

Alpha Through Analytics

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As competition dilutes investors' informational edge, those who leverage technology and data are rediscovering a competitive advantage.

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If technology was supposed to be the great equalizer, across the business landscape it has become the great enabler. But through the perspective of investors and other stakeholders, technology is now creating a larger and more pronounced gap between the haves and the have nots.

Nowhere are the differences more evident than in the disparities that exist between organizations that can leverage data and analytics and those who can't. This is particularly true as big data begins to enable artificial intelligence and, over time, mass customization. Most consumers may recognize this as personalized products, such as the NikeiD line of shoes that allow sneakerheads to design their own signature styles. In business services, though, this takes form as solutions that are fit for purpose, repeatable and standardized to facilitate adoption and build consensus around metrics, and solutions that can meet a range of business demands

without inadequate workarounds.

These were the principles that helped guide the development of AlphaCalc®, a new financial and human-capital benchmarking tool designed specifically for private companies and their investors. The idea behind AlphaCalc is simply to give investors and lenders a deeper understanding of the businesses they own and their positioning against their peer set. This is no easy task considering the pace at which

new assets move into and out of PE and leveraged loan portfolios (at least prior to the COVID-19 disruption). And while private capital providers have produced exceptional returns over the past decade, the delta over public equities has narrowed, creating new pressures for the asset class to demonstrate its advantages in finding and creating value. It's in this hunt for an "informational" edge that many have sought to refine their data capabilities.



Competitive advantages aren't necessarily confined to new analytics; often, it's about enabling on-demand access to the information that matters most and then contextualizing it so it's actionable for investors.

Consider the traditional data requests ahead of a board meeting. Company executives may dispatch the FP&A team, HR executives, operating officers and third-party vendors to pull together analytics that speak to the financial health of the company, any latent risks, and the most promising business catalysts. These data requests, at least to those fulfilling them, can amount to something of a fire drill to find the information, validate it, and present it in a way that allows users to quickly grasp the meaning and impact. Despite the work that goes into compiling the information, data quality issues or inconsistencies can leave stakeholders less than convinced.

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For private equity investors or lenders looking to complement due diligence or establish KPIs to track progress against new initiatives, these challenges can make oversight harder than it has to be. This is particularly the case in the small- and middle-market, where sophisticated FP&A and Human Capital executives are quite rare. When you multiply the data challenges across a larger portfolio, stakeholders are left with a less-than-complete picture from which to monitor and track performance and try to pursue the highest-impact growth strategies.

AlphaCalc, in providing key financial and human capital metrics, creates a data-driven mosaic that reflects a company's current health and competitive positioning. Performance scorecards provide users a "dashboard" view of up-to-date financial measures, from return on sales and inventory turnover to ratios such as current liabilities to net worth, sales to working capital, and accounts payable to sales. The benchmarking data across each of these categories also represents a yardstick that allows users to compare profitability, liquidity and other measures, not just against past performance but against a relevant peer

set. This information can be invaluable in pursuing add-on acquisitions, considering pricing and promotional strategies, or any other strategic initiatives to grab or protect market share.

Another one of AlphaCalc's key differentiators is that it incorporates human capital data into the financial analysis, helping users contextualize their ROI on people, training, and diversity efforts and track other human capital measures. The recent social movements occurring in cities across the country speak to the demand for this data. Today, the protests are focused on the justice system, but business owners have an obligation to promote equality and accountability, and it's against this backdrop that many have pledged to re-commit themselves to continual improvement in these areas. Benchmarking data, again, offers a critical starting point to understand

how a specific company stacks up and where it should focus its attention to make up for lost ground.

