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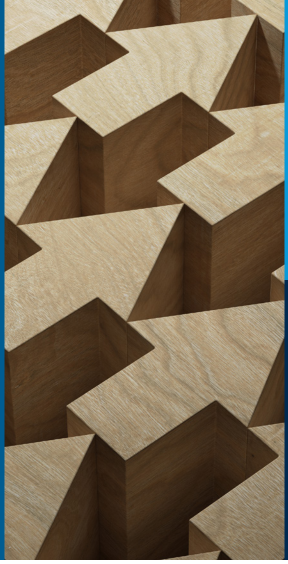

Hands-On Operational Improvement Key to Creating Alpha in the Middle Market

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Key Takeaways

- 'Buy and Hold' is no longer a viable strategy in the current macro environment.
- Hands-on portfolio operations is critical to driving profitability and equity value creation.
- Alignment and integration of investment and operating teams is key throughout the investment lifecycle.
- A deep and broad team of operating resources is essential to driving real change in the portfolio.

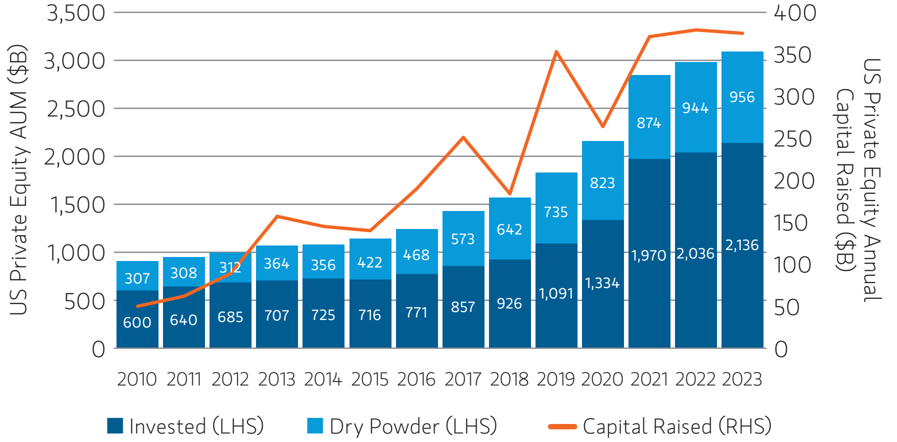
Differentiation is critical in a dynamic private equity landscape

The middle-market private equity landscape has evolved significantly in the past decade. Investable dry powder has set new records each year from 2010 to

DISPLAY 1

Fundraising and Dry Powder

Annual Fundraising and Total Private Equity AUM Have Increased Significantly Since 2010



Source: Pitchbook 2023 Private Equity Breakdown (published February 2024)

2023 and the sponsor universe has seen a significant volume of new entrants. An increasing number of investors, a larger pool of capital that needs to be deployed, and a fixed supply of top-quality companies have combined to drive up asset values, and in turn placed an ever-greater importance on the ability to drive true alpha.

Delivering top-quartile private equity returns in the face of a changing market backdrop requires a differentiated approach to investing and portfolio management. As asset values have increased, the ability to deliver consistent, strong returns through a simple buy-and-hold strategy has largely gone away. Instead, a hands-on approach to portfolio operations and value creation has become critical to generating value in portfolio companies. A successful approach to portfolio operations requires engagement starting with thesis development and diligence, ramps up with the formation and execution of the value creation plan during the first 12-24 months, and then continues over the full investment period to support management and create equity value.

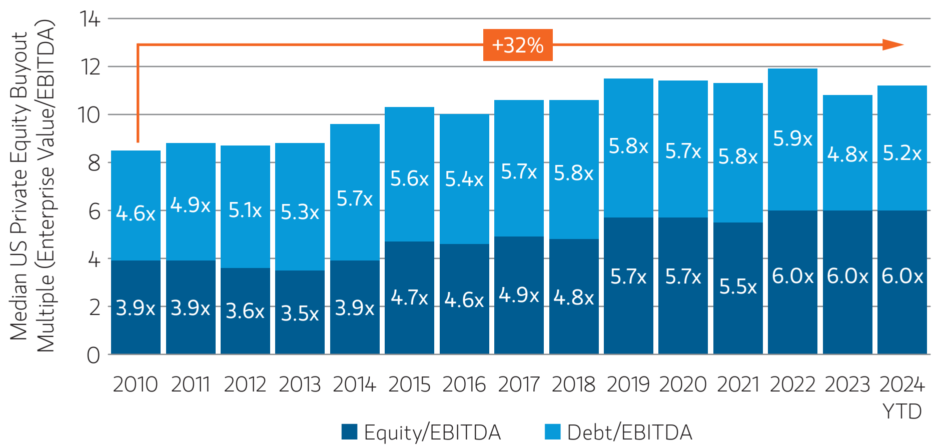
A hands-on value creation strategy has become particularly important given the macroeconomic backdrop of the last several years. The elevated interest rate environment has increased debt service costs and constrained cashflow for many private equity-backed businesses, as shown by a recent increase in borrower distress. In addition, overall market volatility combined with uncertain business and consumer confidence has led to a significant slowdown in private equity exit activity relative to the 2021 market peak, creating the largest imbalance in recent years between private equity investments and exits. This imbalance has created a heightened focus on returning capital to investors across the Private Equity landscape, and further emphasized the importance of building great companies that will be attractive to buyers throughout the ups and downs of the market cycle.

