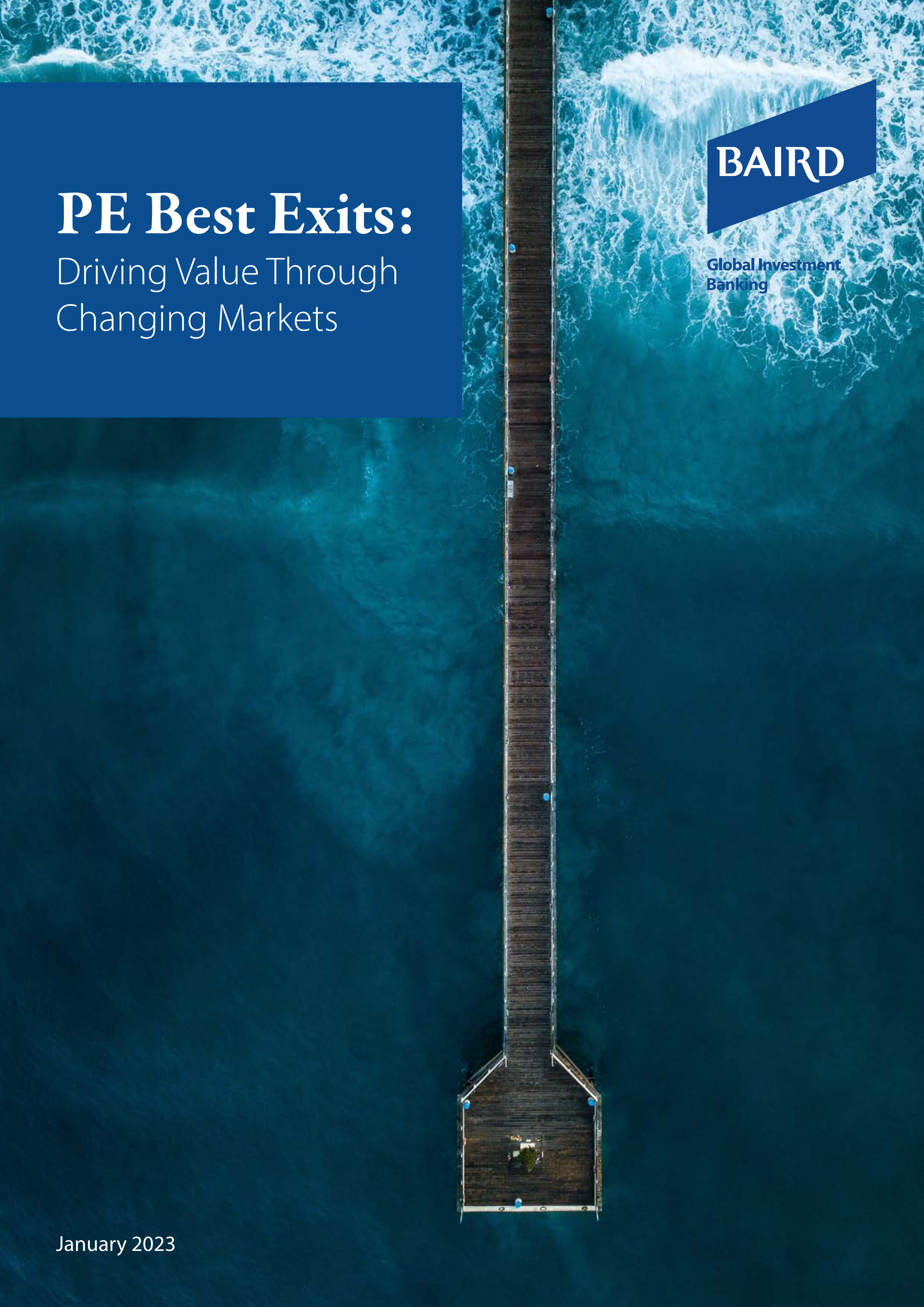

PE Best Exits:

Driving Value Through Changing Markets

BAIRD

Global Investment Banking

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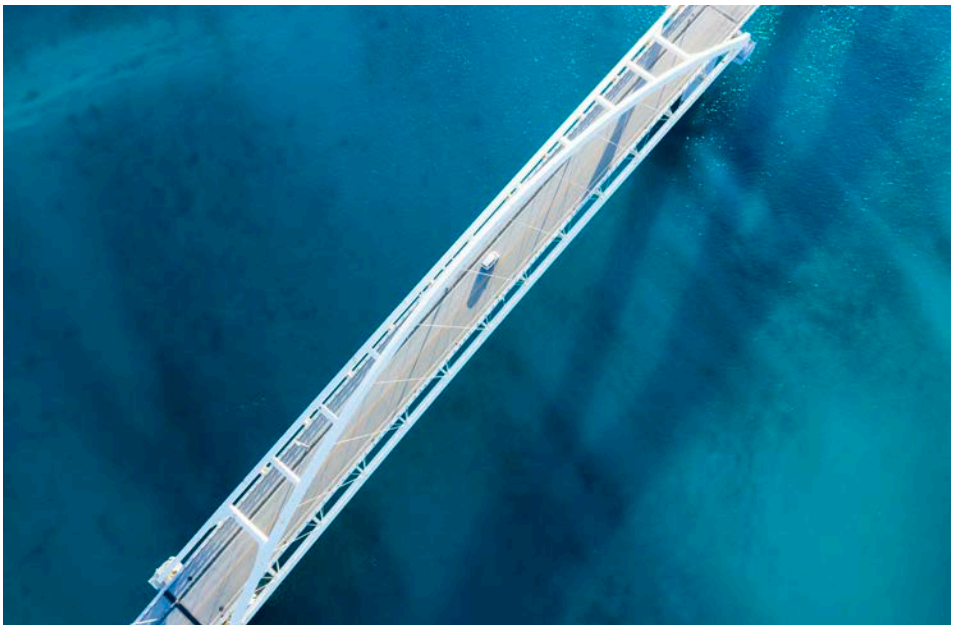
Contents



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Foreword

One of the core Baird culture principles is: "quality is the measure of our success". While perceptions of high quality might vary, we were curious to hear from our partners in the private equity community on how they think about their highest quality exits.

Over the course of our many years in the M&A advisory business, our Global Investment Banking team has witnessed the growth, evolution and increasing influence of financial sponsors on the global M&A market. With the number of PE-backed portfolio companies reaching new highs, we thought it would be timely to examine how sponsors execute on value-building practices and strategies throughout their hold periods.

For this reason, we partnered with H/Advisors Cicero to undertake an extensive study looking at which drivers are most impactful in delivering outsized returns. To do this research, H/Advisors Cicero conducted detailed interviews with senior professionals at nearly 100 financial sponsors, with a focus on exits ranging from Q1 2021 through Q3 2022.

