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Global Dealmakers 2021

Scale and speed: Fast-growing companies defy their limits

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The characteristics of a fast-growth company are becoming clear: digitally led, able to introduce and develop new revenue streams to offset disruption, and with a strong staff and culture. What we are seeing in dealmakers is an understanding of how these levers can be used to accelerate returns and deliver value.

Michael Sonego
Baker Tilly Pitcher Partners, Australia

Executive summary

Companies backed by private equity provide insights into the ways businesses can position themselves for accelerated growth and post-pandemic success.

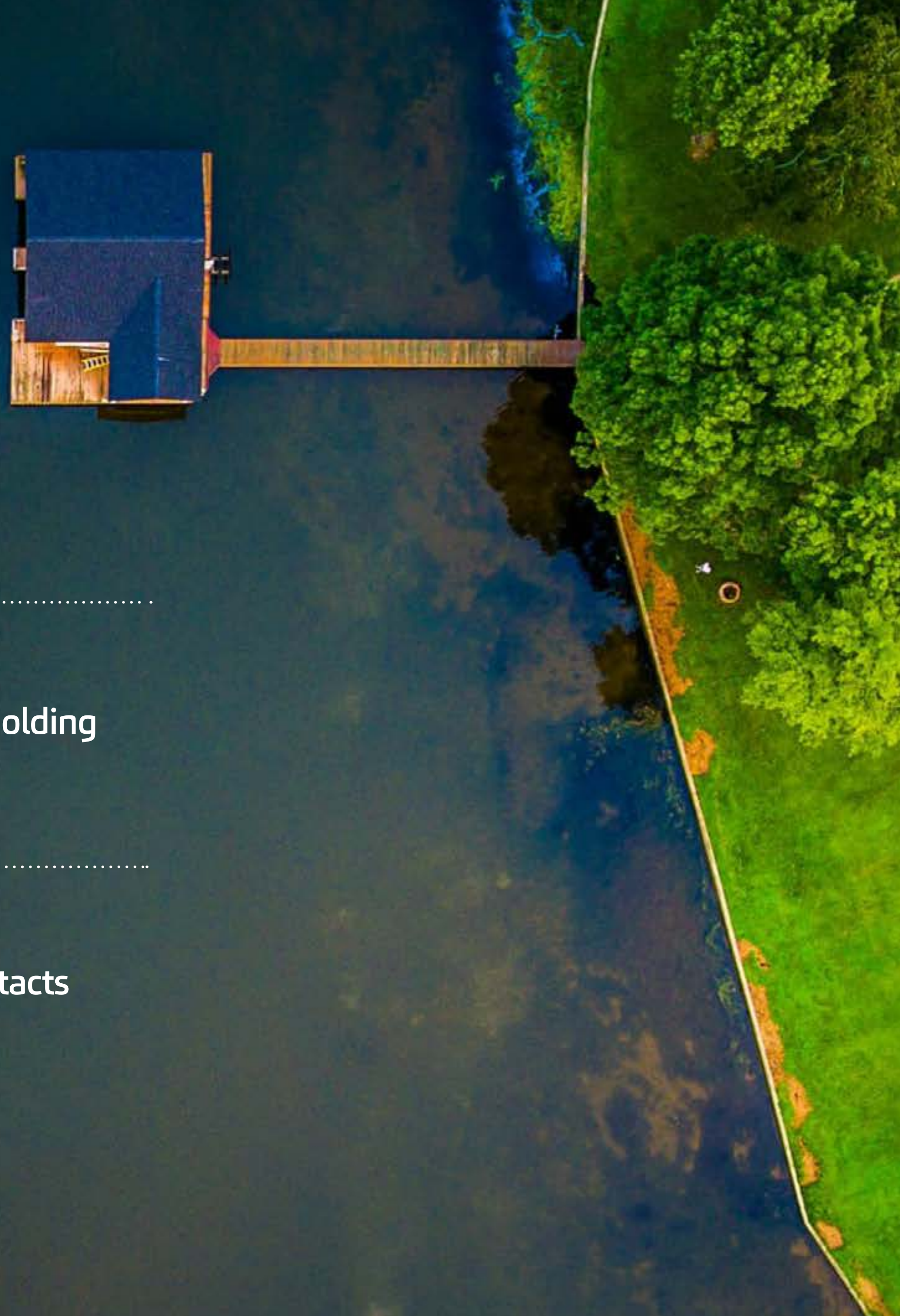
How are companies planning to grow and transform their businesses as the world emerges from the Covid-19 health crisis? Are they pursuing new routes or taking counter-intuitive approaches to achieving these targets?