As sponsors adapt to a dealmaking chapter defined by generally lower levels of leverage, higher borrowing costs, uncertain economic growth, and a temporarily depressed exit environment, a hands-on approach to operational value creation becomes even more important. If a rising

DISPLAY 2

Buyout Multiples and Leverage

Private Equity Valuations and Leverage Have Increased Steadily Through 2022; Fell in 2023



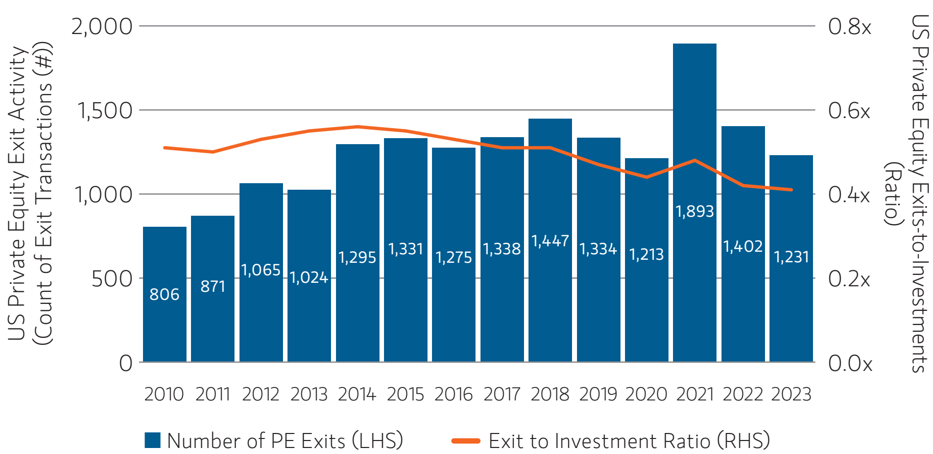
Note: Data represents valuation multiples from Private Equity Transactions financed in the Broadly Syndicated Loan market; 2024 data is YTD through 6/30/24

Source: Pitchbook Q2 2024 US Private Equity Breakdown

DISPLAY 3

Transaction Activity

Private Equity Exits Have Declined Significantly Since 2021 Peak



Source: Pitchbook Q2 2024 US Private Equity Breakdown

DISPLAY 4

Operational Lifecycle of a Private Equity Deal

Portfolio Operations Team Plays a Key Role Throughout the Deal

Thesis Development & Due Diligence

- Operational diligence
- Identification of 'quick wins'
- Management relationship-building

Value Creation Planning

- Create the aspiration
- Identify 3-5 key opportunities which move the needle
- Develop plan, timeline, and simple KPIs

Aligning Priorities with Management Team

- Execute on key projects
- Engage MSCP resources, Board Members, and third parties for support
- Track progress

Ongoing Support & Monitoring

- Monitor progress and adjust plans as needed
- Build out team and processes
- Prepare for exit

← Pre-Deal → ← 90 Days → ← 12-24 Months → ← Remaining Deal →

macroeconomic tide combined with financial engineering can no longer be counted upon to lift all boats, hands-on operational value creation will be key to driving sustainable revenue and EBITDA growth, building scalable and durable businesses, and thus driving differentiated investment outcomes.

Operational expertise is required to drive top-line growth, profitability, and equity value creation.

If hands-on operational value creation is key to driving portfolio company potential success, sponsors must define what a robust portfolio operations approach looks like, and how it drives day-to-day behavior within the private equity firm and within the portfolio companies. Looking across the sponsor landscape, successful operating platforms are fully integrated and engaged across all four stages of a typical private equity investment lifecycle.

THESIS DEVELOPMENT & DILIGENCE

To be truly effective, portfolio operations professionals need to be involved in evaluating a prospective investment from the beginning. Partnership between investing and operating professionals brings diverse perspectives to the evaluation of an investment and allows for the identification and execution of quick win opportunities shortly after close. Engaging early also allows private equity operations teams to build strong trust-based relationships with management, which are critical to establish credibility from the beginning. Successfully delivering operational value creation often requires management teams to embrace significant change, which is only possible when the Sponsor and management team have a truly collaborative relationship and are aligned on the same goals.

VALUE CREATION PLANNING

The first 90 days are key in a new private equity investment. It's during this period when relationships with the management team are solidified, goals are identified, and the strategic plan is developed. An effective operations team will lead the planning process and will move beyond a formulaic 90-day checklist. A differentiated value creation plan creates the aspiration for an investment, identifies a series of initiatives that are rooted in quantitative analysis and prioritized based on impact, and closely measures progress using data throughout the investment.