This report represents the insights from those discussions and features the core ways that financial sponsors seek to enhance the value of their portfolio companies during ownership. Some of the findings are what you might expect, tried and true strategies that while not easy to implement are the cornerstone of investor success – fueling revenue growth, transforming management and achieving tech-enablement, to name a few. There are, however, a number of other key takeaways that aren't nearly as self-evident, which we hope you find interesting (we certainly did!).

While many of the exits covered in this report benefited from macroeconomic and financing liquidity tailwinds that no longer exist today, we believe this report's conclusions largely apply in a variety of M&A markets. Indeed, digging deeper into the many value-enhancing levers pulled by financial sponsors during hold periods illustrated the crucial point that sponsors are primarily focused on building must-own assets, which inherently have a scarcity value and perform well at any stage of the M&A market cycle.

We encourage you to read further for much more detail on the insights gleaned during the study, and we welcome your feedback afterward.

On behalf of Baird Global Investment Banking, we close by extending our gratitude to the participating sponsors for being so generous with their time and insights. The report that follows is one of the first of its kind and could not have been completed without the generous participation of our financial sponsor partners. Thank You!

Executive Summary

Our research into the best exits of the past 18 months found that financial sponsors increased the value of their investments in many ways and at every stage.

From acquisition, throughout the hold period and including the exit process, private equity (PE) owners carefully considered several levers to create a must-own asset with strong appeal to buyers, resulting in a compelling median exit multiple of 15x.

Highly favorable M&A market conditions were clearly a contributing factor around these best exits.

The meaningful multiple expansion PEs saw during their hold period cannot be ignored given the historic nature of the M&A market in 2021 and early 2022. That said, savvy investment strategy, thoughtful execution and sophisticated exit processes also helped to drive significant value creation. This report outlines the key findings pertaining to these latter points.

PE firms enhanced the value of best exits by building on a platform well suited for growth.

- Almost all sponsors cite revenue growth as the key driver of value
  - **41%** note company-driven and market-driven organic revenue growth as a top driver
  - Add-ons were a core focus for **63%** of best exits, generating revenue growth and cost synergies plus multiple arbitrage
- Over one third scaled up through aggressive expansion into new and underserved markets
- Strategically diversifying bolstered resilience, a critical advantage across economic cycles

Sponsors transformed management teams and information systems to maximize the payoffs of growth strategies.

- Strengthening management was the most frequently cited value driver at **78%** of best exits
- One third cite technological transformation as a top value driver, via improving operating efficiencies, advancing sales & marketing activity and supporting decision making

For the large majority of best exits, PE firms prevailed over strategics and provided a superior option relative to other exit alternatives.

- Of all best exits, **71%** involved a PE-to-PE trade
- Sponsor buyers' ability to outperform during this period was due in large part to inexpensive and widely available credit option – dynamics that are less in their favor in current markets – in addition to an ability to move nimbly through a process with speed and certainty

While many sponsors were opportunistic around their exit timing given the strength of the market in 2021 and early 2022, the data on those PEs that held their asset for longer than what might be expected is a noteworthy finding in the study.

- **60%** of best exits were held for a period of 4+ years
- **53%** of PE investors said they exited when planned or later
- Nevertheless, best exits occurred earlier than expected for nearly half, showing how nimble sponsors can be when warranted

To achieve optimal outcomes, PE firms handled exit processes on a case-by-case basis, with many planning for this stage far in advance.

- Over three quarters began preparing for the exit more than a year before the event
- One third noted understanding the likely buyer type as a key part of making the acquisition
- Many PE firms conducted bespoke, highly nuanced exit processes, with fewer than half using a standardized process

Looking ahead, financial sponsors acknowledge that the current environment looks very different than 2021 and early 2022. In particular, the shift in credit markets, with rising interest rates, has materially changed sponsor views on exit timing and willingness to stretch on entry multiple. That said, challenging markets provide new opportunities for PEs to generate value going forward and necessitate a renewed focus on the core operational and execution tactics that help drive growth in any economic cycle.

Section 1

Best exit snapshot

During a series of interviews with 96 senior professionals across key geographies, participants were asked to speak to one example which they considered their best exit over the past 18 months. The below provides a summary of the characteristics of these best exits.

% of Interviewees citing the metrics and/or qualitative factors used to determine the success of best exit[1]

Multiple of Invested Capital (MOIC)	Internal Rate of Return (IRR)	Other Qualitative Factors	Public Market Equivalent (PME)
91%	71%	41%	1%

Geographic coverage of operations and revenue of best exit

Market	%
Domestic market only	49%
Regional market	34%
Global market	17%

Timing of best exit

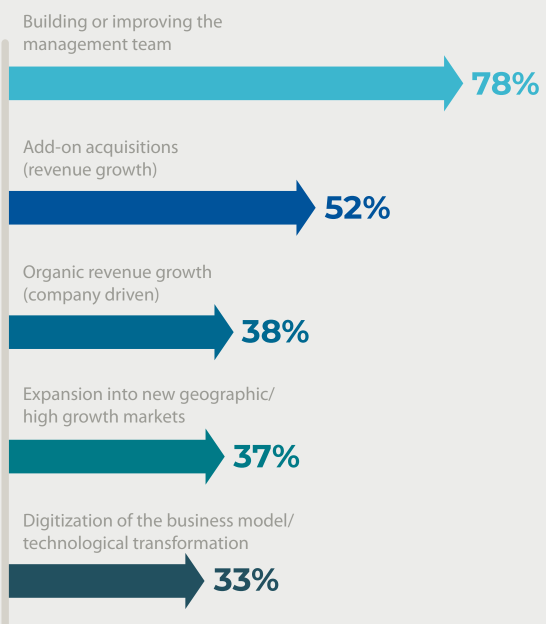
Quarter	%
Q1 2021	17%
Q2 2021	5%
Q3 2021	17%
Q4 2021	27%
Q1 2022	11%
Q2 2022	15%
Q3 2022	8%

