



Think. Forward! (Part Two)

By [Dan Kowalski](#), [Arun Shukla](#), [Phil Lynch](#)

Use Deliberate Thinking to get back in business after the gut punch of COVID-19 in the Private Equity world.

Unless your portfolio is singularly built on business platforms whose models work even when people self-quarantine (think Netflix and hand sanitizer production), your portfolio company valuations have taken a hit due to the spread of coronavirus 2 (SARS-CoV-2). So now what?

Introduction

This is Part Two of our series on how to use Deliberate Thinking to deal with, and bounce back from, the business impact of COVID-19, particularly within the Private Equity space. In [Part One](#) we covered how to make tough binary decisions that have no easy or obvious solution.

As self-quarantining, social distancing, and shelter-in-place orders change normal business patterns, many people have used the adage, “*when life gives you lemons, make lemonade.*” Great advice, but only if you have sugar, water, and ice available. As the world faces this global pandemic, Private Equity Sponsors and Portfolio Company Leaders are faced with new (even if temporary) business environments. This article focuses on how to leverage business strengths in the ‘now’ world, our current reality, and identify new opportunities (i.e., making lemonade).

Are there any lemons [what assets do we have at our disposal]?

If we somehow got a bunch of bright yellow lemons, we would recognize their potential to be lemonade. Similarly, PE portfolio managers are adept at dealing with “lemons” in the form of unstable platforms. The lemons from COVID-19 won’t be yellow, but we may be able to recognize the potential of those at our disposal.

In times of crisis, it’s imperative for business leaders to evaluate their current business models, product/service offerings, assets, and opportunities to collaborate, particularly within a Private Equity Sponsor’s portfolio. What assets (lemons) do we have to execute our business? These may be business assets such as customers and vendors or physical assets like a manufacturing facility, a clinic, a distribution center and a fleet of trucks. These may even be emerging assets such as a strong online brand presence, people who can execute remotely, a technology platform or delivery mechanism, critical IP, etc.

Through this identification process, we can determine if we do, in fact, have lemons. The process itself should be conducted both at the Private Equity Sponsor level (cross-platform) and the individual Portfolio Company level to ensure assets are identified effectively.



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Another example of identifying the lemons within our businesses applies to individual employees. Given the majority of office-based workers will be working from home until the pandemic is under control, the previous lost productivity from commuting, transitioning to different buildings for meetings, and other logistics is now free to become productive time that can be harnessed constructively to drive performance in this crisis.

Are they ripe [can we leverage our assets]?

If we squeeze an unripe lemon, we might get some juice. But probably not enough to make lemonade, and who knows how it would taste. Similarly, at the Sponsor and Portfolio Company levels, we need to conduct a capability gap analysis for our assets with a sharp focus on value preservation and creation. Key questions to consider in this gap analysis include:

- What is the state of the asset(s)?
- Does our asset still deliver optimal value in this environment?
- Can we adapt the usage to fit the new environment?
- Do we have the right people in place to shift the business and execute?

Sometimes we must wait for the lemons to ripen. The gap analysis will help prioritize which lemons (assets) we are able to harvest and use immediately or what actions need to be taken to execute in a new state. We must consider the value of the lemonade (output) by identifying what we will gain and estimate what it will take to preserve or grow the value.

What ingredients (and effort) do we need [how do we make it happen]?

While making lemonade may sound easy, making ‘business’ lemonade is more complicated and requires some forethought. Since each business situation will be different, we must think through what outcomes are needed and how to achieve them.

Using a “pre-parade” process will help us do this.

For a PE portfolio business, the needed outcome is preservation and creation of value. The pre-parade starts with the hypothesis that we can preserve and create operational value in this business environment through a combination of the following:

1. Change in operating cashflow (or increasing EBITDA) through revenue or margin improvement
2. Change in valuation multiple through inorganic and organic means
3. Change in net debt during the hold period through capital restructuring

From this hypothesis, we can then evaluate how to make it happen through an optimal combination of the above. The following steps will assist in identifying the recipe for success:

1. Identify the inputs and steps necessary for the successful hypothesis
2. Evaluate the probability that the inputs delivered to the success to home in on key elements
3. Identify what is needed to increase the probability of success, including timing, costs, personnel, technology, etc.



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4. Capture the expected outcome of the changes
5. Identify who is responsible for driving the steps and who is accountable for the overall outcome
6. Evaluate the plan, costs to implement, and anticipated outcome

Conducting this hypothetical recipe creation process will assist in identifying if the organization can effectively execute in the environment, if the cost/benefit equation is favorable, and if we have the resources – including the people – to make it happen. Essentially, “is the juice worth the squeeze?”

How does this really work?

While this sounds complicated, it just a matter of thinking in an organized fashion.

Main Step	Action	Example
Are there any lemons? <i>What are our assets?</i>	Conduct an inventory of the assets to identify both hard and soft assets at our disposal	Customers, vendors, distribution center, technology platform, brand presence, key leaders, available time, etc.
Are they ripe? <i>Can we leverage the assets?</i>	Conduct a gap analysis of the assets at our disposal	How do the assets fit into the business environment? Are they in a state which can be continued, or must they be adapted? Has there been a change in the way the customers buy and consume our product? Or, for a distribution center, the model may need small safety protocol changes but can continue to operate. An in-person service may need a technology platform to be useful.
What ingredients (and effort) do we need? <i>How do we make it happen?</i>	Identify the inputs and steps for success	Develop a new web page. Ensure video feeds are established. Implement security protocols and a paywall.
	Identify how to increase probability of success	Invest \$X dollars or staff training or 3 rd party transient solution. Mothball certain projects to free up technical resources. Leverage technology from XYZ partner.
	Assign roles and responsibilities	VP of Operations will drive overall project. VP of Tech will develop web platform. VP of HR will ensure key resources are on retention plans.
	Develop anticipated outcome and performance metrics	The new platform will shift business to 50% on the web demand and yield a 35% GM versus traditional GM of 20%.



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What's next?

In Part Three, we will assess the impact of the changes to “normal” business that may come out of this global pandemic. Rest assured, some changes will be temporary, e.g., routine social distancing, self-quarantining, shelter-in-place orders, and a reduction of eating out. However, some changes may be more permanent, e.g., increase in telemedicine, decrease in discretionary medical procedures, remote working as a routine, and delivery and consumption models.

We must assess whether our current methods will work or if we must adjust – both at the Private Equity Sponsor level and at the Portfolio Company level.