Getting an optimum exit price

By David Tager
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Until recently, private equity firms went out of their way to tout their hands-off approach to portfolio companies in order to make themselves more attractive to management when vying for deals. Today, however, we see PE firms emphasizing their hands-on role in value creation. Some have even gone so far as to brand the centralized "value-added operating teams" that they bring into portfolio companies to optimize costs and allocate capital. But the PE firms continue to leave one operational area to the portfolio companies' strategic communications. If the goal is to derive the best price at exit, this is a curious and misguided place to draw the line.

Put simply, a company with a good corporate story that is well understood should earn a higher valuation than a similar company with a good story that is not as well understood. The incremental value between the two is a communications issue.

At purchase, the buyer sees something others do not and capitalizes on that market inefficiency, that information deficiency. By the time of exit, the seller's best interest is to make sure that no information deficiency remains -- leading to full and fair valuation -- whether in the sale of a company under $100 million or in an initial public offering for a $25 billion company.

The key is to help ensure that the market appropriately values not just the physical and financial assets, but everything that makes the company differentiated and valuable: why the company has a strong strategy; why management is able to execute so effectively; why customers, distributors and talent choose the company over competitors; how the company is better positioned than competitors to capitalize on market opportunities; how "the whole is greater than the sum of the parts"; why the company deserves a higher multiple associated with one part of the business over another part.
This doesn't happen spontaneously; it requires a prudent, cumulative corporate communications effort that takes time. This is about effectively building and promoting a compelling, credible narrative that highlights the company's proven success and opportunities for profitable growth.

Importantly, significant additional benefits exist to executing an effective corporate communications program to further justify the investment. A good corporate story that people understand and respect contributes to increased sales, pricing advantages, and the ability to attract talent.

But not all portfolio companies are equally suitable candidates for strategic communications support. The impact of strategic communications and the incremental benefits of additional centralized support will vary greatly based on such factors as the industry sector; complexity of the business and related intangibles; the likely exit strategy and timing; and the portfolio company's existing capabilities and experience.

Judgment and cost/benefit analysis should be applied to determine whether it is worth directing additional communications resources to a portfolio company. The dollar "cost" for such communications support is typically insignificant for any company of size. The bigger issue is a philosophical one: Does management believe in the value of communications? And -- on a related note -- will they devote the time and attention required for the program to succeed.

PE people are typically numbers people, and numbers people often have an aversion to things that can't be readily quantified. Plenty of research points to the strong contribution of intangibles to a stock's value. But the reality is that this is more art than science, the evidence more qualitative than quantitative. Some skeptics might refuse to spend a penny unless someone proves definitively the impact of such a communications program on exit price. While measuring the potential benefit of communications might not be like measuring cash flow or Ebitda multiples, that doesn't make it any less valuable.

At the portfolio company level, we often hear CEOs say that they went private to be private -- to be liberated from the distraction and hassles of needing to communicate in a public way. Actually, it's often the same CEOs who claimed that the Street didn't "get" their story and failed to understand and accurately value the company's diverse, complex business.

That probably means one of two things: either the story is not as good as the CEO thinks, or it is a good story the company was not effective in communicating. Guess what? That issue isn't going to go away. And these companies ought to address it well in advance of exit.

Further, given the financial crisis and the unexpected strains that have impeded the ability of certain portfolio companies to execute on their plans, communicating why and how the company is still well positioned -- for customers, employees, and eventually for potential buyers/investors -- is even more important. Going dark and allowing others to define a company is the worst thing that company can do. Unfortunately, it happens all the time.

For those who remain skeptical about the benefits of corporate communications, it is worth looking at Warren Buffett and Berkshire Hathaway Inc. Some industry leaders point to Berkshire as a model for private equity going forward -- with its ready access to capital and unmatched ability to source deals. And while huge differences are obvious (with Buffett himself likely to disavow any comparisons), consideration of what can be gleaned from Buffett and Berkshire is useful.