[1] Sponsors were given the option to select multiple responses

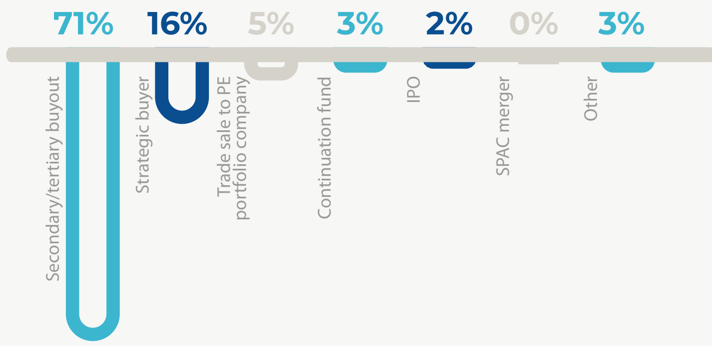
Enterprise multiple of best exit

Debt/EBITDA ratio of best exit

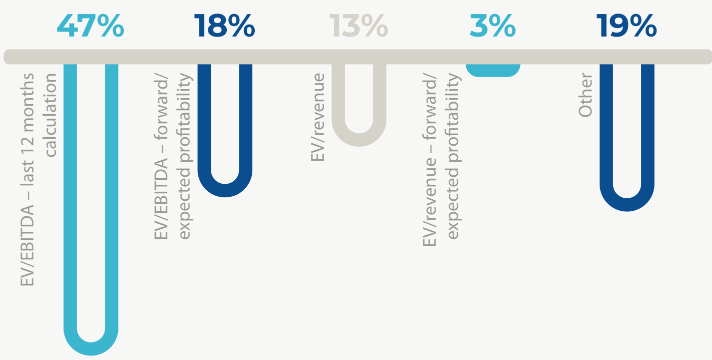
Steps that were taken to drive the value of the asset during ownership



Type of buyer of best exit



Enterprise multiple calculation used when acquiring the best exit

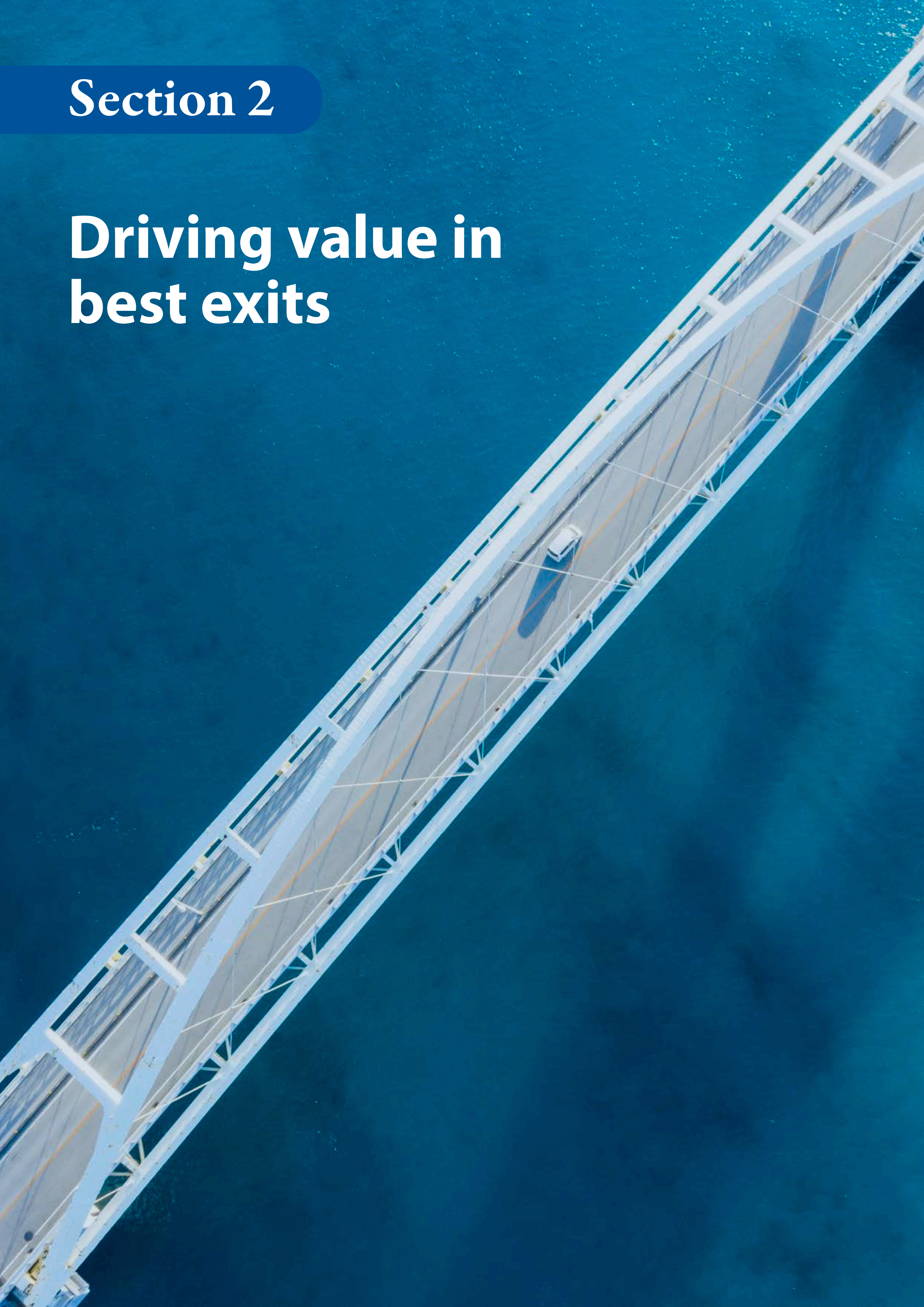


Key takeaways

- Best exits achieved a median exit multiple of 15x EBITDA, compared to 11x EBITDA upon entry
- Best exits did not depend on debt reduction, with median leverage down only one turn relative to entry
- While MOIC and IRR were certainly the key determinants of a successful exit, non-financial outcomes and context held significant weight
- Best exits tended to be found within the local market(s) that the PE firm operates
- Best exits were concentrated in Q3 and Q4 2021
- Assets were most likely to be sold to another financial sponsor at the end of the hold period

Section 2

Driving value in best exits



This report provides constructive insights into how PE firms created substantial value for their best exits over the past 18 months. It cannot be ignored that the unusually strong M&A market was a significant contributing factor to these successful exits.

The historic market conditions of 2021 and early 2022 afforded PE firms rare opportunities to capitalize on impressive levels of multiple expansion that are unlikely to be replicated in the near term.

We now enter a much more challenging period for financial sponsors. Nevertheless, our research reveals many ways that PE firms are creating value on a sustainable basis. Drivers that help sponsors ensure their assets are resilient to the impact of wider market forces and remain attractive to potential buyers in changing markets include:

1. **Growth as the main driver of value**
2. **Transformation of management and digitization**
3. **PE selling to PE**
4. **PE is patient capital**
5. **Bespoke exit processes**

We explore each of these drivers in detail over the course of the following sections.

