

PRIVATE EQUITY

# Private Equity Investing: Improving Operations to Create Value

In the decade leading up to 2022, the rising tide of booming markets lifted virtually all boats—including the private equity industry. But now that volatility has returned to markets, strong returns might not come as easily to many general partners (GPs).

That's because the private equity industry has largely relied on market factors for value creation. But with the protracted era of rallying markets behind us, GPs can no longer count on multiple expansion to drive returns.

This trend sheds light on our third and final step to private equity investing: creating value through operational improvements. After identifying high-quality businesses and acquiring them for value, improving their operations is critical to enhancing cash flows.

Here, we demonstrate how improving the operations of portfolio businesses can drive the majority of private equity value creation—and how it's best approached with an established, repeatable playbook.

# Three Steps to Investing in Private Equity



STEP 1



Identify high-quality  
businesses



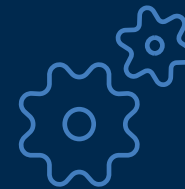
STEP 2



Acquire them for value



STEP 3



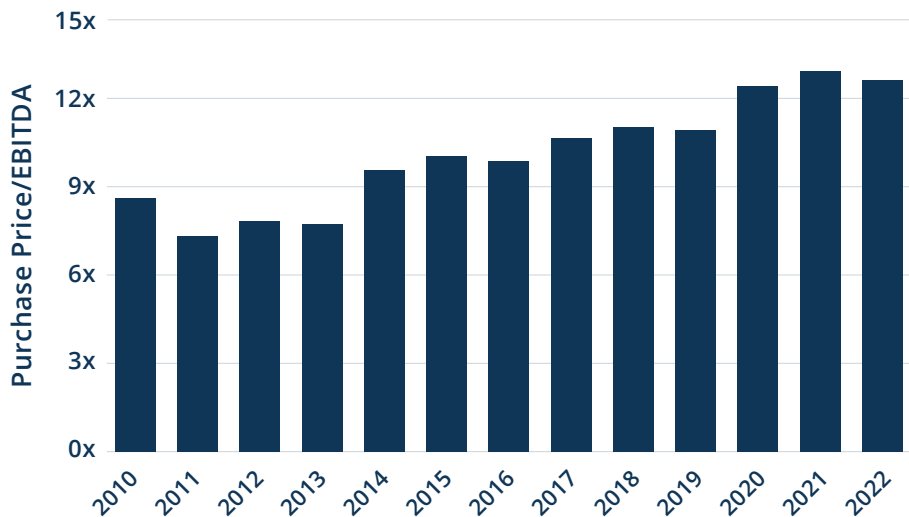
Meaningfully enhance  
their cash flows  
through operational  
improvements

# The Perils of Relying on Market Factors for Performance

The broad global market expansion during the most recent cycle has helped drive increasing multiples in private equity (see Figure 1).

**FIGURE 1**  
**Global Buyout Entry Multiples Have Increased Over the Last Decade**

Median Buyout Entry Multiples, Turns of EBITDA

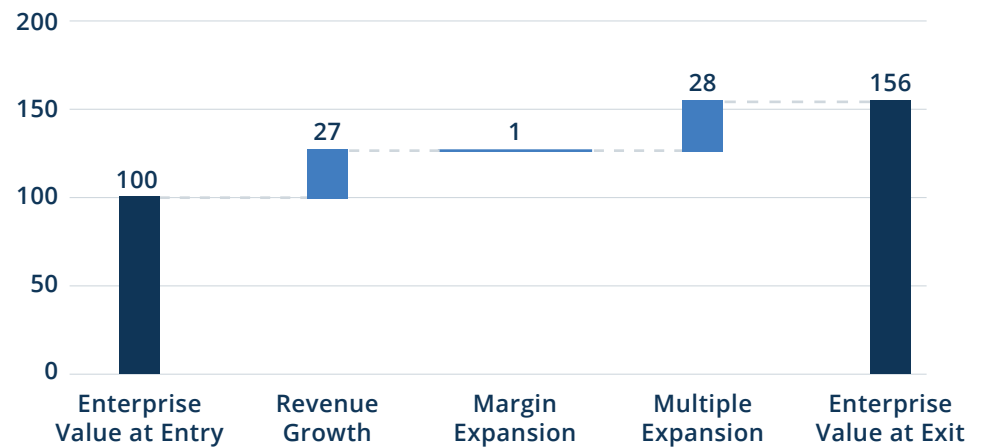


Source: McKinsey

A closer look at the drivers of private equity value creation reveals that the concurrent strong performance is no coincidence. Private equity returns for the period were driven primarily by multiple expansion, particularly in recent years (see Figure 2).