These are the questions underpinning our research in this report, the third in our Global Dealmakers 2021 series on global M&A and deal trends, as we uncover how corporate management teams are positioning their organisations for rapid expansion.

To provide answers and insights, we focused on developments and strategies at fast-growth private companies, specifically those with private equity backing. These funds predominantly invest in fast-growth companies and on average aim for 40% annual growth in revenue, although almost a quarter of respondents say they try to achieve growth of 50% or more.

In light of the health crisis, respondent views are encouraging. The majority believe these companies are getting back on track — and can achieve stellar performance over the next one to two years. Most are using technology and innovation to optimise and sharpen their competitiveness, while others are considering aggressive acquisition plans to branch out into new markets.

The views of these management and investor teams provide a roadmap and best practices for other corporate leadership to follow, as they look for ways to grow and expand in what is still an uncertain and complex world. As this research shows, there are multiple avenues to take — as well as risks to be aware of — on the post-pandemic road to recovery to capture value and enhance the business for success.



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About this report: From May to June 2021, Baker Tilly International commissioned Acuris Studios, the publishing division of Acuris, to canvas the opinions of 60 respondents at private equity firms focused on investing in fast-growth companies to gauge their opinions on trends and challenges in the global market. Respondents were evenly split and based in the following regions: Asia-Pacific, North America and Europe.

Regarding their investment in fast-growth companies, respondents said they targeted organisations with annual growth in revenue of at least 38% (average) — and a quarter of respondents said they target growth of at least 50%.

Within the graphed survey results, percentages may not sum to 100% due to rounding, or when respondents were allowed to choose more than one answer.

Key findings

68%
of respondents expect to achieve a growth rate of 50% or more in the next 1-2 years, despite setbacks and complexities caused by Covid-19.

92%
will focus on digital transformations to drive growth in the next 2-3 years.

67%
say M&A will be a key focus of their growth initiatives going forward.

67%
say the pandemic has not changed their approach to globalisation and that they are pursuing cross-border expansion.

33%
are focused on expanding in domestic markets rather than considering cross-border M&A.

37%
are actively looking at consolidation opportunities.

Key metrics and criteria at fast-growth companies:
- Market share
- Revenue growth
- Reputation/Leader within industry

80%
say North America offers the most opportunities for investment in fast-growth companies.

92%
say the top challenge facing fast-growth companies will be economic volatility in the year ahead.

90%
say regulatory challenges will also be an obstacle impeding growth.

43%
say they are holding on to investment companies longer than initially planned.

Secondary exits
(sales to PE firms) will be the preferred exit route.

Back on track: Strong sentiment that higher growth rates are within reach for companies with the right plan

The past 18 months has underscored the importance of having a 360 degree view of customers and operations, and the companies that have invested in technology that collates this information and makes it easy to understand and act on the findings are in a much better place than those who still have fragmented systems, with data scattered online and offline and held in different places.

William Chapman
Baker Tilly, USA

Respondents are confident the pandemic will prove to be a short pause for breath in their search for growth, rather than an enduring setback.

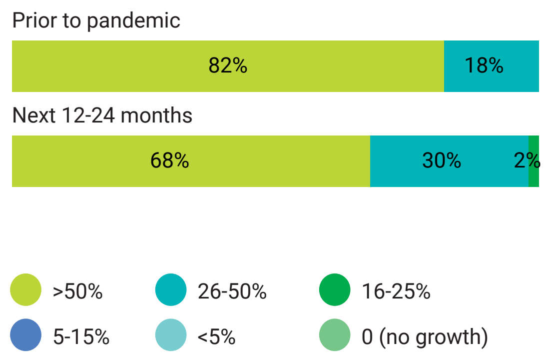
Respondents expect fast-growth companies to bounce back with renewed strength from the pandemic, with projected growth rates down only modestly from pre-Covid-19 figures. Impressively, more than two-thirds of respondents (68%) believe these companies will deliver a growth rate of more than 50% over the next one to two years. A further 30% anticipate achieving rates of between 26% and 50%.

For many, this confidence comes from moves and investments made during the depths of the pandemic, when it was apparent that staying the course would prove detrimental to bottom lines — or even survivability. As the partner at one Indian PE firm says, “During the pandemic, we targeted many operational improvements, and our management teams took decisions to move along the growth. In the next 12 to 24 months, we will be targeting a 55-60% growth rate, and we know that the company has the potential to enhance performance.”

In North America, the Managing Director of a US PE firm adds: “Prior to the pandemic, the digital platform was able to achieve 30% growth and the higher demand for digital solutions is now driving profitability.”

