Playnation was no longer viable, he had to go back to square one. After assessing various options, he chose to make the strategic acquisition of FunHouse Leisure as it allowed the company to move into a new sector.

"We doubled the size of that business in 12 months," he says, adding that it wasn't just a cash grab. "It was about exposure into that market space, which meant that it was more scalable for an acquirer."

Grand exit strategies won't count for much if business performance drops. In such instances, raw pragmatism is required to get the company back on track.

This is something Criticaleye Board Mentor **John Allbrook** has experienced first-hand. Until recently, he was the Executive Chairman of Syscap, a PE-backed specialty finance company. After joining in 2010, John undertook a significant turnaround as revenue had fallen from around £160 million to £60 million per annum.

"We identified one market where we really felt there was an opportunity and that was providing bespoke lending facilities to smaller legal partnerships," he explains.

"This initiative proved hugely successful and was instrumental in our recovery plan as revenues once more climbed north of £150 million. >

"Our situation was too challenged to say: 'We won't chase that opportunity because it doesn't fit with the exit strategy.' We needed to cut cost, redefine the growth strategy and quickly become cash-flow positive. But once the strategy started to work it became extremely clear who the buyers were likely to be, because they were the companies we were competing against."

Build your team

Investing in the right employees and a strong succession plan can only benefit the business.

"Don't underestimate the value your staff holds," says **James Boot**, Senior Relationship Manager for Private Equity at Criticaleye. "High employee retention rates, clear and functioning incentive plans and a positive workforce can be very attractive to the right buyer, perhaps to the extent of an extra multiple."

A good team will mean the CEO can delegate operational responsibility as they devote more time to the exit strategy and deal itself.

Ewa recommends: "Plan for senior executives to be totally absorbed by the process, therefore the operational team needs to focus on keeping the results going, which is vital to good exit metrics."

This is precisely what **John** did for the exit he led at Syscap. "The sale process was handled predominantly by myself and the CFO. Other members of the management team focused on the day-to-day running of the business. Of course we had to bring them into management presentations to prospective buyers and parts of the diligence process, but we kept it tightly managed to minimise distraction," he explains.

> *" There are some parties that will put their loan notes to rank ahead of management "*

Agree the equity spread

Suspicion and sniping within the senior management team about the equity spread is in nobody's interest.

As **James** notes: "Being clear to potential buyers about the management's equity expectations is key. Therefore when writing the investment memorandum put the current equity spread, and who is set to make what type of return from the exit, on the first page."

Similarly, it's essential that when a management team originally takes on PE investment, they fully understand the terms of the transaction so they can remain incentivised.

ECI's **Charlie** warns: "If you're going in with a high valuation it's harder to generate returns and the management team, as the deliverer of that shareholder value, is under more pressure. But I'd say the biggest risk is taking on excess debt commensurate with the high price.

"If you can, steer the deal towards someone who is willing to pay the right price but still willing to put in less debt and be more collaborative with the team. There are some parties that will put their loan notes to rank ahead of management, put exit fees in and do all sorts of things that will be very detrimental to management teams."

It's one of the reasons why a CEO should take care when deciding which PE house to bring in. **Adam** spoke to about 15 PE houses before agreeing a sponsor for his MBO – it wasn't the highest bid, but it was the best fit. He explains: "What was most important was that they [the sponsor allowed] me to get on and run the business myself; they wouldn't micromanage me". ■

Featuring Commentary From:

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