Three ways private equity tech portfolio companies can improve cash strategies

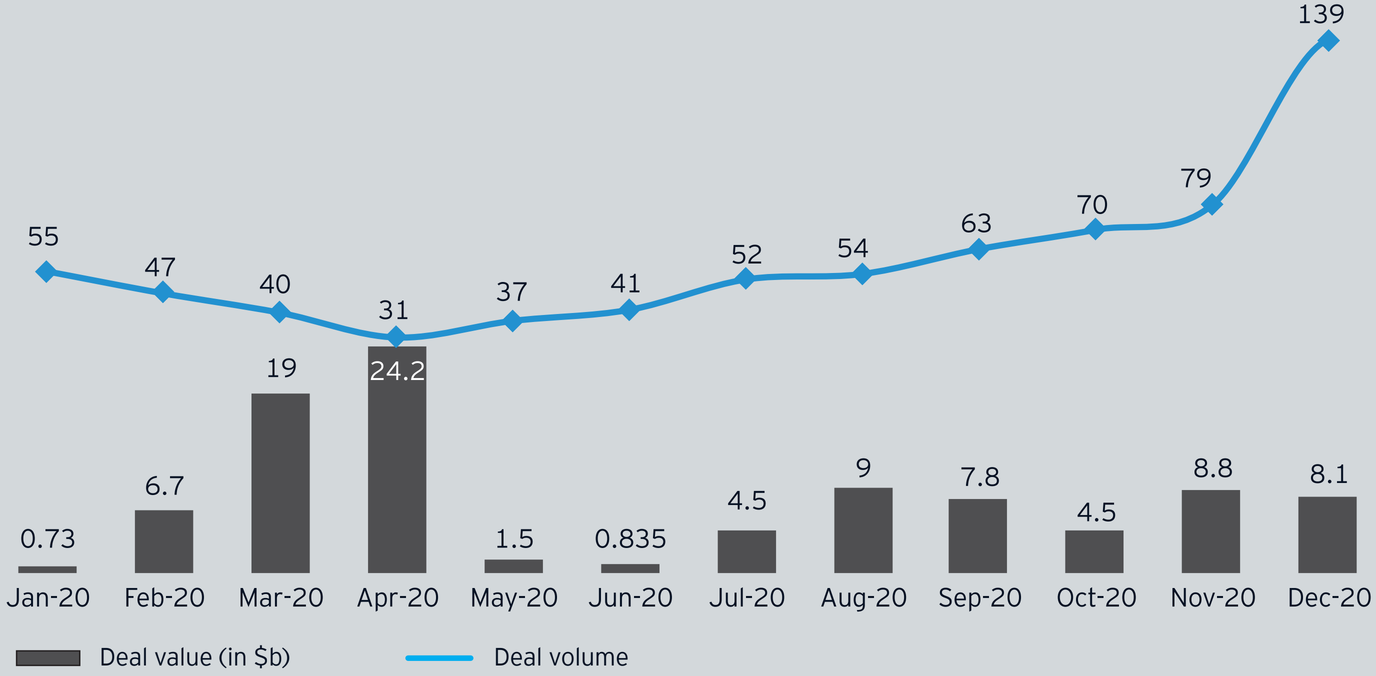
Private equity technology portfolio companies can use cash management strategies to boost valuations and free capital that can be put to work.

EY Parthenon
Building a better working world

Private equity (PE) technology portfolio companies seeking to fund growth may be tempted to ignore free cash flow (FCF) and working capital management given today's low borrowing costs and the volume of PE dry powder. This view forgoes the readily accessible and sustainable improvement to cash, operations and service levels that can boost value.

PE technology deal values in 2020 were historically high, reaching $95b, with 70% of those investments in software, software-as-a-service and apps. Working capital improvements at these newly acquired tech portfolio companies can lead to better return on investment and balance sheet performance. Firms that engaged with the EY-Parthenon US team have achieved an average of 5-7% of revenue in cash flow improvements from working capital, in the last year.

US PE investments in technology



Source: EY PE Tech Capsule

On the flip side, PE firms looking to divest technology companies can use working capital improvement strategies — including cash release options, such as contract renewals, better deal desk operations and alternate financing options — to show acquirers operational discipline. Our experience shows that buyers often place greater value on operational rigor and FCF, enabling them to fund strategic initiatives in a challenging economic environment.