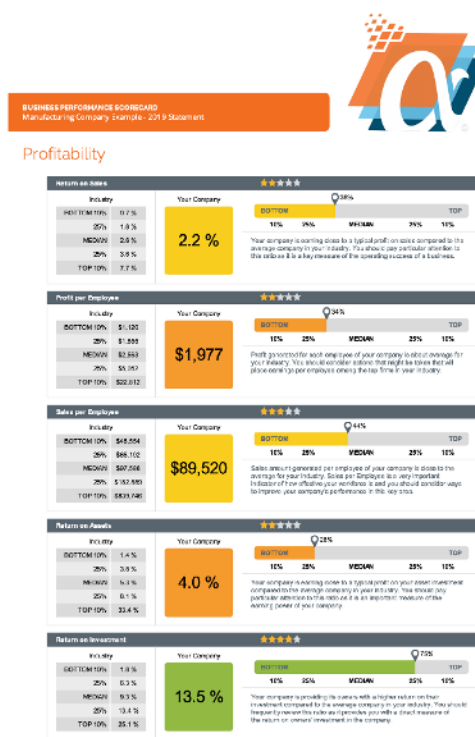
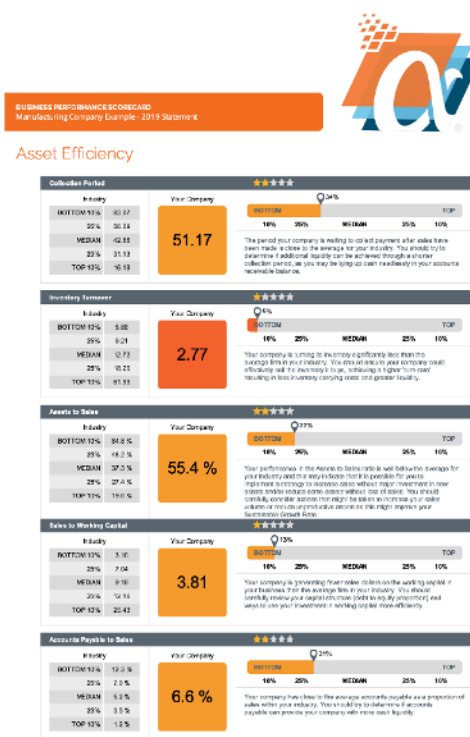
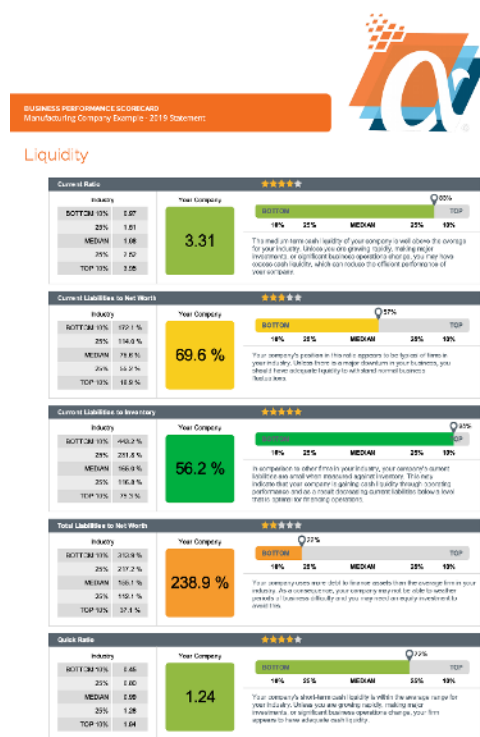
Taken together, what investors get is a more thorough picture of the overlooked components that support value creation as well as the risks that threaten to degrade

value. Some have equated the solution to a Carfax report for M&A, but it's about understanding the unique needs of private capital investors, offering a standardized data set that allows for apples-to-apples comparisons, and creating a solution that's as intuitive as it is informative.

Fit for Purpose

There is no shortage of data around public companies nor the number of analytic solutions that leverage public disclosures. The problem, at least for middle market investors, is that much of the data is irrelevant. Take valuations, as investment bank Lincoln International recently documented, following the initial coronavirus outbreak, the declines in the enterprise value of private middle market companies were far less severe than the haircut endured by large-cap public companies.

To a certain degree, this speaks to the discipline of private capital investors, as purchase price multiples in the middle market leveled off over the past year and a half, while public market valuations soared ever



higher. It's also reflective of a more conservative approach from investors to markdown portfolios based on business fundamentals versus public sentiment. Whatever the case, it underscores why private capital investors require analytics designed for their specific needs.

AlphaCalc mines data from nearly a million private businesses, across 2,600 industries, allowing users to benchmark against representative comparables. And with so many metrics at their disposal, users can see how other variables – beyond just Ebitda or revenue growth – factor into valuations.

Standardization Key to Adoption

One of the biggest challenges when it comes to data is understanding what's relevant and what isn't. ESG data, for instance, has struggled with this challenge for many years, as what is appropriate for one company in one industry may be irrelevant to another company in another sector. According to one study, less than 25% of the data in traditional ESG scores are considered material for as many as two thirds of all securities in the Russell Global Large Cap Index.