Moreover, even where firms are anxious about whether they can pick up where they left off, most have a range of plans for meeting whatever challenges may arise in the year ahead — which we discuss in the next section “Post-pandemic action plans”.

Figure 1. What growth rate was the company able to achieve in the 2-3 years prior to the pandemic — and what growth rate do you expect to achieve in the next 1-2 years?



Digital platforms should be workhorses not show-ponies. We are seeing more companies using their digital presence to test and introduce new business models and revenue streams, and allowing a seamless experience for a customer that is now more likely to be remote. There is little room for an analogue company in the new digital market.

Xavier Mercadé
Baker Tilly, Spain

Post-pandemic action plans

Technology and M&A feature among the leading strategies private companies will deploy to expand and achieve higher growth rates.

Leading lever: Digital transformation

Even before the pandemic, digital transformation was a key priority for most businesses as many scrambled to prepare for and compete in the digital age. Now, the crisis is accelerating the rapid shift to digitalisation — from the rise of ecommerce to the need to support more flexible working — and this trend shows no sign of slowing.

Indeed, in many industries, digital transformation is underpinning new business models: manufacturers are moving from just selling products to delivering services as well, while new entrants to financial services are disrupting incumbent providers in areas such as payments. In this context, 92% of respondents say digital transformation is paramount to growth.

“Investing in technology and innovation is now essential for any business,” says the partner of a Norwegian PE firm. “We are integrating new digital solutions for procurement and distribution that will transform its entire supply chain management.”

Supporting measures: Looking outside and inside the organisation

Despite the advantages it creates for businesses, digital transformation is no panacea for growth and competitiveness. Other levers must also be considered and many respondents (87%) say alliances and JVs are necessary to respond to change.

Almost as many (82%) are focused on addressing internal aspects of the business, such as ensuring staff have the skills they need to prosper in this new world. Almost three-quarters (73%) cite the need for operational improvements while more than two-thirds (68%) are focused on effective capital allocation.

M&A: Cross-border dealmaking still on the agenda

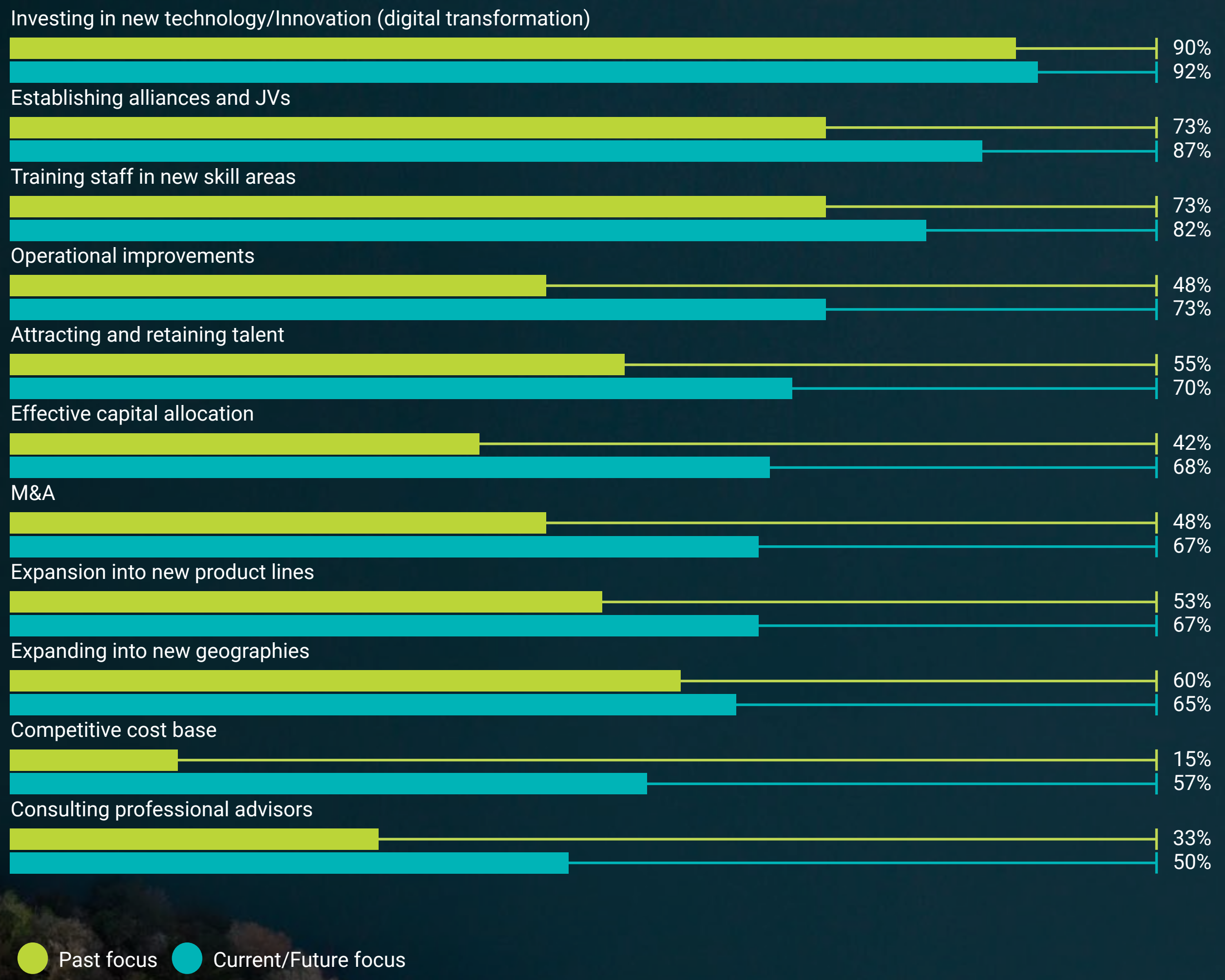
While acquisitions fall on the lower end of considerations among respondents, more than half (67%) still view M&A as crucial to business growth. In particular, many are returning to pre-pandemic strategies and to international markets for growth.

