KAISER ASSOCIATES

The Changing Role of Tech in the M&A Lifecycle

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Introduction

From a macro perspective, Private Equity is prospering — illustrated by record fundraising numbers, high valuations and strong deal activity. Even the adverse impacts of the COVID 19 crisis are expected to be temporary. However, when we peel the curtain back to examine the diligence process, it becomes evident that PE firms are behind the curve when it comes to:

1. Evaluating the risk and upside potential of tech in our investment targets
2. Our own use of tech enabled services to automate and enhance the effectiveness of diligence and our ability to successfully execute, measure, and track value creation strategies

Kaiser's recently concluded market study engaged a mix of senior PE investment professionals on the evolving role of tech enabled tools during diligence and the impact of tech on value creation. Through conversations with industry leaders and investors, we gained rich insight into the current state of workflows and internal processes at PE firms from pre-diligence to exit. We invite you to dive into Kaiser's 2020 study "The Changing Role of Tech in the M&A Lifecycle" – as an insider, you are likely to nod your head and share similar sentiments to those interviewed. Most importantly, we hope you come away with a few takeaways to act on at your firm.

Kevin Slayden
SENIOR PARTNER,
PRIVATE EQUITY

Current State of the Market

The investment process for PE firms, from pre-diligence to exit, is typically well defined but includes many unmet needs and pain points

THE STATUS QUO IS MANUAL & SUBJECTIVE

A snapshot of the Private Equity investment process reveals that while most PE firms have some version of structured processes for diligence, there is still substantial room for automation and increased sophistication.

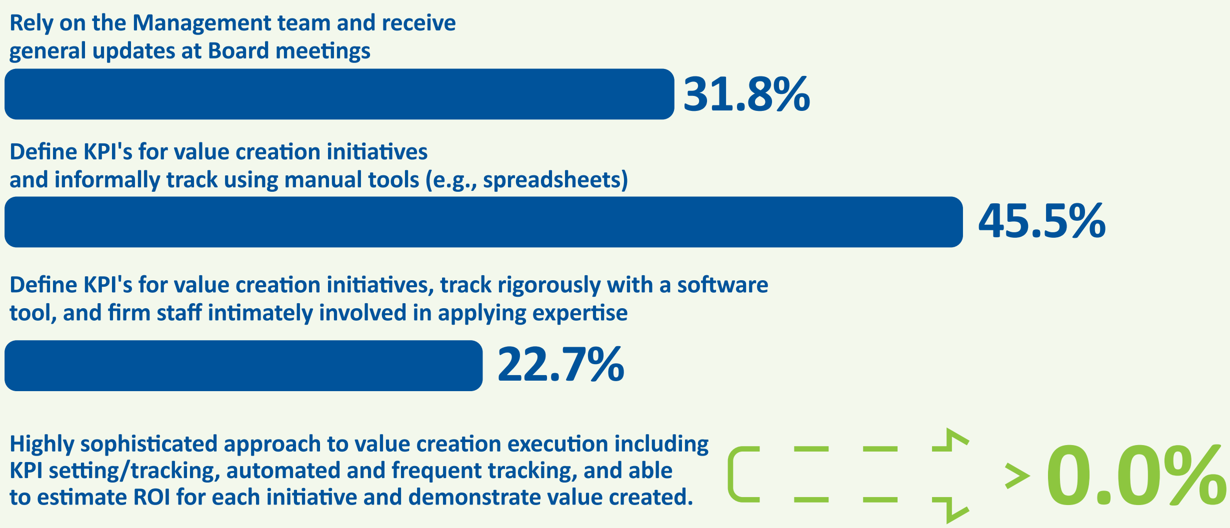
Many firms continue to rely on outdated tracking methods (read: Excel) to document diligence checklists and findings. Information streams are funneled from a variety of investment professionals working on any given deal, and synthesis is impeded and complicated by resulting individualized and subjective data tracking.

As a result, diligence analysis and decisions rely on siloed data and insights. While the process of manually capturing data has historically been successful in informing valuation, downside risk, growth accelerations, etc. – it is becoming more and more evident that these methods are not enough to stay competitive.

In part, a manual process has stayed in favor for so long due to lingering hesitation that broadly applying a standardized playbook will fail to meet the bespoke needs of different types of companies. For the collective industry to break away from ingrained manual processes, new tech-oriented diligence vendors will need to address these concerns head on. Further, it's critical that training and education take place between PE firms and digital strategy experts to identify and close the gap on which value creation levers to pull.