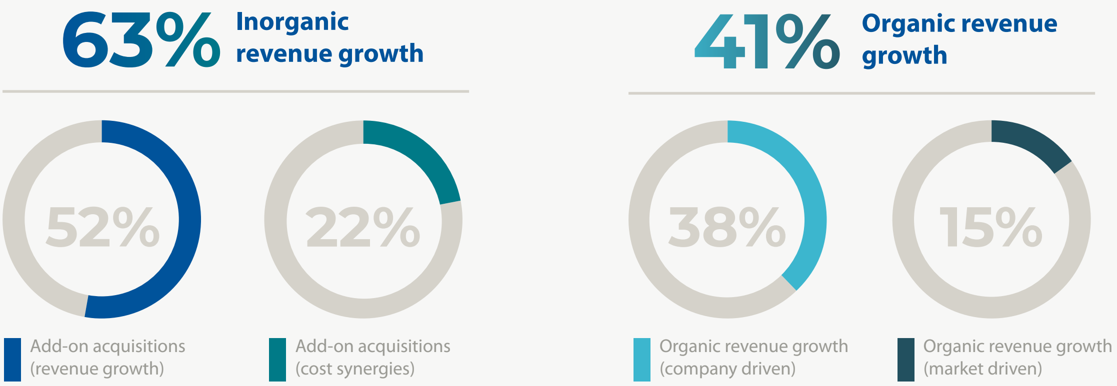
1 GROWTH AS THE MAIN DRIVER OF VALUE

While there will always be exceptions based on the sector, revenue growth – both organic and inorganic – was cited in our interviews as the key driver of value across almost all best exits.

To be clear, profitability remains important. However, in the debate around prioritizing growth versus improving margin, our work suggests that increasing growth is king.

To dig a little deeper on that point, a total of 63% of best exits over the last 18 months cite add-on acquisitions – either to achieve increased revenue or cost synergies – as a key lever used to drive value; while a further 41% cite organic growth as a key driver of value creation. For context, it is worth noting that buyers paid a higher growth premium than usual amid the peak M&A market conditions experienced during many of these best exits.

Add-on acquisitions for revenue growth was cited as a driver of value by 52% of best exits



A total of 52% of best exits used organic revenue growth as a key aspect of their narrative to prospective buyers

"We were primarily driving topline, organic revenue growth. The way to do that is primarily to increase the go-to-market effort, expand sales and marketing and that is what we did. We grew the topline by adding new customers."

"Strategics don't want to buy businesses that aren't growing or are losing money, so generating and proving topline growth with the core products was important."

"We were focused on actions that could drive strong revenue growth, as opposed to focusing primarily on optimising for profitability. As a result we tripled the company's revenues."

Add-On Acquisitions Continue to be a Core Focus

Each sponsor has a nuanced approach to M&A, but in most cases, PEs cite inorganic growth as a key driver in best exits. In a number of the discussions we had, finding a platform in a fragmented space was highly attractive to sponsors, and executing on a strategy of efficiently tucking in logical add-ons created meaningful value. The market is quite sophisticated around evaluating this strategy, so sponsors have been focused on finding targets that are truly strategic and getting the integration right. When done effectively, the available revenue and cost synergies, as well as the multiple arbitrage between add-ons and the broader platform, provide a substantial uplift. And when paired with strong organic growth, the combination of both growth levers working in concert is undeniably powerful.

"M&A is such an important lever. There were healthy levels of organic growth, but the M&A lever was really powerful. We took advantage of opportunities to consolidate a fragmented industry."

"We had a European business, but it was all done through a distributor. We bought the distributor to gain worldwide control of our brand and were able to do so for a low multiple. This meant we could expand more rapidly in Europe, control all costs and profit up and down."

"Our strategy was all about execution. We looked to make tuck-in acquisitions, and do as many as possible, as fast as possible. Then integrate the operational efficiencies of our playbook after each acquisition. We kept organic growth but pushed the inorganic growth."

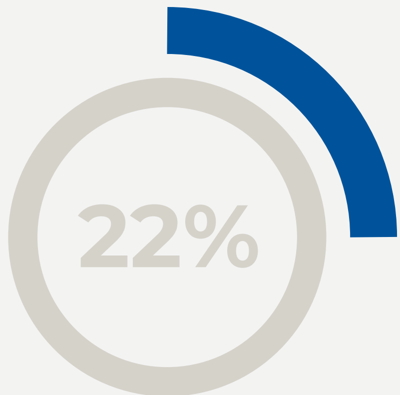
"The company was operating in a fairly fragmented sector, so one of the investment objectives was to be a key consolidator in this space and M&A was part of the strategic initiatives that we pursued."

Margins Matter Despite Rare Mentions

Although revenue growth ranked higher among cited drivers, strong margins are certainly a vital ingredient to prospering during the ownership period and attaining a rich multiple upon exit. Enhancing margins helps sponsors generate healthy cash flows to satisfy leverage requirements and fund growth. In addition, prospective buyers considering a bid at a stretch multiple would have a positive view of robust profit margins as signaling a healthy market position.

Based on our research, roughly one in five best exits cite profitability as a key lever used to generate value during the hold period. The relatively infrequent mention of margins as a value driver likely reflects that many of the best exits represented premium platforms already operating with high margins, leaving less opportunity to boost profitability.

22% of best exits cite profitability/EBITDA as a key lever used to generate value during the hold period



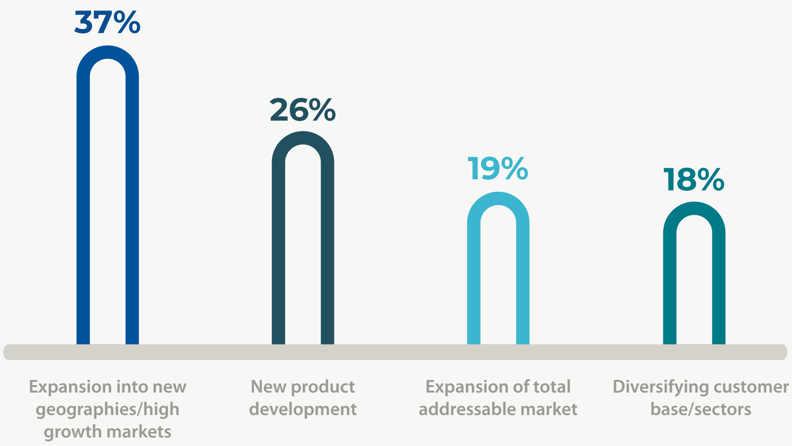
"We set out to buy other players in this space, to grow geographically in the US, but also to diversify our supplier base, with the view to de-risk the business and in doing so make it more attractive to buyers."

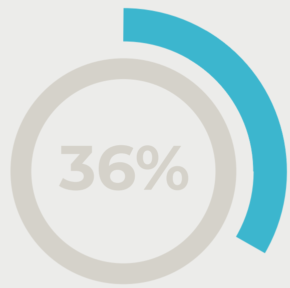
"The strategy is always to look at client and customer diversification. That is about de-risking the business and making it look more attractive to potential buyers."