Among respondents, the majority (67%) say that despite the ongoing difficulties of completing cross-border deals, they remain committed to international expansion and the broader globalisation of their businesses. The remainder (33%) are focusing on domestic markets, at least for now.

“Globalisation is one of our main objectives,” says the Managing Director of a Chinese PE firm. “The pandemic did affect some of our operations, but we are getting accustomed to new practices and we want to maintain the same approach to expansion.”

The Managing Director of a US firm argues that globalisation opportunities may even be enhanced as other businesses pull back. “We want to enter new markets before there is too much competition,” the executive says.

Figure 2: Which factors have been most important to growth in the past 2-3 years and which areas are you focusing on to ensure continued growth in the next 2-3 years? (Select all that apply for both categories)

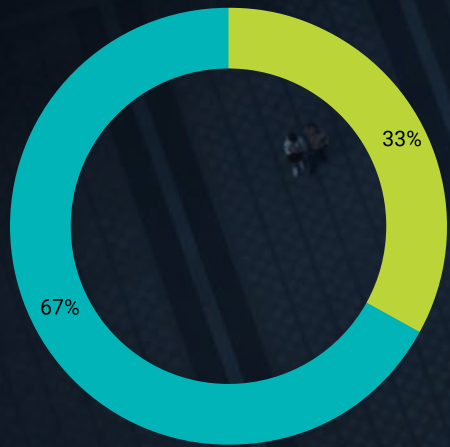


Industry mergers: Consolidation on hold for many

Despite the focus on growth, many PE firms remain cautious. Notably, there is no consensus on whether now is the time to focus on dealmaking within the industries in which they operate. While the pandemic may have created opportunities for consolidation, with weaker businesses now looking to sell, only 37% of firms say they are actively looking at such possibilities — though 33% may begin doing so in the near future.

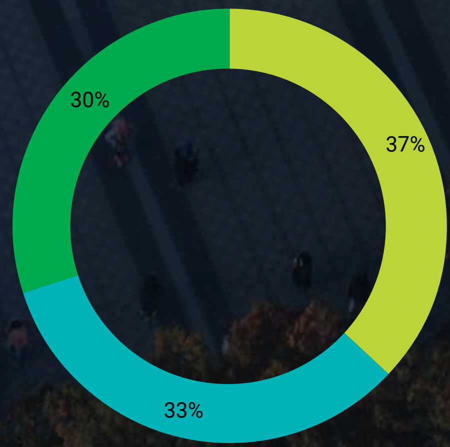
Views are mixed. “Consolidation opportunities are being pursued because we do not want to miss out,” says the Managing Director of a US PE firm. “Consolidation would be tough and disruptive,” counters a partner in a UK firm.

Figure 3: Has the pandemic caused the fast-growth company you’ve invested in to change its approach to globalisation and cross-border expansion?



- Yes, we are currently focused mostly on expanding in domestic markets
- No, we are continuing to consider cross-border expansion

Figure 4: Has the pandemic caused the fast-growth company you’ve invested in to change its approach to consolidation within its primary industry?



- Yes, we are actively looking at consolidation opportunities
- No, we are not currently looking to consolidate but may consider in the near future
- No, we are not looking to consolidate and were not considering even prior to the pandemic

Fast-growth companies and where to find them

Respondents weigh in on the markets with the best opportunities.