Buffett is a tremendous communicator. He takes an active role in educating the market by promoting Berkshire's operating companies and the outstanding talent across the organization, such as the strength of executives Ajit Jain and Dave Sokol. This achieves two things: it bolsters market perception of Berkshire in the present, and it helps inform and build market confidence about Buffett's own eventual succession.

Of course, Buffett has unique, extremely high-profile platforms to promote the intangibles of his businesses -- his famous shareholder letter and annual meeting extravaganza, in addition to any top-tier media interview whenever he chooses.

This just means that the rest of us have to work harder and smarter to get out our stories effectively to support full valuation. That's why it's so important not to automatically defer this crucial responsibility to the portfolio company -- certainly not before first assessing its capabilities in this area.

To appreciate how important communications is in supporting value and when it should be factored in, turn again to Buffett. Imagine the first meeting between Buffett and Tony Nicely of Geico, or Eitan Wertheimer and Jacob Harpaz of Iscar Ltd. Buffett probably valued intangibles like their intelligence, management skills and character as much as anything else, even though those factors were "soft" and not readily quantifiable. Buffett is exceptional in his ability to assess the future value of a company, and that includes all of these contributing factors. He sees more than others see. And then, after the deal, he communicates effectively so others understand and recognize that value too.

Like Buffett, the deal team should form a point of view about the investment opportunity based on the current market perception and the "untold" story. The team should assess whether applying operational guidance and support in the area of strategic communications would lead to meaningful incremental value.

For instance, take a large financial data processor with a diverse business that has grown through many acquisitions. A complex opportunity requiring outstanding management might be an excellent candidate for strategic communications support. On the other hand, consider a small energy producer with a few power plants. That company most likely will be sold to a larger energy producer -- a commodity, capacity play. In that scenario, it probably wouldn't be worth devoting much time and money for strategic communications.

Take a moment to address timing issues specific to IPO exits. Given the Securities and Exchange Commission guidelines concerning the "quiet period," establishing a pattern of communications as part of "the normal course of business" is important. So, if you determine that a portfolio company would benefit from additional corporate visibility, that initiative should start at least two years in advance of exit.

After concluding that strategic communications would be beneficial, you need to assess existing capabilities at the PE firm and portfolio company levels.

You can build the function or retain outside resources. Regardless of where the talent resides, these individuals need to have a combination of analytical and creative skills that you see demonstrated in a strong investor presentation (that is, ability to build a clear, compelling, credible narrative) combined with strong business media relations and other external communications expertise. The company might have product marketers and perhaps communicators who focus on employees, the community or regulators. But that's not the same thing. And you can't just insert someone who lacks the specific, relevant experience and expertise to lead this initiative and expect a positive outcome.

First and foremost, the people who lead a strategic communications initiative need to have earned the confidence of management at both the PE firm and portfolio company levels. They need to be perceived as business partners who provide crucial input for shaping market, public and governmental opinion to help ensure the success of major operational initiatives and to drive the profitable growth of the company. It's not going to work if they are perceived as tacticians, people who take orders, and simply draft and distribute press releases and employee newsletters.

In terms of retaining outside resources, many larger PE firms regularly work with public relations firms that specialize in transactions support or other acute situations and projects -- litigation, crisis management. Of note, these firms typically have a different focus in terms of capabilities, business model and work style. In a transaction, the PR firm is often brought in by outside counsel or the investment bank, and leave with them after the deal is done. Ongoing communications programs are often multi-year efforts that require not only expertise, but also the right "fit" with the internal team.

PE firms have already dramatically dialed up their operational role with portfolio companies. If getting the optimum price at exit is the goal, strategic communications should be included as a core component of the PE firm's centralized operational team. This communications capability can be built internally or outsourced but requires experience and expertise in identifying the components of the most compelling, credible narrative for that company and the skills to convey it effectively over time.

Not all portfolio companies are good candidates for such communications support. Often the benefits might not justify the costs -- specifically the cost of management's time. Therefore, it's important to use screens and be rigorous in determining how investors would benefit, making the same kind of judgment call as with any other important resource allocation decision.

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