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Taking the mystery out of Carve-outs: IT perspective

Feb 28, 2019

AGENDA

01 Why Carve-outs are Increasing in Numbers

02 Common IT Execution Strategy Errors

03 Successful Solutions and Strategies

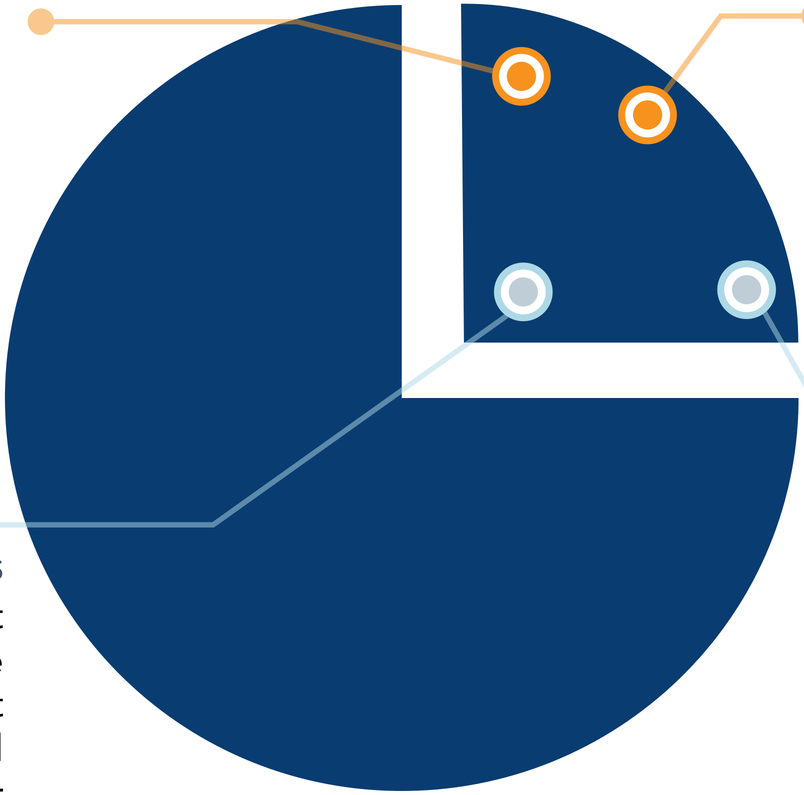
04 Real World Examples

05 Q&A

CARVE-OUT DEFINITION AND USE CASE

Underserved Division
Parent company is often underserving and underinvesting in the soon to be NewCo and there exists a market growth opportunity.

Large Conglomerate
Carve-out usually starts with a Large Enterprise Conglomerate parent company that is selling a division, in it's entirety, to a private equity firm who will run the business as an independent entity, which we will refer to as NewCo.



Private Equity Firms
Carve-out investment thesis assumes the parent company's cost of doing business will be significantly higher than NewCo to recreate operations.

Carve-out (NewCo)
This division relies heavily on the parent company for IT: Applications, Security & Compliance, User Support and Data Center. The NewCo will need to "recreate" IT from scratch during the stand-up process.

Rightsizing and modernizing NewCo IT routinely reduces IT spend by 50%

Parent Company IT Annual Charge Back	$3,000,000
NewCo Post Carve-out IT Run Rate	$1,500,000
Positive EBIDTA	$1,500,000
Investor Return 8X EBIDTA	$12,000,000

01

Drivers behind why Carve-outs are increasing in numbers

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WHY CARVE-OUTS ARE MORE COMMON

Increase in Demand

Increase in Dry Powder

Increase in dry powder is driving up multiples through deal competition and threatening investment thesis.

Niche Investments

Buyers are exploring more niche investments; Carve-outs being one of those.

Conglomerates Under Pressure

Conglomerates under pressure divest underperforming assets while increasing focus on core competencies. Market speed of change is favoring smaller, more agile decision making, causing business lock up in conglomerates to lose their position (and value) in a fast-pace market. As a result, huge corporations are ruthlessly narrowing their focus and shedding anything in the way of this. There is a subtle reorganization in the way the broader markets are competing, and specialization is no longer for the small niche player.

Mega Mergers Divesting Assets

Mega Mergers subject to anti-trust investigations are divesting assets that allow them to incrementally cross the goal line.

Profitable Divestitures

Deal multiples are allowing profitable divestitures.