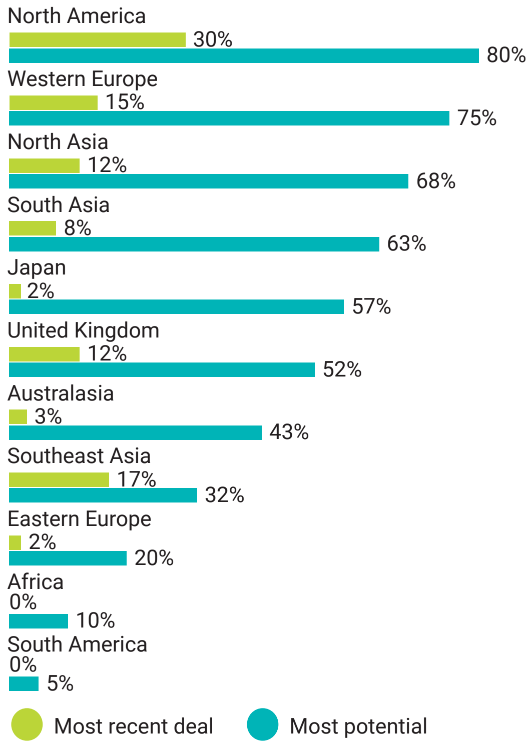
While developing economies are often regarded as offering particularly attractive prospects for high-growth companies, respondents currently view advanced economies as offering the greatest potential for these businesses. In particular, 80% pick out North America as the most promising market, while 75% cite Western Europe. By contrast, areas such as Southeast Asia, where firms had previously done significant numbers of deals, are now less in focus.

This is not to suggest emerging markets are dropping out of the reckoning. Many respondents still see opportunities in these regions — North Asia, for example, is a potential target market for acquisitions for 68%, likely driven by the desire for increased exposure to China. Still, the more rapid progress made by many Western countries on Covid-19 vaccination programmes may be prompting focus on these markets, at least for the time being and as countries in Asia-Pacific make progress.

The Managing Partner of a US PE firm sums up this view. "Economic and political conditions in a region have to be stable enough to support growth as expected," the executive warns.

Still, opportunities beyond these more stable markets have not been forgotten. "The last company we invested in was based in India and similar investments remain available — once pandemic conditions are under control, we can pursue these opportunities," says an executive at an Indian PE firm.

Figure 5: Where have you already acquired a fast-growth company — and where will you look for future opportunities?



Challenge forecast: Economic and regulatory complexities are leading threats to growth agenda

Ongoing uncertainty and new policies in key markets pose the greatest obstacles for fast-growth companies.

Despite broad optimism that fast-growth companies can deliver over the next one to two years, respondents cite a number of challenges that could threaten their growth trajectories. In particular, the prospects of economic volatility (a concern for 92% of respondents), regulatory challenges (90%) and further uncertainty and disruption related to Covid-19 (87%) all loom large.

Such fears are not unfounded. In its most recent World Economic Outlook, the IMF forecast that global economic growth would recover to 6% in 2021 and 4.4% in 2022, an upgrade on its January projections. The IMF also warned that "Global prospects remain highly uncertain… the outlook depends not just on the outcome of the battle between the virus and vaccines — it also hinges on how effectively economic policies deployed under high uncertainty can limit lasting damage from this unprecedented crisis."

Moreover, perceptions of an increased focus on regulation are not misplaced. In industries such as financial services and technology, policymakers continue to pursue regulatory reforms. Data regulation is increasing on a global scale. The US-led initiative on minimum corporate tax rates is also focusing minds.

These developments are not limiting the ambitions of fast-growth companies — many continue to pursue cross-border deals. Nevertheless, risk management is top of mind — and the possibility of setbacks in the battle against Covid-19, whether in particular markets or more globally, is ever-present. Indeed, the pandemic is another source of regulatory upheaval, as governments continue to focus on measures such as travel restrictions and lockdown.

