Q&A ROUNDTABLE

A CONVERSATION WITH CTPARTNERS

Financial Transaction Advisory Services Talent Experiences Strong Demand and Short Supply

In a deal-hungry business world, the demand for financial transaction services, ranging from due diligence to asset valuation to portfolio optimization is growing exponentially. Accordingly, individuals who can effectively wield these tools also are in hot demand. That's true among transaction services users such as private equity and venture capital boutiques, and among the major transaction services providers, ranging from the Big Four global audit and accounting firms through to smaller and mid-sized financial advisory services firms.

CTPartners colleagues Aidan Kennedy, a London-based Partner, and Martin Mendelsohn, a Washington, D.C.-based Partner, recently spoke with business journalists Jill Fraser and Laura Walbert about this expanding field and the resulting talent management challenges found on both sides of the Atlantic.

Q: **The demand for transaction services is expanding rapidly. Can you describe the market forces driving that growth?**

Martin Mendelsohn: Over the past two to three years, the transaction advisory services business has experienced nonstop growth. The surge in the buying and selling of companies generated by private equity firms and others—fueling a strategy of privatization, often followed by a return to public status a few years later--has significantly increased the volume of transaction services related work.

As a result, from the perspective of human capital, we have seen two categories of firms going head to head to secure the resident talent to perform this work. The first group is the private equity firms themselves. PE firms have traditionally outsourced their advisory work to financial advisory and accounting firms, such as KPMG, PricewaterhouseCoopers, Ernst & Young, Deloitte, Houlihan Lokey, Grant Thornton and so forth. Now, PE firms are increasingly attempting to build that capability internally.

Aidan Kennedy: PE firms generally do have financial experts on the modeling side, who are more strategic. But historically, the firms would less frequently have internal financial professionals to handle due diligence. That's the work they would outsource. Yet Martin and I recently have seen large PE operations and venture capital firms hiring internal experts for valuation, audit and due diligence work. These firms are still in the minority, but it's a growing trend.

The second group demonstrating a growing demand for transactions services talent is the professional services firms themselves. As they look to keep pace with expanding client demand for transaction services, these financial advisory services (FAS) firms have been under pressure to retain people, especially those at the senior manager and principal (executive director) level.

Q: **Why are PE firms now looking to develop transaction services talent internally?**

Martin Mendelsohn: The relevant issues for these PE firms are control, predictability and cost management. Transaction services are not inexpensive offerings. When PE firms outsource these services, they are paying quite a bit of money. And yet, despite the hefty fees being paid, the PE firms still don't have the ability to pick up a phone to contact a colleague today and get that colleague on a plane tomorrow to go look under the hood of a potential acquisition. An internal staff allows greater cost management and control of project work flow.

Q: Given those advantages, why don't all private equity firms have their own staff to handle transactions services?

Aidan Kennedy: A private equity firm's interest in bringing transaction services in-house usually is closely related to the size of the PE firm and its deals. For a buyout shop that handles exceptionally large transactions, a judgment needs to be made as to whether the firm wants to absorb the cost of having all of its transactions services capacity in-house. Clearly, having sufficient staff to perform all of the work on even the largest deals would result in a large overhead expense. Frequently it makes far more sense to outsource those larger transactions.

Martin Mendelsohn: Exactly. And the tangent to that point is that a PE firm that manages $200 million to $500 million in assets, with perhaps five to ten portfolio companies, may not have the consistent deal flow to warrant bringing financial (and operational) due diligence experts on staff.

Aidan Kennedy: For firms that specialize in mid-market or mezzanine-level deals and have a steady deal flow, building internal transaction services capacity makes a lot of sense.

Q: So the firms handling the very largest deals and the smaller buyout firms would still be prime candidates for outsourcing transaction services? Who are the transaction services providers, and what strategies are those firms utilizing to tap this market growth?

Martin Mendelsohn: These services are, of course, offered by the Big Four accounting firms, and those firms have the upper hand when it comes to winning the work on the largest - and global - deals. It comes down to the size of their staff and their resident expertise across the globe. But there is also a tier of smaller and mid-sized financial advisory services firms, such as FTI Consulting, Alvarez & Marsal, Huron Consulting, and Duff & Phelps. They come out of different backgrounds. For instance, Duff & Phelps' heritage is on the valuation side, while FTI has a heritage more centered on the litigation consulting and expert witness testimony side. Today, these firms are all broadening their total transactions services offerings.

Aidan Kennedy: Martin, on your side of the Atlantic, are these developing providers of transaction services, who are trying to take market share from the Big Four, seeing transactions services as a way of deepening their relationships with the PE community and hoping they can get additional work?

Martin Mendelsohn: That's exactly the right point. These FAS firms want to make sure they rope in the PE firms for the first project and for many subsequent mandates. PE firms usually retain these FAS firms first for due diligence and valuation work, seeking independent, objective advice on whether a company's representation of its revenue, cash-flow, assets and property valuation, whether those are all legitimate. Once a FAS firm has its hooks into a PE firm, the next job might be portfolio optimization, and the next task might be restructuring workout and advisory. In other words, to finish Aidan's thought, if the FAS firm misses out on the first business opportunity, they might be missing out on five opportunities.

Q: With so much of the growth in transactions services work tied to business from PE firms, isn't the recent slowdown in PE deals worrisome?