Sponsors Seek Scale to Achieve Maximum Multiple Expansion

Our research clearly indicates that driving growth, with the ultimate goal of reaching greater scale, is viewed as essential to achieving a successful exit. One of the core ways in which sponsors are attaining greater scale is through aggressive expansion into new geographies and previously underserved markets. The ability to grow total addressable market is viewed as a major value enhancer, but our research also shows that entering into new regions/markets, or developing new products, serves to diversify business models and provide greater resilience. That last point is particularly critical as sponsors look to develop assets that will thrive in various economic cycles, with an inherent diversification that can endure in periods of uncertainty.

A total of 37% of best exits expanded into new geographies/high growth markets





A total of 36% of best exits used strategic opportunities (e.g., entries into new markets/sectors) as a key narrative for potential buyers

“The asset had some client concentration which we wanted to diversify to reduce the risk of the investment for us, while also making it more attractive to potential buyers.”

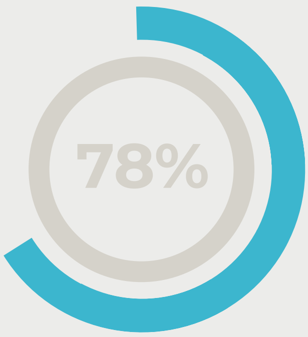
“We wanted to organically build new locations in new geographies, leveraging where we had already made some headway, as well as through add-on acquisitions that were strategically located in geographies that were otherwise more natural to add on. It is often the case with an exit that we try not to be overly reliant on singularly organic growth or add-on acquisition growth. That usually makes for a good outcome.”

2 TRANSFORMATION OF MANAGEMENT AND DIGITIZATION

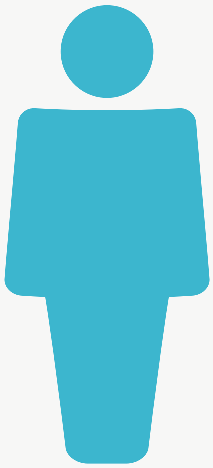
Financial sponsors view large investments in leadership and IT systems as essential to maximizing the growth strategies of their holdings. In our research, PE firms frequently credit their transformation of management teams and digitization of operations during the early stages of ownership as leading value drivers.

Putting the Right Team in Place

An experienced and capable leadership team is critical to drive the success of a new platform. Overwhelmingly, the majority of sponsors (78%) view the transformation of the management team as a key lever to drive value. The right leaders must be in place to develop and execute a strategic vision for the next chapter of growth alongside their PE partner. This is a foundational step to building a best-in-class business and possibly the single most important driver of value during the hold period. Importantly, this does not always require a complete overhaul of the entire team; rather, PE firms often take a partnership approach in strategically identifying areas for improvement and enhancement across the senior leadership team.



78% of sponsors cite **transforming the leadership team** as a method used to drive value during the hold period



20% of sponsors cite **transforming the leadership team** as the single biggest driver of value during the hold period

20%

"When we acquired the business, the CEO had the right resources for the stage of growth the business was at, but was not equipped for the next phase of growth. For our M&A efforts to be successful, the asset required the foundation of a strong leadership team."

"Restructuring the management team was a condition to achieve everything else we accomplished operationally. The company ventured successfully into new segments, product areas and markets, but it was finding the right people to manage this growth that meant it was a success."

A Robust Team to Execute M&A Buy-And-Build Platforms

As previously highlighted, PE firms are increasingly adopting a buy-and-build strategy to drive value in their best exits. To successfully lead a company undergoing significant expansion through add-on acquisitions, a strong management team is needed to manage growth internally and integrate new operations, cultures and products.

"You have got to execute on the M&A and after you buy the acquired firm, you must successfully integrate it. It is so much more than just the M&A activity alone. That is where the right management team can be make or break."

Robust Technology to Facilitate Growth and Scale

Introducing technology across a platform can drive increased operational efficiencies, accelerate sales and marketing activity, as well as support product and service innovation to better serve customers. As such, technological transformation and the digitization of the business model is among the top-five value drivers cited by PE firms within their best exit over the past 18 months (33%).

Upgrading Operational Systems and Tech-Enabled Business Models

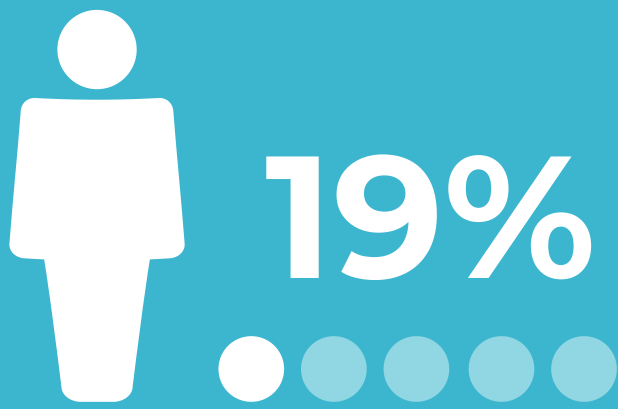
By integrating digital operational systems, PE firms are enabling their businesses to price more competitively, deliver more quickly and efficiently and improve the overall customer experience. Our research identified five key ways that surveyed PE firms are enhancing operational systems:

- Greater automation in production and distribution
- CRMs/tracking of consumer experiences and outcomes
- Migration of contact management systems
- Development of digital marketing platform and strategy
- Streamlining procurement/supply chain management

"On the productivity side, we invested in automation equipment. That both held margin and expanded output, which meant we could get more out of the existing facility and drive organic growth."

"We introduced tech-enabled systems to improve the core business operationally. This included a tracking system to understand our consumer outcomes, and a contract management system to implement management controls on solution provision. We also upgraded the sales process and sales model with an increase in digital marketing."

A number of sponsors highlighted the importance of developing new or improved digital sales and e-commerce platforms in order to widen the customer base and better serve existing customers. The expanded customer/market opportunity was a key part of their narrative to prospective buyers for nearly one-in-five best exits.



19% of best exits built *changing customer/market opportunity* into their narrative as to why the asset was attractive to potential buyers

Further, many firms directly attribute the strong performance of their asset through the pandemic to the work undertaken to digitize business operations and distribution of goods and services.

"We wanted to transform the business into a solution provider through investments in technology and the expansion of digital capabilities.

"A key objective was to make the business more of an omni-channel concept. When we bought the business, it was just selling wholesale to retailers, but we wanted to create an e-commerce site where we could do a portion of our business direct to consumer."