This is the same challenge that has stood in the way of more companies and investors adopting human capital management (HCM) strategies. The distinct differences across each industry have largely preempted a “playbook” approach for investors to quickly gauge areas of risk or opportunity or which levers to pull in pursuit of “people alpha.”

AlphaCalc, through applying sector-specific ISO Standards for human capital, creates a “true north” for organizations to track productivity, mobility and turnover, assess and refine recruitment initiatives, and track diversity and inclusion. Incorporating these standards into financial analysis also helps the broader organization, as well as investment and underwriting teams, recognize the impact of human capital on performance and returns.

A Business Solution for Business Users

To be sure, investment firms have explored strategies to improve their data and analytic capabilities, although many have found that it's not easy or seamless to incorporate these skillsets into existing processes. Data science, for instance, has been among the most in-demand skillsets on Wall Street over the last five

years, but it's also a field that has seen a tremendous amount of turnover. The challenge for many firms is that there's often a breakdown between the data engineers accessing the data and the portfolio managers tasked with applying it to their investment strategies.

AlphaCalc, alternatively, was developed by business users for business users, to eliminate the legwork that goes into compiling data for competitive analysis and then simplifying how this information is presented, via color-coded performance scorecards. Users can quickly get a read on a company's profitability, asset efficiency, liquidity scores and other financial and human capital analytics. And benchmarking data – derived from multiple sources ranging from financial and credit-reporting institutions to government agencies – provides context that allows users to quickly understand how a company stands up against its peer set and where it is falling short. The entire database undergoes an automated 250-plus step data-cleansing protocol to validate data and ensure accuracy and timeliness.

The point, though, is that analysis tools need be intuitive and accessible to spur adoption among business users. It's been our experience that the “black box” approach to technology – catering to very specialized data engineering or programming skillsets – creates more questions than answers for business users looking to apply the data to their day-to-day analysis.

Knowing What's Material

Data for the sake of data, when it's not aligned to investment objectives or designed for end users, creates a paradox of choice. Rather than instill conviction, it can give rise to new doubts or create “analysis paralysis.”

AlphaCalc was created distinctly with private capital in mind and iterated and refined with feedback from middle market private equity investors and lenders. There's no limit to the number of “use cases,” but practitioners generally appreciate the value of the platform when they leverage it to inform due diligence,

value creation initiatives and monitoring portfolios.

A regional SBA lender, for instance, may have a limited amount of capital available to deploy. Business performance scorecards offer standardized analysis to compare prospective borrowers side by side to identify the best candidate for long-term risk-adjusted returns. This isn't a replacement for fundamental analysis, but can certainly complement the due diligence that goes into underwriting.

When it comes to value creation and capital-allocation decisions, HCM data can help identify the roles essential for growth, the cost to fill these positions, and the market for talent in a given geography. In assessing organic expansion, to cite another example, real estate prices and tax incentives should only be one consideration; if the talent isn't available or is too expensive in a particular market, these efforts may be destined to fail.

One of the biggest challenges for any investor or lender, beyond helping guide value-creation initiatives, is just tracking the progress of those efforts along with the performance of the portfolio. AlphaCalc's “transaction readiness” assessment is an automated tool that can flag any areas that need to be addressed ahead of a prospective sale or exit. These capabilities can help prevent an aborted sale process or enhance the exit timing to optimize sale multiples.

The private equity and leveraged loan industry have experienced quite a bit of innovation over the past 30 years. However, most of the advances revolve around new strategies to deliver returns to investors or the maturation of new, complementary categories, such as the secondaries market to bring liquidity into an illiquid asset class. But technological innovation has eluded the asset class other than its budding interest in software and SaaS companies. New capabilities, however, can offer a new lens for investors that helps sponsors and lenders manage risk, gain conviction in the pursuit of key initiatives, and ultimately drive returns through an informational edge that most associate with a far less efficient marketplace. 🚀

As a founder and Chief Innovation Officer, Jason Wood builds systems and solutions that provide practical and actionable insights for investors, acquirers and savvy business leaders, who recognize the value in people and other intangible assets. He draws on inspiration from his time as a dot-commer, implementation and extensive experience in HR technology and solutions.



As a Partner and COO, Eric Lane helps fund managers and PE-backed organizations appreciate and quantify the value of human capital tools, capabilities, processes, and individuals. With over 17 years as a Human Capital leader in Fortune 100 companies, Eric has helped organizations understand, quantify, and measure the value driven through human capital.