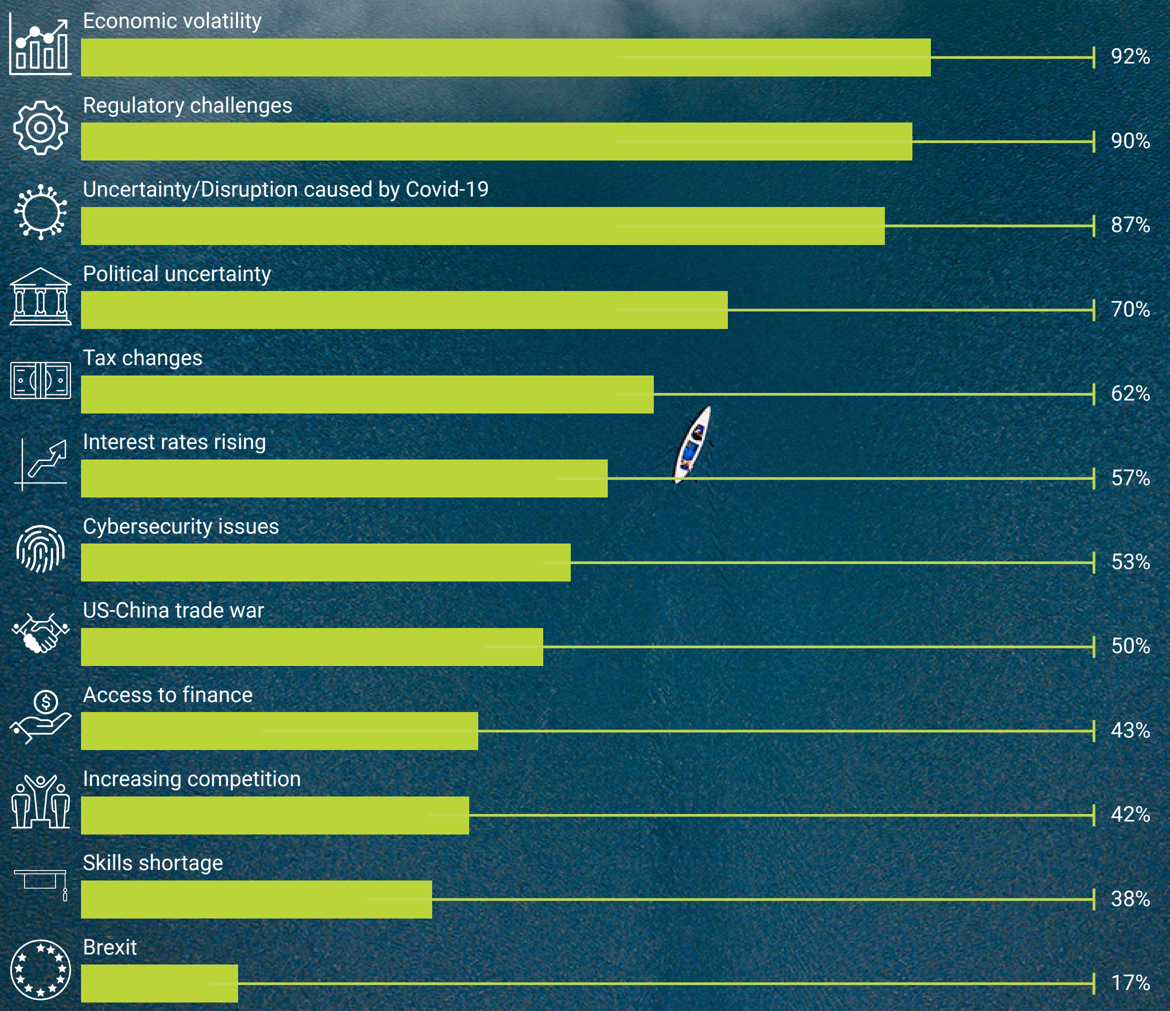
The Managing Director of a US PE firm puts this into perspective. "Volatility is the major threat — the growth plans of our investee company have to be put on hold or re-evaluated because of these economic influences and there are few measures we can take to mitigate these risks."