Aidan Kennedy: The two are, of course, connected. But there is a significant difference of opinion on whether the tighter credit markets we are experiencing in the U.S. and Europe will cause a PE market slowdown that will extend into many quarters, or only one or two quarters. Despite the market, lines of credit are still open to certain firms for select transactions and there is a lot of commentary from senior level financiers expecting to see increased deal flow from first quarter 2008. That being said, a tighter credit market is no doubt having an impact on the larger (multi-billion USD) sponsor-led deals.

Q: What is the level of transaction services business coming out of Latin America and Asia?

Martin Mendelsohn: Deal flow out of Miami is increasing. There are several FAS organizations that already have set up shop in a couple of different Latin American countries as these markets expand. PE firms are looking for Latin American experience to round out their teams as they consider acquisitions in those geographies.

Aidan Kennedy: Transaction services business is growing in the Asian market although much of the work remains corporate rather than sponsor related. The FAS teams of Australia, Hong Kong and Singapore are the most mature but the Chinese and Indian markets have all seen headcount growth in this space. The level of deal flow however insures that in-house groups are still a rarity within the PE firms.

Martin Mendelsohn: The considerable complexity in Chinese deals due to the network of inter-relationships between enterprises, the state and individuals in addition to changing regulation fuels demand for strongly networked and experienced local talent.

Aidan Kennedy: Yes, a domestic network is virtually a prerequisite to be effective in parts of Asia.

Q: Other than the private equity market, what markets do these transaction services providers target?

Martin Mendelsohn: Financial advisory services firms usually also provide expert witness testimony and litigation support, which is oriented toward law firms. They perform corporate advisory work, aimed at corporations. There are other business lines as well, but over the past few years, the transaction services sector has experienced the fastest growth.

Aidan Kennedy: Agreed, but corporations do need this kind of service for transactions and acquisitions, large and small. Although the credit squeeze has led to a falloff in PE debt work, corporate credit is still relatively healthy, at least that is the case in Europe. Now that PE activity has peaked, some corporations are clearly seeing this as the perfect opportunity to take advantage of more economic pricing to acquire targets. So you are probably seeing more corporate work amongst the transactions services firms within Europe right now rather than work from PE firms. Added to this is a weak dollar rendering U.S. acquisitions more attractive to UK and European buyers. Martin, is the same true in the U.S.?

Martin Mendelsohn: I think that in the U.S. we are just about there. The shift is happening, but is has not been pronounced yet. You can see it coming.

Q: When searching for talent in this field, what kind of employment background, training, and skills are most critical?

Aidan Kennedy: These individuals will be evaluating portfolio companies, so the superior candidates will have both transaction and due diligence exposure, but it would go beyond those valuation skills to include modeling. The modeling will be forward-looking, so the individual needs experience creating comparative models, and especially working without perfect information. This is pre-analysis work, not just post-analysis.

Martin Mendelsohn: Candidates may have served as a vice president of finance or CFO or chief accounting officer at a corporation. But the most relevant part of their background will likely be their experience at one of the public accounting firms. I refer to these individuals as "super" due diligence experts. They have a CPA and they have several years of experience running transactions for private equity firms, performing due diligence on transactions pre- and post-investment.

Aidan Kennedy: Even a classically trained audit professional without transaction exposure is pretty light. That background would require a lot of getting up to speed to become truly effective within the role. The traditional route has been audit work followed by transaction experience, and so on. Five or six years of transaction experience is invaluable, absolutely invaluable. And PE and FAS firms understand that the experience is critical, so in most cases, they are willing to pay for it.

Q: **So compensation packages have increased along with the growing demand?**

Martin Mendelsohn: Yes, the base salaries for this kind of work are consistently rising, which was not necessarily the case even as recently as 2004 and 2005. Some of the accounting firms also have created new positions and titles that place transaction services experts just below the level of the revenue-generating partners.

Aidan Kennedy: That is happening here in Europe as well. The director level position is being used by some organizations for people of partner grade who do not choose the path of becoming business originators. These individuals have the senior expertise to run these transaction services business, they know the processes, but they may not have the network or the commercial nature to follow the revenue-generating partner course.

Q: **How can partnering with the right executive search firm make a difference for companies seeking talent in this competitive field?**

Martin Mendelsohn: Well clearly, there is a significant amount of risk and responsibility tied to these financial transaction services roles. If a firm were to go out into the market with an individual who did not have the necessary skill set, who did not understand the client needs and requirements, there is a high probability that the individual would fall flat. These are sizeable financial transactions, so taking a risk on talent that is less than superior is myopic at best.

Aidan Kennedy: At CTPartners, we have a strong culture of reaching across industry boundaries to build search teams that best serve our client needs. Martin and I have expertise in both the financial services and professional services fields. We have access to, and knowledge of, the broadest possible candidate pool. And with our global purview and in-depth understanding of the industry and its growth challenges, we feel uniquely qualified to guide clients to the superior talent that will propel their businesses to continued growth and success.

Aidan Kennedy is a Partner with the CTPartners Financial Services Practice. Aidan may be reached at +44.207.901.0483 or akennedy@ctnet.com. Martin Mendelsohn is a Partner with the CTPartners Financial Services & Professional Services Practices. Martin may be reached at +1.202.730.7906 or martinm@ctnet.com.

For more information regarding CTPartners, please visit www.ctnet.com.