Increase in Supply

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CARVE-OUTS ARE DIFFICULT: IMPACT OF POOR EXECUTION FOR IT

HIGH COST
Duplicate Systems, Consultants won't go away, IT staff twice as big as promised

LOW VALUE
IT moves slow, Outages, poor response to the business

SPEED TO EXECUTION IS SLOW
They take forever to finish anything

SECURITY & COMPLIANCE SURPRISES
Seems to be one surprise after another

CUSTOMER SAT. IMPACTED
Internal IT challenges are impacting customer interactions

IT NEVER ACCOUNTABLE
It's your fault for not giving them enough resource

IT CARVE-OUT GONE BAD

Permanent Transition: IT never becomes an enabler and a contributor to value creation and business plan execution, they are an inhibitor. Instead of IT being a competitive advantage, they begin to feel like an internal competitor for resources and the enemy of progress.

CHARACTERISTICS OF A FAILED CARVE-OUT

#1 #2 #3 #4 #5 #6 #7 #8

1 ADVISOR vs PRACTITIONER
Carve-out Advisor is hired for Program Management but doesn't actually do the work or make decisions - Facilitator

2 BLUEPRINT ADOPTION
Adoption of Parent Company IT blueprint instead of transforming IT

3 VENDOR RFP
The Blueprint is RFP'ed to vendors to get the best price on the Parent Company IT Blueprint

4 EARLY IT STAFFING
Advisors immediately begin staffing up NewCo IT

5 8-12 WEEK RFP DELAY
Vendors often spend months with Advisors while they deliver pricing and execution plans

6 THE HANDOFF
Advisors immediately begin handing off control of vendors and projects to new team as they transition out

7 ADVISOR MODE
They move quickly into a non-decision - making mode as "advisor" to new IT team

8 EXIT
They usually exit out long before projects are finished

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DUPLICATING PARENT IT BLUEPRINT: AVOID IF POSSIBLE

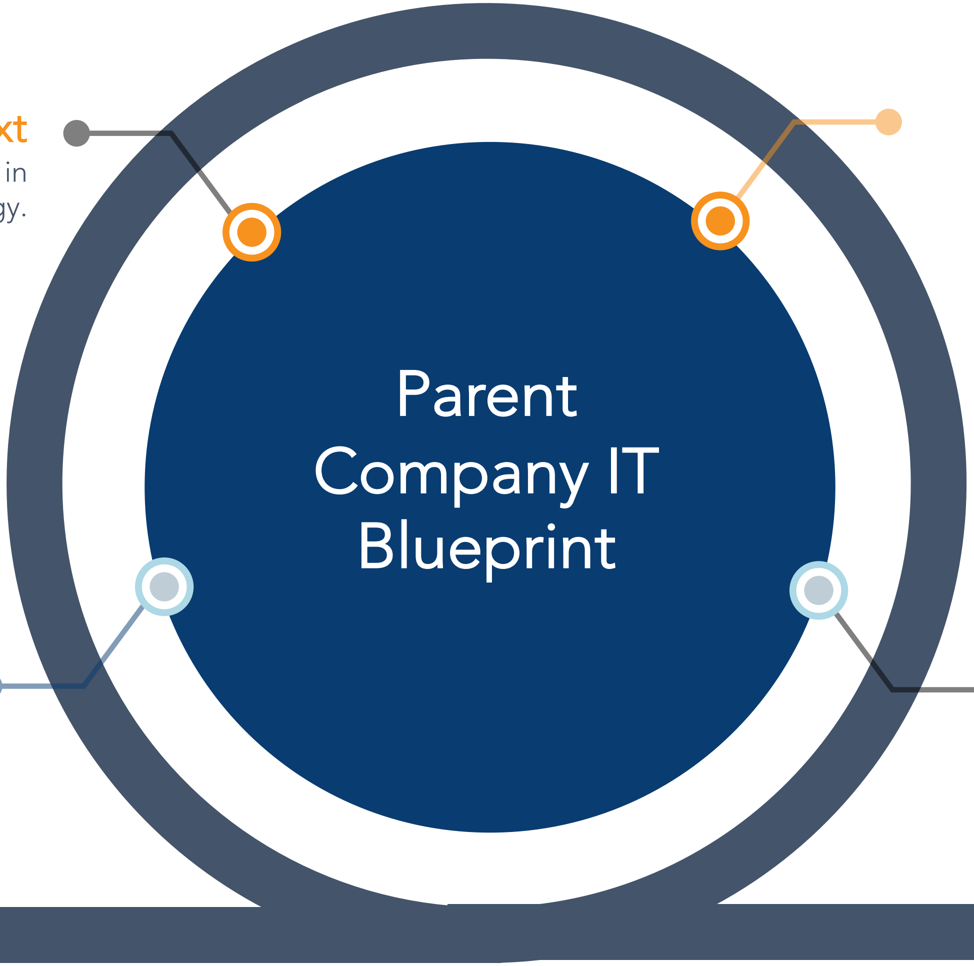
#1 Automatic Adoption of Parent Company IT Blueprint: Such as ERP, CRM, Telco, Phone, Data Center strategy.