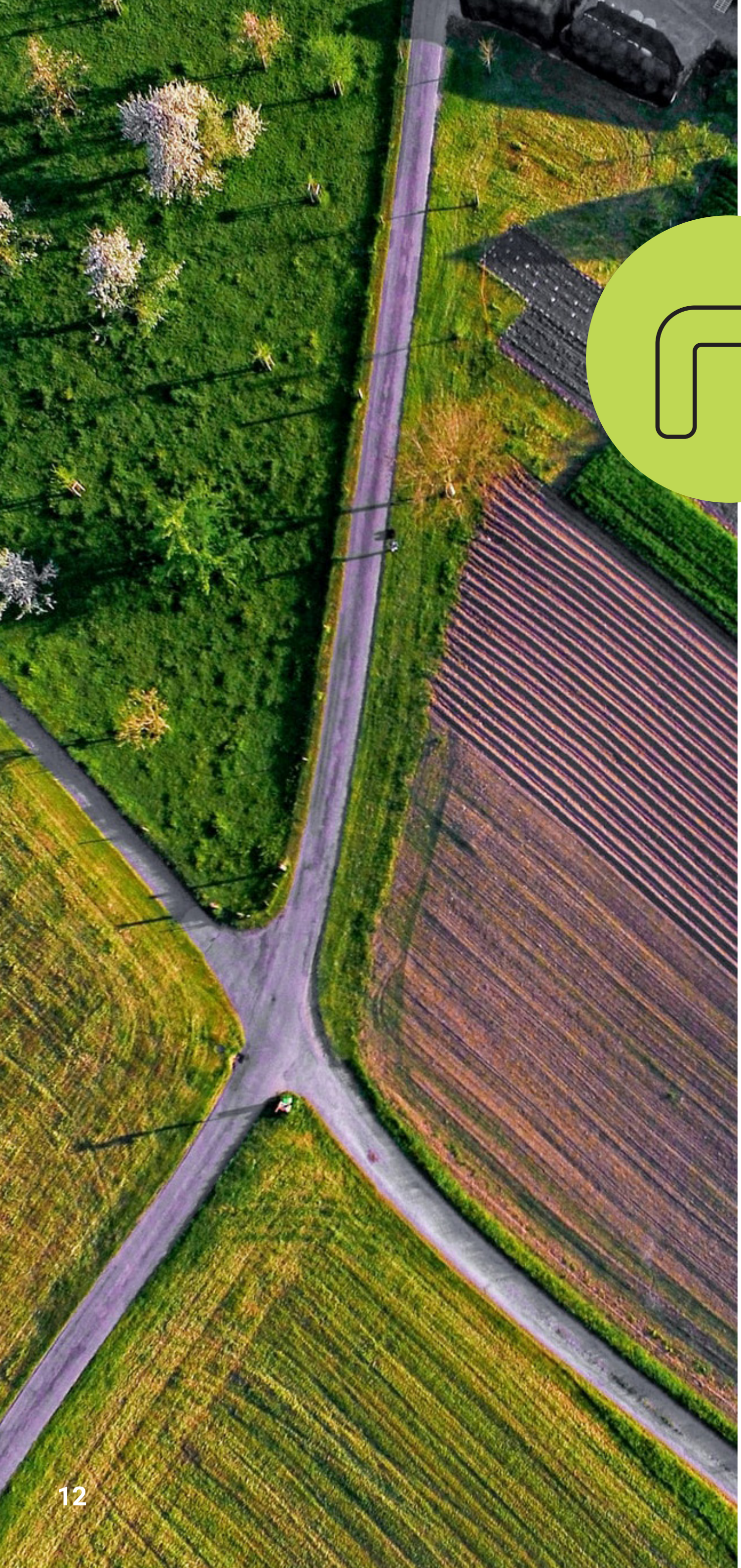
Still, it would be wrong to be too pessimistic. As we have seen, most respondents expect a return to significant growth from fast-growth businesses. There are many reasons to be optimistic. In particular, the supply of funding is robust for businesses in need of capital: fewer than half the firms in this research regard it as a potential obstacle to growth. Similarly, fears of a trade war between China and the US have faded in the months since US President Biden's election — only 50% are now worried about this issue.

There is clear pent-up demand for cross-border expansion but recent experience of new waves has continued to limit the option for companies to travel and explore new opportunities. That has left a gap: if companies are able continue their cross-border expansion plans while competitors are land locked, they can take first advantage of new markets.

James Lawson
MHA MacIntyre Hudson UK

Figure 6: Which of the following poses the greatest threat/challenge to continued growth of these businesses? (Select all that apply)





Exits: Longer holding periods amid uncertainty?

Respondents are weighing up whether or not to exit their investments in private companies — and through which route?

One consequence of the Covid-19 crisis appears to be that close to half (43%) of PE firms are holding on to investee businesses for longer than originally planned. The majority (53%), however, are sticking with the exit plans they had all along.

One reason many are extending their holding periods is that the disruption of the pandemic has checked the rapid growth of many businesses, leaving investors short of their target returns. Another driver is nervousness about pursuing a sale given current market conditions, where volatility is continuing and visibility is limited even in the short term.

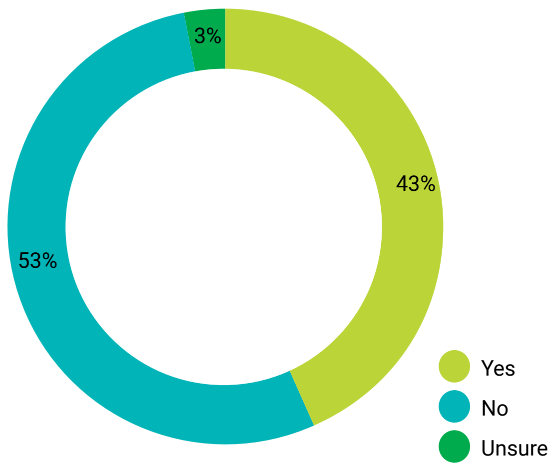
Nevertheless, some firms insist that it makes sense to stick to established timelines — and that it is possible to achieve this goal even in trying circumstances. "We have focused on achieving our targets," says the Managing Director of a Swedish PE investor. "The situation was more challenging, but our teams are experienced enough, and we proceeded to exit in time; there were delays in sending and receiving documents, but these issues were sorted soon enough by using digital solutions."