3 out of 4 PE firms reported that they use manual tracking methods and **0 companies** reported using a highly sophisticated approach (e.g. automation) to value creation execution

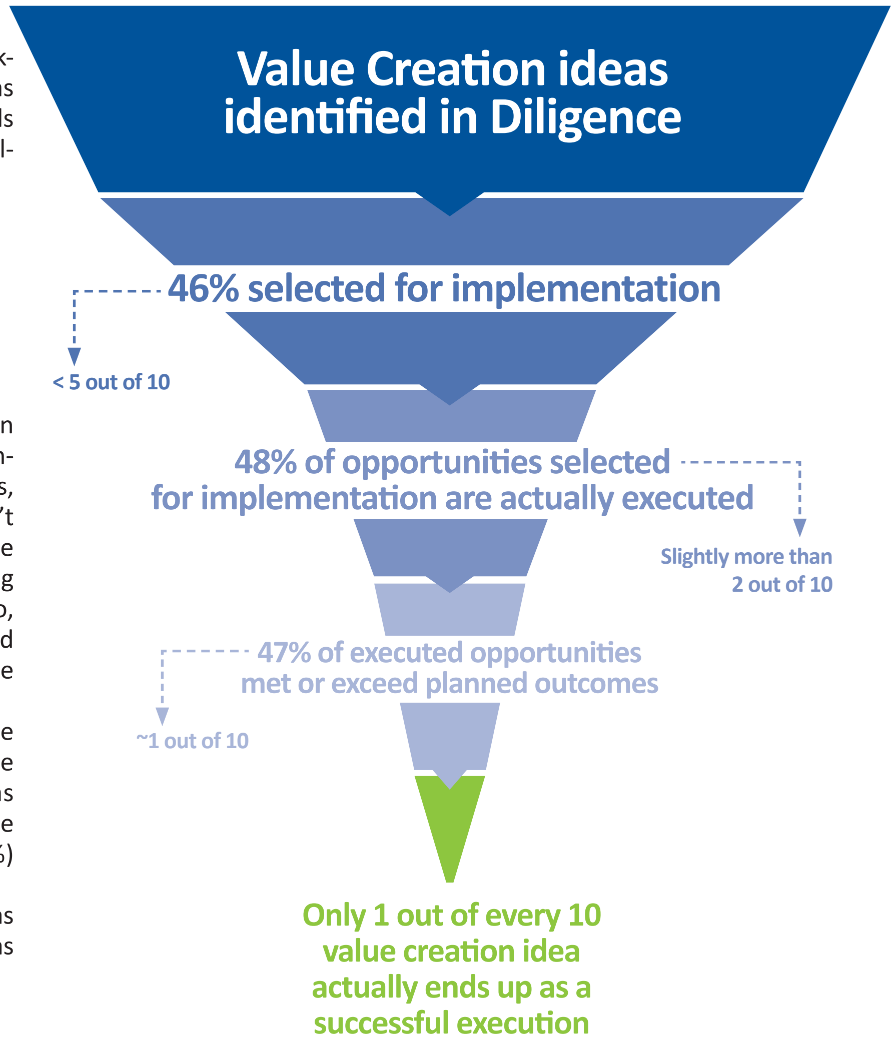
Which statement most accurately describes how your firm manages, measures, and tracks value creation initiatives?



> "There is no objectivity to the process — even when you do the work, you don't necessarily believe the outcome…"
>
> — PARTNER, UPPER MIDDLE-MARKET FIRM

Value Creation Funnel

The survey revealed a range of unaddressed pain points in the value creation funnel with highly inefficient translation of value creation ideas to successful execution.



UNTAPPED VALUE CREATION

When we dig deeper to understand the breakdown in processes and why the industry has been slow to digitally advance diligence tools and processes, we observed 3 primary challenges commonly identified by PE firms.

1. **Measurement of ROI/Financial Impact**
2. **Sourcing Vendors**
3. **Standardization**

The standard ROI tracking approach relies on receiving specific initiative updates from management teams at quarterly Board Meetings, however these reporting methods often don't explicitly link to value creation achieved. While there has been some success in the applying value creation approaches across the portfolio, specifically digital marketing and integrated CRMs, opportunity remains to substantially scale those efforts.

Strikingly, more than half (54%) of value creation ideas developed during diligence are not acted on and often lost. Out of the ideas selected for implementation, only 48% are executed, and less than half of those (47%) are successful.

PE firms self-report that less than 1 out 4 ideas they select for implementation are viewed as successful executions.