Metric-Driven Decision-Making

Data is instrumental to making effective decisions faster. A cornerstone of success within the best exits cited in our research is putting the right systems in place to track the right data. PE firms develop critical KPIs to track success over time so that evidence-based decisions can be made expeditiously. Digitizing internal and external data is essential to creating a metric-driven organization where decisions are increasingly based on real-time information. PE firms and management teams can harness data to drive targeted operational improvements that will enhance topline growth and expand margins.

Our research demonstrates that data-led and evidence-based business forecasts are a key aspect of the narrative for prospective buyers – cited by 45% of best exits. By using data, PE firms can easily quantify the value they created and articulate credible future opportunities for buyers to continue to grow the business. Such data points could also support PE investors as they raise funds in the more challenging current environment.

"We are very focused on data and analytics to inform decision making. We took what was an analog business and gave it real business intelligence. As soon as you have that at the operating level and it becomes an objective throughout the organization, you are going to get better efficiency."

"The company wasn't making data driven decisions before. They were using a lot of gut intuition and ad hoc information. So, we put a very regimented project management office in place. We also put corresponding metrics and measurement in place to ensure that the strategies being implemented were actually generating the return we thought they would."

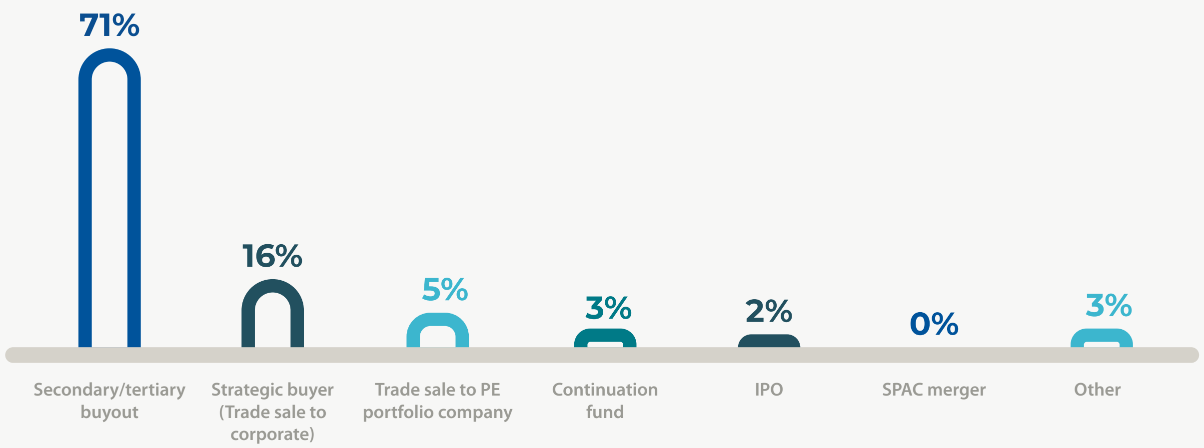
45% of best exits
built future business forecasts into their narrative as to why the asset was attractive to potential buyers

3 PE SELLING TO PE

While we often talk about a "lightning strike" outcome emanating from a strategic buyer, our research shows that a majority of best exits came through PE-to-PE deals. The PE interviews suggest a handful of reasons as to why that is – which we explore below – but it represents an interesting takeaway that challenges conventional thinking.

As we unpack the findings, it's again worth noting that market conditions from this period provided a fairly significant advantage to private equity buyers and we would not be surprised if a study of the best exits of the next 18 months arrived at different findings. For example, with the unusually strong financing markets of 2021 and early 2022 no longer available to sponsor buyers, the current backdrop may be more constructive for strategic buyers.

71% of best exits over the previous 18 months were either secondary or tertiary buyouts



> **"It was a very good time to be exiting businesses. Private equity firms were aggressively investing money. The backend of 2021 was the busiest time of my career, in terms of transactions."**

Fundraising Dynamics and Available PE Capital as a Key Driver

Private equity activity reached new heights in 2021 as market conditions produced a historic surge in deployment and exits. Global PE deal volume finished 2021 at $1.7 trillion, representing 30% of overall global M&A volume and a 72% increase over 2020.[2] Sponsors' ability to raise larger funds, driven by increased LP demand, coupled with immense "dry powder" helps explain the strength of the secondary market. While dealmaking in 2022 was slower and fundraising not as robust, a lot of capital remains available, with many funds now behind on deployment goals for 2022. In fact, the current global figure of uninvested private equity capital stands at a record $1.6 trillion.[3]

Barring further deterioration in the credit markets, a number of sponsors we spoke with anticipate an uptick in activity moving into 2023. That belief is driven by the need to deploy capital, as described above, as well as a recalibration on the sellside around valuation. We encourage financial sponsors to be opportunistic buyers in the current environment, noting that PE investments made during past periods of economic weakness (for example, in 2001 and 2009) demonstrated superior returns.

"There is certainly opportunity in the market because of the funds that have been raised. Institutional investors are putting more and more money into alternative investments. Over the next year to 18 months, I think there will still be plenty of competition. It's not like we can just sit on the sidelines for a year and wait for the markets to rebound. Investors will apply pressure to deploy capital."

"There is an unbelievable amount of capital out there. As broader economic growth becomes more muted and public markets slow, the delta for alternative investments will, in turn, continue to widen as investors seek out opportunities to put capital to work."

[2] Dealogic M&A database.
[3] Preqin data

Speed and Certainty Also Play a Major Factor

While sponsors have outcompeted strategics on value in many cases, this is not the only reason they have frequently become preferred buyers. In our discussions, we found the speed with which PEs can get a deal done, the sophistication of their diligence process and their willingness to equity backstop deals have also been a real differentiator. Throughout most of 2021 and early 2022, the competition for assets was fierce; the same could be said for "A+" assets in 2022. Sponsors have strategically picked their spots and focused on situations where they saw a distinct chance to win. This led to secondary trades delivering nice outcomes in terms of multiples, but also situations where speed, often through some sort of pre-emption, was equally prevalent.

On average, secondary or tertiary buyouts achieved a 16x multiple on exit

Secondary/Tertiary Exits

11x

Average EV/EBITDA
on entry

Secondary/Tertiary Exits

16x

EV/Average EBITDA
on exit

> **"We have certainly seen sponsors be very competitive with strategics, primarily on price but more so in the speed and certainty of execution they can offer. I wouldn't be surprised if the mix of sponsor vs strategic acquisitions has shifted towards sponsors, based on those observations. Sponsors have certainly become more aggressive."**

We had four private equity firms trying to pre-empt the process, which meant we were able to get a deal done at a full price that exceeded our expectations. It was done very quickly, and having that speed and certainty early in the process was very helpful.”

“Success is determined by the return firstly, but the efficiency of the process is also important. You can have a successful deal in terms of returns, but this can be ruined by a super painful, high-risk process.