For some investors, an expedient exit can pave the way for deals with other fast-growth companies that might otherwise be missed. "We have been watching the investment climate and the opportunities that can be derived from a timely exit," says the Managing Director of a PE firm in Singapore. "There would be more risk in holding the companies beyond the discussed timelines."

Exit options: Preference for secondaries

As well as the timing of exits, PE firms have also given more thought to potential exit routes. In aggregate, respondents now appear more inclined to pursue deals with other PE acquirers than in the past. By contrast, trade sales and IPOs are less of a priority.

Figure 7: Is the current holding/investing period longer than what was initially planned?



> The past year has seen a lot of excitement around IPOs and SPACs, but dealmakers are first turning to private equity, given the amount of capital available that has not yet been deployed. In the future, though, they may be more willing to explore other exit strategies if they can secure a faster, more lucrative exit that allows them to redeploy capital elsewhere.

Adrian Cheow
Baker Tilly, Singapore

There are a number of explanations for this shift. One is simply that the PE sector is currently sitting on significant amounts of dry powder — with so much capital to deploy, the industry is naturally a competitive bidder. Trade sales, on the other hand, depend on the financial strength of acquirers that have had to trade through the Covid-19 pandemic and, in many industries, the crisis may have undermined the ability of businesses to pursue M&A.

Public markets: Uncertainty hinders further floats

As for IPOs, public markets remain volatile. While IPO activity has continued to recover strongly during the first half of 2021, there is nervousness about the difficulty of managing public sale processes. Given the additional costs and complexities of an IPO process, many firms appear to prefer the private route. Indeed, even before the pandemic, there was a clear trend for fast-growth companies to remain privately owned for longer.

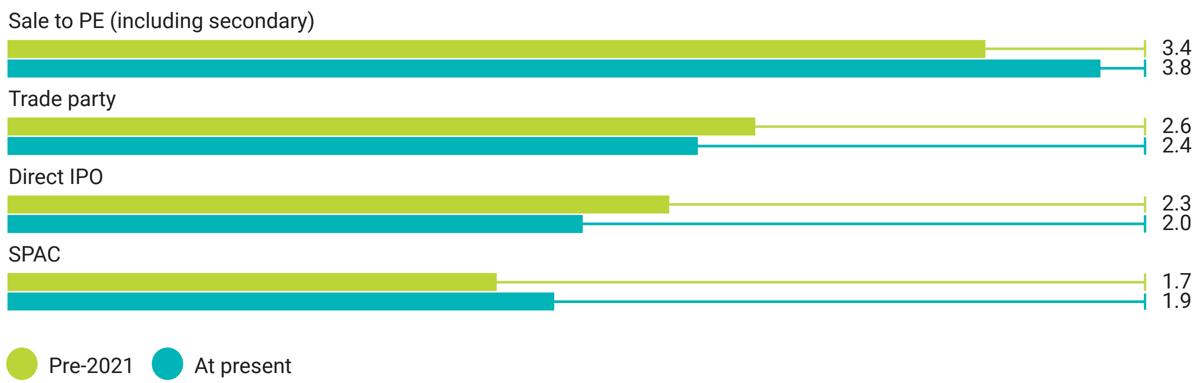
In the end, suggests the Managing Director of a US PE firm, it is all about limiting uncertainty. "Mainly, it is the volatile conditions that we are worried about," the executive says. "The economy has not recovered completely from the Covid-19 turmoil; the financial position of many companies has been affected during the period; there would be less liquidity in markets as well."

SPACs: Viable solutions?

Still, against this backdrop, some PE firms report greater interest in pursuing a public market listing through another route. More are looking at sales to the growing number of special purpose acquisitions companies (SPACs) launched to pursue M&A opportunities. Acquisition by SPAC effectively moves the business into the public market without the regulatory and compliance burden of an IPO.

"We do believe in timely exits and keeping the company for a prolonged period will be detrimental — given market challenges, SPACs are increasing in popularity," says the Managing Director of a PE firm in Singapore.

Figure 8: Which exit options were you considering in order of priority pre-2021 and at present? (4 = top priority)



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