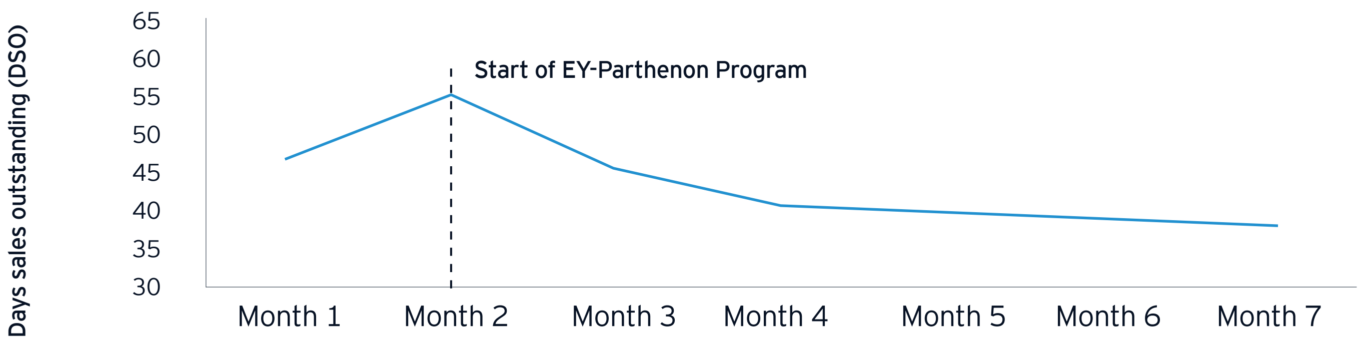
On the next page, we discuss three areas where companies can improve cash strategies.

1. Look to receivables.

For technology companies that are traditionally light on payables and inventory, better use of quote-to-cash (QTC) metrics around receivables, such as weighted average days to collect, weighted average days if late and days billing outstanding, can lead to higher FCF. Companies can significantly improve these metrics by focusing on leading practices and increasing operational discipline.

For example, one PE-owned health care software provider identified gaps in QTC processes, resulting in excess cash flow that was used to fund incremental acquisitions. The program included an analysis of historical transactional data, an assessment of customer categorization, and restructured operational processes, including collections and dispute management. Attention to subscriptions, and accelerating renewals to maintain billing cadence and reduce time gaps between agreements, can be important components of operational discipline that enable accurate cash forecasts. The leading practices the company followed released 5% of revenue in cash flow improvements.

Example program: improving DSO by looking to receivables



2. Don't forget deal desk operations.

Another capability critically important to tech companies looking to improve QTC metrics is incorporating cash impact in deal desk operations. In a subscription-based revenue model, the deal desk must understand and price commercial arrangements that are the most advantageous to the business, including those with end-user fluctuations. But quoting systems typically need software upgrades to include contracts with variable pricing based on the number of end users.

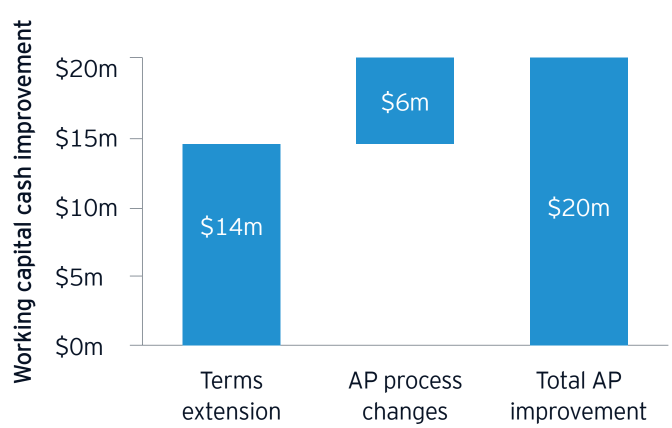
Within a matter of weeks, the EY-Parthenon team identified QTC improvements, including deal desk opportunities at a PE client's global software portfolio company. This was accomplished through a current state and gap analysis, identifying clear deal acceptance criteria and processes, and the creation of a metrics dashboard. Cross-functional involvement can help confirm that agreed-to deals are in line with business objectives and downstream capabilities, such as billing.

3. Improve procurement and payment processes.

For tech companies looking to improve working capital performance, many relevant procure-to-pay strategies can be deployed. These can include accounts payable (AP) process improvements, industry-acceptable vendor payment terms and tech-based supply chain financing programs that link the parties in a transaction, lower costs and improve efficiency.

The EY-Parthenon team helped a PE firm's security software portfolio company turn its AP processes into leading practices. This accelerated AP improvement program focused on supplier risk assessment criteria, segmentation and a negotiation strategy for changes to payment terms and payment frequency. By implementing AP trade balance improvements, the tech company quickly increased cash by 1.5% of revenue.

Example program: cash improvements through procurement and payment processes



Summary

While tech companies may prioritize growth over cash in the short term, fixing cash management and internal operations maybe imperative for certain PE owners. Improved cash management can fund growth and improve outcomes. The big question is: are you keeping cash at the center of your strategy to drive success in the technology industry? The time is now to examine these working capital levers.

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