4 PE IS PATIENT CAPITAL

Best exits often take patience, with longer time horizons required to scale leadership, drive inorganic and organic growth and produce evidence of transformation cited in the prior sections.

Historical analysis of the typical length of hold periods shows an increase over the past decade, from an average hold period of 4.7 years in the period around the global financial crisis to an average of 5.8 years post-crisis.[4] While one might assume that the increase in the length of the hold period is tied to COVID timing and dynamics, our findings suggest that COVID played a minimal role in delaying exits. Indeed, our research shows that funds are choosing to extend their average hold periods for their best exits – with 60% having a hold period of four years or more. Additionally, 53% of sponsors interviewed say their best exit occurred on time or later than originally planned to allow growth strategies and transformations to enhance the trajectory of the asset. In our research, longer holds often involved executing dividend recapitalizations – a step that 32% of PE owners took part-way through that longer hold period.

"Our basic principles include a business plan with 10 years visibility. This kind of time horizon allows us to put the right plans in place to do things like nurturing future banker and buyer relationships, and the necessary awareness building around the work we are doing with an asset."

"We are focused on long-term fundamental improvements, not quick hands, so we tend to hold assets for longer than is typical. With this asset, we invested significantly in an organizational restructure that fundamentally transformed the business, but we needed to be patient and transform the business responsibly with low volatility, which took longer."

60% of best exits came after a hold period of 4+ years

53% of firms exited when planned or later than planned with their best exit

32% of firms executed dividend recapitalizations during the hold period

[4] Juha Joenväärä, Juho Mäkiaho and Sami Torstila, The Journal of Alternative Investments Summer 2022

Sponsors Remaining Flexible and Opportunistic

While our research shows that PE firms are holding onto their assets for longer, a significant number of best exits (47%) were executed earlier than originally planned. Among this segment, PE firms cited favorable market conditions as the reason. We did a bit of a double take on this point since it appears contradictory to the data on the longer hold periods. However, in reality the data underscores the strategic mindset of sponsors who think long term and, at the same time, retain flexibility to judge their asset performance relative to market performance to deliver optimum results for investors.

"Competitors were selling and that was pushing the market value higher. We decided we wanted to catch the wave and engage with the market at that earlier point in time."

"The business had exceeded and outpaced our original expectations, which was really a reflection of the work that had gone into the asset to that point."

"Our strategy had the attention of a large corporation. From an investor perspective, selling meant capital could be recycled."

5 BESPOKE EXIT PROCESSES

Unsurprisingly, our research shows a high correlation between 1) the early development of an exit strategy and 2) clear guidance for the acquisition strategy and an ultimate successful exit.

77% of the best exits cited in our research began preparing for the exit more than a year before the event, endorsing what we have believed for many years, which is that exit processes benefit from thorough preparation.

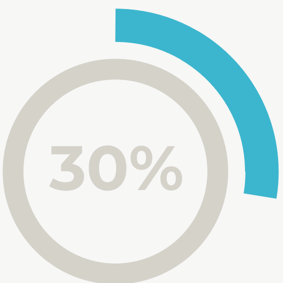
Exit Strategies Determining Which Assets are Acquired Today

While there is not a standardized, repeatable exit process for most firms, the preferred buyer/buyer type is typically considered early in the hold period and in many cases before the asset is acquired.

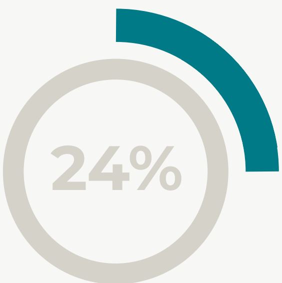
For nearly one in three firms, understanding who is a likely buyer/buyer type is a key part of the initial decision-making process when acquiring an asset. Additionally, this view of the anticipated buyer often drives the value strategy during the hold period.

"Exit consideration needs to form a central pillar of your underwriting process before acquisition, so there needs to be a clear consideration of who your likely buyers are, what they are looking for, what needs to happen for the organization to reach that point and what is the gap analysis on that. Some firms will do that in a more documented way than others – but it needs to happen in all cases to drive decisions during the ownership period."

"When we are hunting for companies, it is a strategic process. In all cases, we think about who the potential buyers are and how we are going to exit before we buy the business."



30% of firms state that their exit strategy determines which assets they acquire

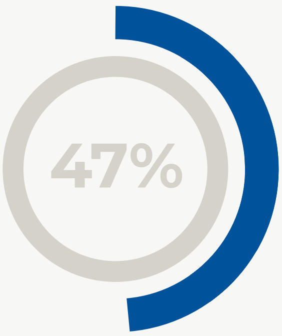


24% of firms state their best exit was developed right from the outset of the hold period

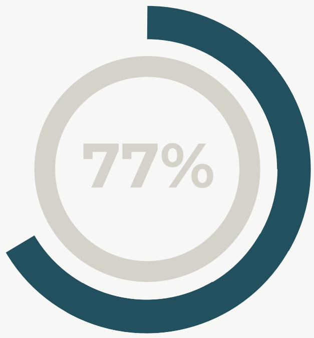
No One Single Process Fits All

While nearly all sponsors say the best exits involve a clear and evidence-led narrative, there does not seem to be other best-in-class specifics for an exit process. Fewer than half of PE firms claim to have a standardized or repeatable exit process. The market views the exit process as bespoke to the asset and often highly nuanced.

Where such processes exist, they are typically seen as broad frameworks as opposed to strict processes – able to flex to the unique case-by-case circumstances of each asset. The research shows that most firms rely on strategic advisors to guide them through the exit process, with the sponsors maintaining oversight.



Fewer than half of firms have a standardized or repeatable exit process



77% of firms prepare for the best exit more than one year before the event

"There is no playbook, every situation is different. There are things we try to align but it is all about drawing on the experience of our partnership. Many of us have worked for over 20 years on exiting businesses."

"Our strategy is very specific to each exit and to the type of process that we want to run. The process itself and the documentation for the preparation is very bespoke."

"How we think about and go about exiting is standardized. However, for different assets, you need to think about different things."

Section 3

Looking ahead

We applaud financial sponsors for making the most of a great M&A market through the effective strategies and tactics covered in this report. And to their credit, our discussions with PE professionals indicate that they are well aware of the need to adjust their game plans for current market realities.

Looking ahead, financial sponsors are less likely to benefit from aggressive buyer groups and extreme valuations during their exit processes in the near term. Nevertheless, interviewed financial sponsors expect opportunities to deploy significant capital, with the strategies used in recent best exits providing confidence in their ability to build highly valued businesses.

Deal makers face headwinds from elevated inflation, spiking interest rates, supply chain disruptions and concerns about an imminent recession. This backdrop is forcing investment committees to weigh more volatile trends in business performance in conjunction with debt financing becoming more expensive and less available.