Each Decision Impacts the Next

Everything in IT is connected together. A decision in one area can end up determining your entire strategy.

Cost Reductions are Limited

Your moving to a smaller house, don’t buy industrial kitchen appliances unless you have very good reason beyond time frame. Enterprise, custom IT is counterproductive to a mid-market company.



Limits Ability to Outsource IT

Mid-size companies lack the economies of scale to have enough skill sets to cover the complexity of modern IT stack.

Underperforming Assets

Usually have underperforming tools Parent companies are often selling these divisions because they are no longer strategic and have been ignored.

DRIVERS BEHIND "DUPLICATING THE BLUEPRINT MISTAKE"

Time and Risk

NOT TRANSFORMING
IT CAN COST

200%

MORE THAN NECESSARY

REPLACING KEY SYSTEMS = TIME CONSUMING

CARVE-OUTS ARE CHAOTIC

TRADITIONAL CARVE-OUT PLAYBOOK GRAVITATES AWAY FROM TRANSFORMATION

TSA TIMEFRAMES LEAVE LITTLE ROOM FOR ERROR

TRADITIONAL ADVISORS NOT ALWAYS PRACTITIONERS

TRANSFORMATION CAN BE ACCOMPLISHED WITH THE RIGHT TEAM

RFP & VENDOR SELECTION PROCESS

RFP CHALLENGES	SOLUTIONS
Takes 2-3 Months of Timeline	1. Hire a Practitioner who will come to the table with vetted solution sets and vetted vendors where they already know the pricing models and competitive landscape.
Eliminates Transformation Option 100%	2. Hire transformation expertise, not vendor management.
Low Price on Expensive Solution	3. Hire outcomes and not just "a good start": This requires the practitioner to own the outcome and stay until the projects are done.
Valuable Time Spent on Low Value Tasks	4. This requires the practitioner comes with a proven model that may not allow the luxury of waiting for the new IT staff to be identified, hired and brought up to speed on the plan before the solution is chosen.
	5. This requires the practitioner doesn't hand-off decision making to new staff before the transition is complete.