> "There is a huge gap in the industry for building a value creation plan that goes past the typical 100-day plan to ensure all initiatives and objectives are followed."
>
> — PRACTICE LEAD, UPPER MIDDLE-MARKET FIRM

The Rising Demand

The demand for diligence products and services to assess technical risk is rapidly rising and starting to cover a broader scope

ACCELERATING THE DILIGENCE PROCESS

It's clear there's a need to improve the diligence process. Fortunately, there is overwhelming demand and motivation for change. This is a top of mind issue for firms facing pressure to stay ahead, identify new opportunities and deliver positive returns.

Across the industry, firms are willing to integrate better, tech-oriented tools in their diligence processes and value creation activities. But, to what extent? What categories are prime for substantial adoption? And what are the foreseeable roadblocks?

The most commonly conducted tech-related diligence category is technology operations (e.g. IT organization, business continuity), which is currently being carried out 60% of the time, with an expected 25% growth over the next 5 years.

Overall, the tech-oriented diligence performed today still tends to focus heavily on assessing downside risk and exposure. However, the market is moving quickly, and as more companies begin to implement these solutions, focus will also begin to shift towards growth and upside potential assessments.

DILIGENCE ACTIVITY	FREQUENCY OF CONDUCTING DILIGENCE	EXPECTED GROWTH
Other Non-Tech Diligence *(Legal, Insurance, Tax, Compliance, QofE)*	93%	→
Market / Commercial Diligence	78%	→
Technology Operations *(IT Organization, Biz. Continuity)*	60%	↑
Security Systems *(Cyber, Privacy, System Audit)*	48%	↑
IT Back-Office *(CRM, ERP, Accounting, Licenses)*	45%	↑
Software Product Assessment	43%	↑
Digital Marketing Capability *(SEO, Lead Gen)*	42%	↑

Future Outlook

A handful of innovative firms are leading the way and paving a roadmap for the collective industry to adopt tech-oriented tools during diligence and value creation

FIRST-MOVERS

A small number of leading firms have advantageously prioritized the integration of new digital tools and processes during the diligence process. These firms have invested in building out their digital capabilities and talent to set up dedicated, in-house teams.

San Diego-based Ensunet has been a world-class provider of IT enterprise architecture solutions since 2008 The firm's team of solutions architects and engineers specialize in executing for their client's unique needs in the lightning-paced, no-margin-for-error world of M&A. Their suite of services covers the following areas:

- **Post-merger integration**
- **Enterprise infrastructure**
- **Applications**
- **Cybersecurity**
- **Pre-merger due diligence**
- **Data center relocations, design, and operations support**
- **Outcome-based IT planning and consulting**

Ensunet's IT diligence methodology allows rapid identification of weaknesses and opportunities that a buyers' team would identify during due diligence.

Another example is Cerberus Capital, an NYC-based firm with $50B under management. Cerberus utilizes a highly sophisticated model for diligence, leveraging in-house diligence, data analytics and IT teams that partner with investment and operational teams.

In late 2018, Cerberus Technology Solutions began building a team of 50-60 data scientists to leverage emerging technology, data, and advanced analytics to drive transformations for portfolio companies. Collaboration between Cerberus Technology Solutions and investment teams facilitates new investment opportunities and helps Cerberus assess risks and opportunities during pre-investment diligence processes. In addition, the dedicated in-house IT teams help the diligence team build models to analyze and improve maintenance cycles, cost and frequency of outages for portfolio companies

As a result, Cerberus is far more advanced and sophisticated than the market by using a holistic approach addressing full IT and digitization needs in both due diligence and value creation initiatives.

Another firm deploying innovative solutions and IT tools that create value in diligence is Triton Partners. Triton is currently invested in 41 companies in Europe, with combined sales of around €16.5bn and around 80,000 employees. The firm provides consultation to companies on the best digital improvements, and potential growth areas based on industry and company capabilities. They are also actively pursuing value creation opportunities through their Digitalization Group. The Digitization Group facilitates 'digital journeys', including improvements to internal systems, staff augmentation, tool upgrades, and workshops/trainings.

Additionally, new approaches and tools are also emerging to help PE firms manage the internal diligence process. DiliVer, an M&A software company, specializes in due diligence solutions that help yield better combined entity outcomes based on advanced analytics for enterprise performance to date and growth potential in the future. DiliVer's MAST™ (M&A Software Tools) SaaS applications offer the FinTech M&A market's only packaged enterprise-wide, metrics-based due diligence scorecard tools that allow executives and investors to make data analytics-driven deal decisions to improve the quality and reduce the risk of M&A transactions from both the buy side and the sell side.