When asked to identify the likely impact of the macro environment on M&A activity over the coming year, not surprisingly, sponsors generally foresee lower valuations and constraints in debt financing, contributing to a slowdown in deal making. However, sponsors also discuss how this backdrop can create acquisition opportunities, while others feel that it will lead them to focus on making businesses more resilient and likely holding onto assets for longer periods.

In light of the macro environment, sponsors foresee declining valuations and difficulties in financing debt

Declining Valuations

"Rising interest rates will have impact on valuations and will likely lead to drop in valuations."

Difficulties in Debt Financing

"The increased caution from the recession and interest rates will mean the financing of debt will suffer."

Overall Slowdown in M&A Activity

"It does depend on the type of assets, but at a total level we will certainly see a slowing down in deals."

Acquisition Opportunities

"Yes, there is a lot of caution and complexity, but it is an interesting time to be a buyer – with plenty of opportunities."

Emphasis on Resilience of Businesses

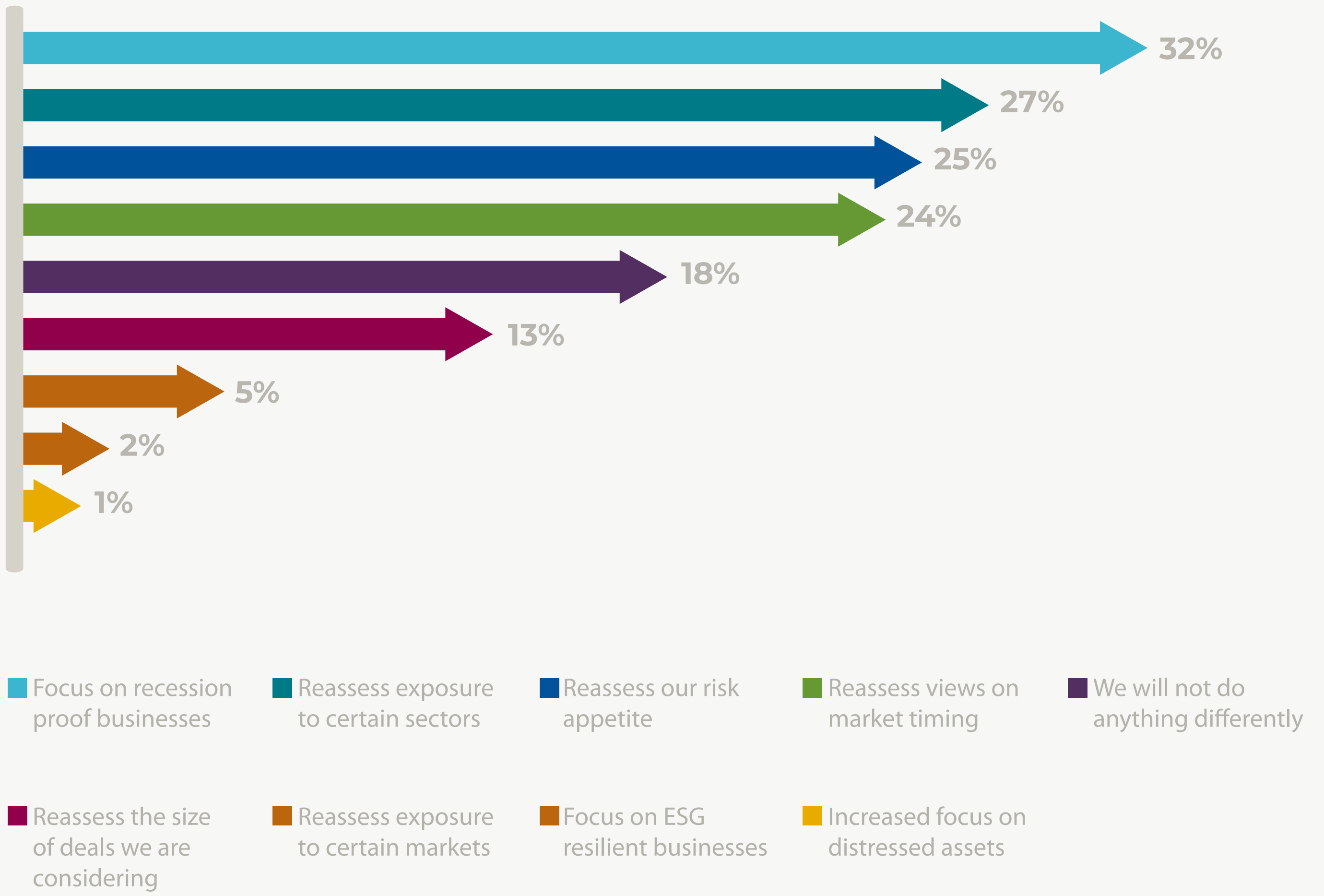
"Investors are going to be demanding 'good' businesses. We will have to focus on creating those good and resilient businesses."

Longer Hold Periods

"Deals are going to be done by management teams and founders that have 10-year horizons and not two-year horizons."

In view of the macroeconomic outlook, firms cite a more cautious approach: reducing exposure in certain sectors/markets or reassessing appetite to risk, maintaining focus on the tactics used in recent best exits to ensure continued performance and focusing on the long-term strategy for building and growing resilient businesses over periods of years.

32% of firms state that they will focus on recession-proof businesses over the course of 2023



"In my view, if you are changing what kind of businesses you are looking for based upon the macroeconomic outlook, you are obviously not doing a very good job at investing. We are looking for the same businesses we have always looked for – a key characteristic being that they are recession resistant."

"In my 20+ years of experience in private equity, I have reflected on every period of downturn wishing I invested more."

This study makes clear that, with the help of market tailwinds, sponsors have been adept at deploying value creation strategies to maximize returns. Even accounting for the wind at their backs, achieving a median 15x exit multiple is very impressive. Those results demonstrate how shrewd private equity investors have become in growing businesses in meaningful ways.

Despite changing markets, private equity as a whole continues to elevate its ability to build "must own" assets. Outcomes in future periods of disruption will require teams to work harder, but it will be exciting to see how those disciplined and consistent investors grow the next investments and turn them into best exits.

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ABOUT THIS REPORT

To better understand the developing trends among the M&A market's best exits, Baird commissioned H/Advisors Cicero to undertake detailed interviews with Private Equity (PE) professionals on their 'best exits' over the previous 18 months. During a series of interviews with 96 senior PE professionals across key geographies, participants were asked to speak to one example which they considered their best exit over that period. These insights form the basis of this report.

Special thanks go to the contributing PE firms.

FOR MORE INFORMATION

Contact a member of Baird's Global Financial Sponsor Group to discuss this report in further detail.

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