ALIGNING PRIORITIES

Once the plan is developed and the sponsor and management team are aligned on priorities, a hands-on approach to operational value creation is necessary to translate the plan into action during the first 12-24 months, which are critical to the success of any private equity investment. The specific drivers of value creation will vary by investment, but there are several common themes across the middle-market landscape. Operating professionals who can be on the ground with management teams and bring practical expertise around revenue growth, strategic pricing, cost reduction, M&A integration, and how to build a best-in-class management team through talent development and recruitment can drive repeatable value creation, and become a key source of alpha in a competitive marketplace. This ability to drive tangible operational improvement, and ultimately sustainable EBITDA growth, has become increasingly important in recent years, as cash interest costs have risen significantly after a period of near-zero interest rates and put stress on Private Equity investments that were predicated solely on financial engineering.

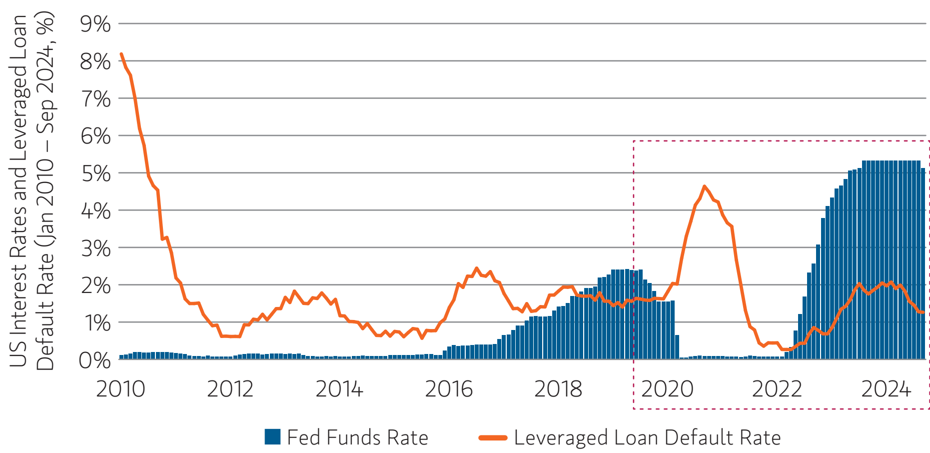
ONGOING SUPPORT & MONITORING

The focus of a portfolio operations team will naturally change throughout the lifecycle of an investment. After the plan is developed and implemented during the first 12-24 months, there is a shift in focus towards ongoing monitoring and support of the company. During this phase, key responsibilities include closely tracking the results of the value creation plan and making adjustments as needed, identifying needs within the organization, bringing the right resources to the table, and otherwise working with the management team to continue scaling the business.

DISPLAY 5

Borrowing Environment and Interest Costs

Higher Interest Rates Driving an Uptick in Leveraged Loan Defaults and Borrower Distress



Source: St. Louis Federal Reserve (FRED), accessed October 2024; Pitchbook (Morningstar LSTA Leveraged Loan Index Default Rate)

Success in operational value creation requires an aligned culture, strong team, and repeatable playbook

Delivering repeatable value creation through hands-on portfolio operations requires real investment from the sponsor. The most effective operations teams are fully resourced with the people needed to support a private equity portfolio of 10-20 companies at any given time, as well as the capabilities needed to identify and execute on multiple value creation levers.

Best-in-class operating platforms have built out deep teams, ranging from senior operating partners to mid- level and junior professionals focused on day-to-day support and execution.

Many sponsors have built some level of operating partner support over the last 10 years. However, these professionals are often external consultants or are deployed on a deal-by-deal basis. While this can be effective in some scenarios, there are real structural advantages to a model where operating partners are fully integrated with the investing team and are full members of the investment committee and carried interest pool. An integrated model ensures that operating professionals are involved with the full investment lifecycle as described earlier and that incentives are fully aligned around the long-term success of the full portfolio, avoiding potential deal-by-deal misalignment.

As operational value creation has become a bigger focus and a driver of alpha over the last five-plus years, best-in-class sponsors have invested further to build capabilities beyond a team of senior operating partners. Given the ambitious growth and transformation agendas that are common in middle-market private equity investments, leading sponsors have built depth below the operating partner level, with the goal of ensuring that each portfolio company has a dedicated mid-level professional who is solely focused on supporting the management team to drive equity value. The best portfolio operations teams today are composed of a full range of professionals across seniority levels and backgrounds, utilizing a proven and repeatable playbook that they have developed over years of experience.

Conclusion

A successful approach to operational value creation has been key to driving successful outcomes over the last decade and has become increasingly important as market participants adjust to an environment of higher interest rates and inflation, lower levels of financial leverage, and uncertain macroeconomic growth.

While many private equity investors today claim to have some level of operational capability and value-add, a truly differentiated approach is defined by several factors. Specifically, a focused strategy, a fully integrated team of professionals, a defined value creation planning process, and a proven playbook can come together to deliver outsized returns for sponsors that have invested to build these capabilities.

IMPORTANT INFORMATION

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