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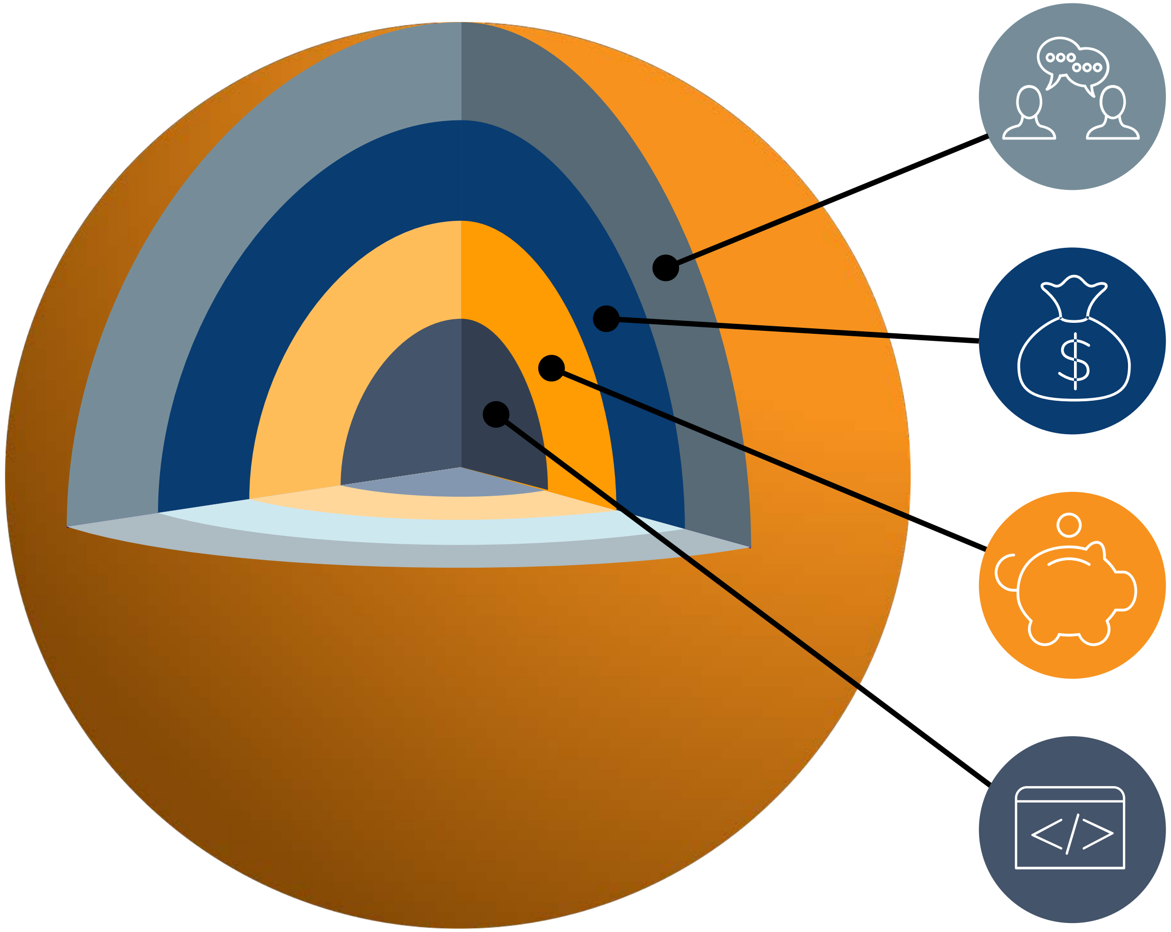
MID-MARKET IT STAFFING RECOMMENDATIONS



Operation Skill Sets
IT staff should have an operations skill set.

Transformational Skill Sets
Not a good long-term fit.

Staffing Levels at Stable State Levels
Keep costs low by staffing at the level that matches stable state run rate. If the staff has time to help with projects, your staffing levels are too high.

The CIO Decision
Careful with a CIO decision: If you have a good plan for the length of your hold period you may not need a technologist, but rather a vendor manager. If you have a tech-enabled business model, hire a business analyst, not a technologist.

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IT TRANSFORMATION

IT People Always Think They Can Do Transformation

01

Unnatural Speed

IT transformation in Carve-out needs to happen at a speed that is unnatural to those not experienced. They will slow you down and you will fail to perform a timely transformation.

02

Counter-Intuitive Decision-Making Process

IT transformation is COUNTER-INTUITIVE decision-making process: Maybe 1 in 10 will naturally understand transformation.

03

Career Development

IT Staff will see the project it as career development opportunity: This may be true but your Carve-out is not the time to make sure someone's skill set is improved.

04

Fear Will Result in Escalation

They will be scared by the "unnatural decisions" and pace and will scare CEO's and CFO's into allowing them to intercede in decision-making.

05

Outsource Threat

They will fight to outsource: IT have been trained to perform IT functions. They think they can do it better and outsourcing is a threat to their future.

06

PE IT is Different Than Regular IT

PE IT is different than big company IT – decision criteria is different. Cost of moving slow is dramatically different.

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MYTHS OF IT

1

IT is complicated and needs to be customized

90% of IT decisions can be standardized around a playbook.   90% of IT should be a templated decision model. We have proven it.

2

Insourcing is cheaper: Internal IT always think they can do cheaper

Adopting outsourced solutions that have been created by those vendors is usually much cheaper and provides scale up/scale down of IT mix as your needs change.

3

Multiple vendors is good because it keeps everyone honest

Quality IT providers, that your advisors have vetted out, are focused on keeping their offering as cheap as possible and as high value as possible.

4

Why not maximize capitalization

Accept that IT world is moving to an expense "As-a-Service" model, which may on the surface impact an EBIDTA model negatively but is a huge payoff.

5

Everything will work in Amazon or Azure

Not True. Amazon/Azure are great tools as part of the strategy but NOT the strategy.

SUMMARY OF LESSONS LEARNED: Q&A

Hire Practitioners not just Advisors

Don't Just Duplicate Parent Company IT

Transform IT during TSA

Hire Practitioners with Vendors and Solutions Ready

Outsource Where Possible and Staff Accordingly

Allow Carve-out Experts to Execute Plan Unimpeded