> "IT and Tech used to be something that was just not looked at in diligence. Now, it is an ever-increasing component of what we do..."
>
> — DIRECTOR, LOWER MIDDLE-MARKET FIRM

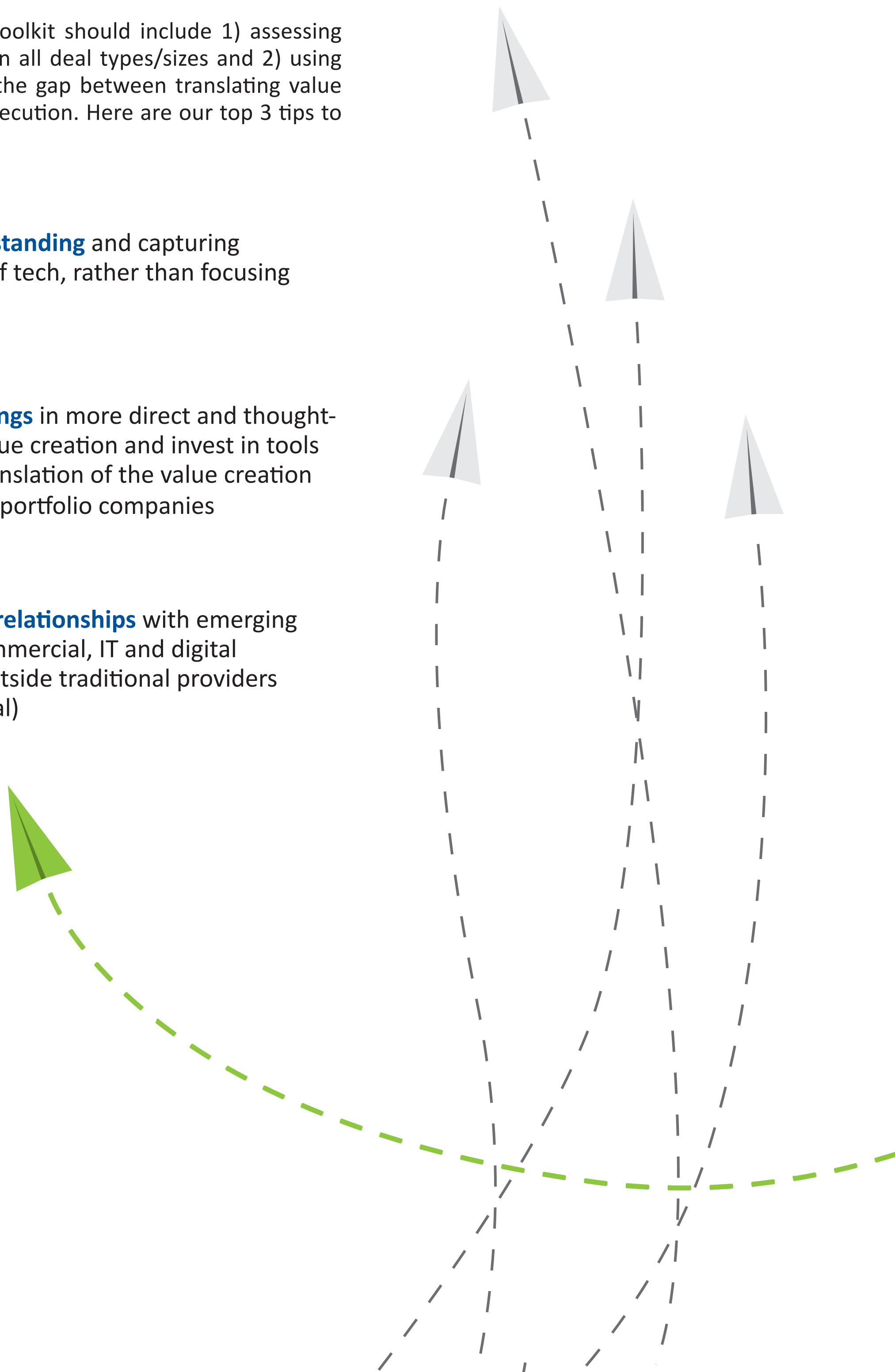
TAKEAWAYS

Moving forward, every PE investor's toolkit should include 1) assessing the risk and upside potential of tech in all deal types/sizes and 2) using tech-enabled diligence tools to close the gap between translating value creation ideas at close to successful execution. Here are our top 3 tips to help PEs prepare and stay competitive:

Invest more in understanding and capturing the upside potential of tech, rather than focusing on downside risk

Utilize diligence findings in more direct and thoughtful ways to inform value creation and invest in tools that ensure better translation of the value creation plan to action for the portfolio companies