**FIGURE 2**  
**PE Industry Value Creation Has Primarily Been Driven by Multiple Expansion**

Median Index Value Creation (Global Buyouts, Deal Entry Years 2012-22)



Note: All calculations in U.S. dollars; deal universe includes buyout deals globally; all deal sizes; deal entry years 2012-22; fully realized and partially realized deals

Source: Bain

While surging public markets were a tailwind for private equity returns, the tides have since turned. The post-GFC bull market ended abruptly in 2022, and volatility has extended into 2023. As such, GPs can no longer rely on growing multiples and access to cheap leverage to drive value creation.

The good news for private equity investors is that multiple expansion doesn't have to be the primary source of value creation. We believe operational improvements—not market factors—can account for the majority of value created within a private equity portfolio.

# Creating Value by Focusing on Controllable Outcomes

Broadly, creating value through operational improvements is about providing leadership and direction as portfolio companies execute on their business plans. This generally involves some combination of strategic repositioning, operational excellence and enhanced commercial execution.

The process starts with identifying the operational changes that can drive the most value. This requires a focus on several core functional areas, with established special teams possessing domain knowledge in each area (see Figure 3).

Assessing and transforming an organization means thinking like an operator but evaluating like an investor—and having operational teams that are fully capable of stepping in and running portfolio companies. This can often mean taking a secondment as an interim step to establishing a strong long-term management team.

FIGURE 3  
**Core Functional Areas for Identifying Value Drivers**



# A 'Rinse and Repeat' Playbook

Improving business operations is best approached with a tried-and-true playbook. Following an established, repeatable process that focuses on core functional areas can effectively enhance portfolio company cash flows and drive value.

The process requires a holistic approach to developing a business strategy that incorporates both macro environment and internal considerations. The business plan can then inform strategic priorities and an operating plan can be built around them—ensuring that people, structure and processes evolve alongside the strategy (see Figure 4). An effective playbook for improving portfolio companies' business operations should also involve several key activities (see Figure 5).