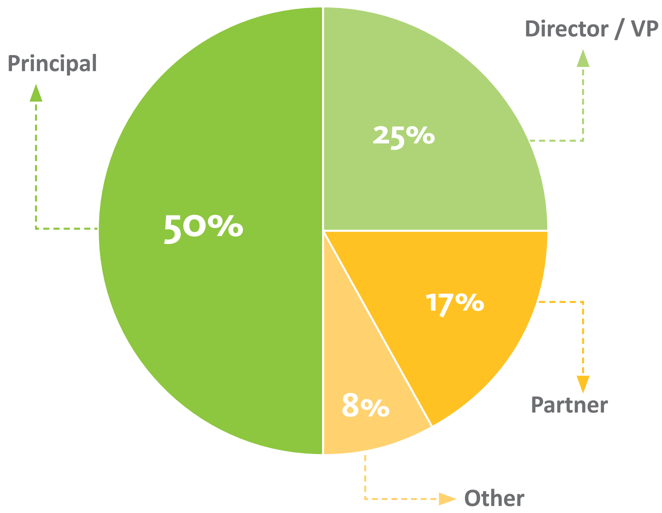
Build and strengthen relationships with emerging diligence vendors (commercial, IT and digital marketing) that are outside traditional providers (Q of E, insurance, legal)



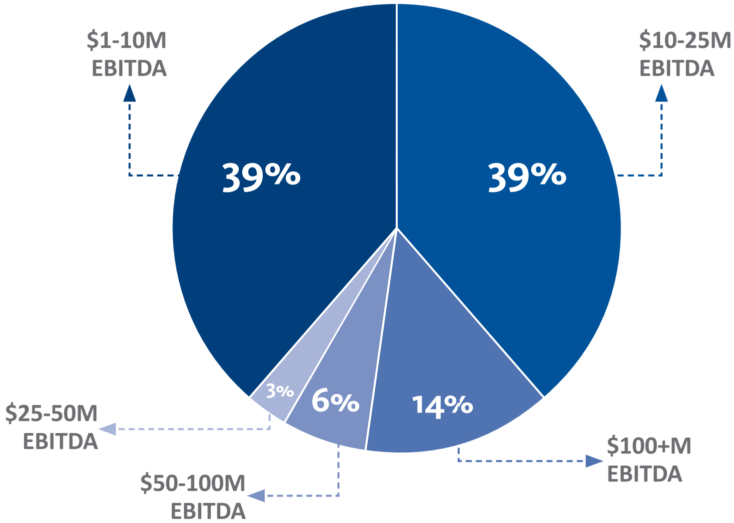
Methodology

Kaiser's "The Changing Role of Tech in the M&A Lifecycle" study explored the evolving role of tech-oriented tools during diligence and value creation through in-depth conversations with senior leadership at private equity firms across the US ranging from lower to upper middle market. From January to March 2020, Kaiser Associates conducted primary interviews and online surveys with ~40 private equity firms in addition to a handful of service providers that have current market offerings in the space.

QUESTION 1: WHAT IS YOUR CURRENT ROLE?



QUESTION 2: WOULD YOU PROVIDE SOME DETAILS ON THE TYPICAL SIZE OF COMPAINES YOU INVEST IN?



About Kaiser

Kaiser Associates is a global strategy consulting firm that set the standard for "fact-based" strategy and implementation. Since founding in 1981, Kaiser has deployed unmatched 360^{o} research capability and rigorous analytics to generate original, granular insights that help our clients turn their most difficult challenges into game-changing growth and productivity opportunities.

Today, Kaiser continues to approach every engagement with an entrepreneurial spirit, often operating like a start-up to remain nimble and agile with a bias towards action. We are privileged to be a preferred thought partner to some of the world's most admired companies, currently working with 8 of 2020 Fortune's Global 50 most admired. Kaiser supports global clients from our headquarters in Washington, DC and offices in London, Hong Kong and Sao Paolo.

KAISER'S PRIVATE EQUITY BUSINESS

Kaiser's Private Equity and M&A Practice partners with active acquirers ranging from middle market, large cap firms, to active Corporate Development teams. We support clients across the entire M&A lifecycle including deal generation, threshold question testing, market sizing, commercial due diligence, portfolio operations and exit.

Our approach combines rigorous qualitative and quantitative analysis, original primary research, and industry expertise in 5 core sectors: Consumer & Retail, Financial Services & Payments, Healthcare, Industrials and TMT.

Our services are particularly effective in niche and fast changing sectors, or in situations where the investment thesis is based on a particular angle that is not sufficiently covered in the public domain due to our unique ability to create a totally "new-to-the-world" and accurate fact base.

GET IN TOUCH WITH US

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