FIGURE 4  
**Our Guide to Value Creation**

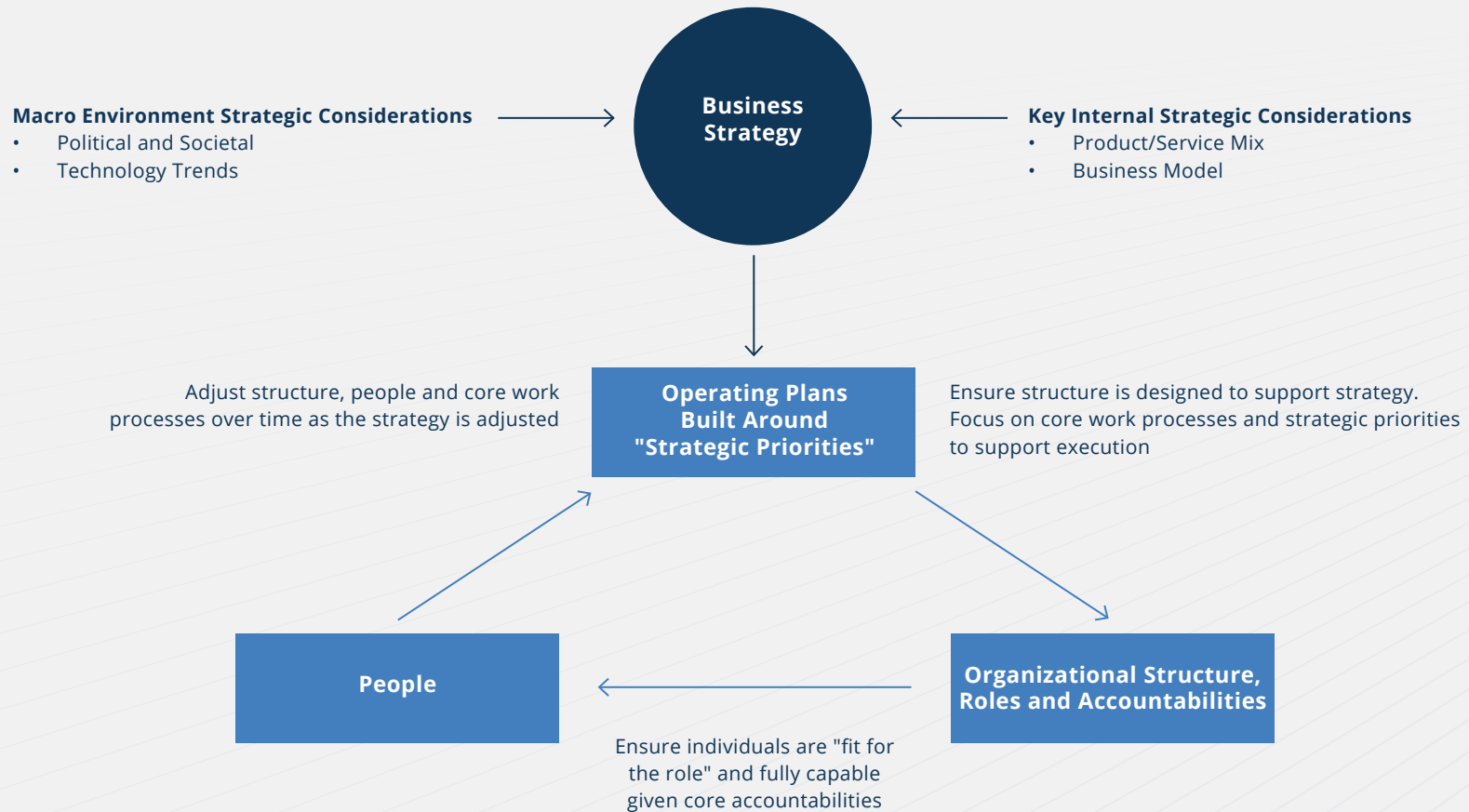


FIGURE 5

## Investment Process Playbook



### DUE DILIGENCE

- Broad-based strategic review, assessing the business model, core competencies, marketing positioning and allocation of capital
- Organizational review to assess alignment with strategy
- Value creation underwriting to determine opportunities and levers for cash flow improvement



### ONBOARDING

- Establish Board and Executive Oversight Committee, create alignment on value creation plan and onboard various functions to ensure day-one readiness
- Develop 100-day plan to continue strategic review, confirm value creation priorities, ensure a customer-centric business, and install a management operating system



### ASSET MANAGEMENT

- Active management approach based on areas of need and stage in the lifecycle, with business operations professionals often seconded directly into the business
- Execution of value creation initiatives across various functions, promoting a culture focused on cash flow generation



### EXIT

- Maximize value through successful implementation of value creation plan
- Demonstrated execution of a well-defined strategy and competitive advantages

# The Brookfield Playbook in Action: Creating Value at Westinghouse

Westinghouse is one of many examples where our playbook has delivered meaningful results when it comes to operational improvement value creation. Westinghouse is the leading provider of technology, fuel and services to the global nuclear reactor fleet. The company operates four main segments: operating plant services, nuclear fuel, energy systems and environmental services.

## The playbook

As part of our due diligence process, we conducted a broad-based strategic review. After assessing the company's organizational structure, we first installed an experienced management team to instill a culture of operational excellence and restructured the operating model to be customer centric and focused on cost to deliver.

Our strategic review also identified Westinghouse's core competencies to inform value creation priorities. This enabled us to sharpen our focus on the products and services that generate the most profits—and exit the businesses that don't. We consolidated the facility footprint and improved the nuclear fuel production process, increasing efficiency and optimizing the supply chain. We also renegotiated key supplier contracts, resulting in significant savings.

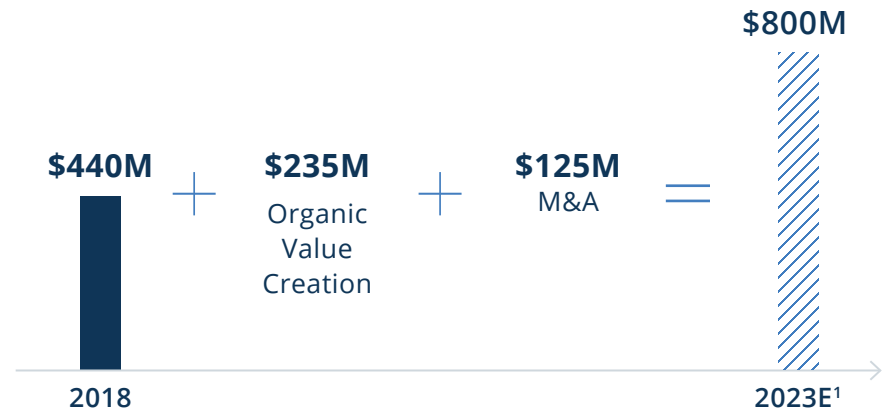
## The growth initiatives

We determined that revamping the company's commercial strategy to align the sales team and product innovation with identified market opportunities was essential to driving growth. We also expanded the geographic footprint and product offerings through M&A, integrating eight accretive add-on acquisitions.

## The value creation

Following our established playbook, we improved operations at Westinghouse with measurable value creation results. Through a combination of targeted operational improvement and M&A, we enhanced the company's EBITDA by over \$350 million (see Figure 6).

FIGURE 6  
Enhanced EBITDA by Over \$350 Million



<sup>1</sup> Reflects estimated EBITDA inclusive of synergies from add-on acquisitions, and based on numerous assumptions, including but not limited to synergies expected to be realized and operational improvements planned. There can be no guarantee that Westinghouse will be able to reach this run-rate EBITDA.

# The Final Important Step

Driving operational improvements to enhance cash flows represents the third and final step in our private equity strategy. While the first two steps—targeting high quality businesses and acquiring them for value—are essential, this third step is what drives value creation within a portfolio, and it is all through levers that we control.

In today's uncertain market environment, it's critical that GPs have the ability to create value independent of market factors. Improving portfolio company operations is a key driver of value creation—but it requires an established process with a track record of successful execution.

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