KEYNOTE INTERVIEW

Why focus is key to effective investing

In a highly competitive environment, TPG Capital is digging for alpha in the 'nooks and crannies' of its target industries and staying laser-focused on its strategy, say Nehal Raj, Jeffrey Rhodes and Todd Sisitsky

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Last year, TPG partners Nehal Raj and Jeffrey Rhodes joined Todd Sisitsky at the helm of the firm's TPG Capital platform. Here, the trio lay out how they have refined their investment approach over many years investing together, and how they intend to keep delivering for their investors.

Q What do you consider to be the private equity industry's biggest challenge today?

Jeff Rhodes: There is stronger competition within private equity today, which is a challenge but also an opportunity. In any industry that becomes more competitive, you need to become more innovative and more efficient in the way you think about driving your performance. As the industry has grown more competitive, we have also seen more specific and divergent strategies appear among firms, and that means multiple different approaches can be successful.

Todd Sisitsky: The market is much more sophisticated than it was. At TPG Capital, we have said, in a competitive market, you need to have a clear strategy. Everyone needs to understand that strategy, you need to hone the strategy and you need to evolve it. A strategy isn't something you set and come back to 10 years later.

You also need to resource yourself around that strategy, so that you have the right people to execute on what it is you are trying to accomplish, and then keep a high bar around both. Is your strategy working? How did your investments operate and perform relative to your expectations? Have your resources and partners, and the ecosystems that you built around your strategy, added the value that you expected

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>
> **TODD SISITSKY**

them to? These are questions we turn back to regularly as we evaluate our strategy.

Q How do you intend to continue to deliver on your strategy for your clients?

Nehal Raj: We have continued to refine and evolve our investment approach to remain at the cutting edge – innovation and efficiency are driving factors for us. If there is one key word for us over the last several years of doing this together, it has been 'focus', and that is across two areas: sectors and deal types.

As it relates to sector focus, that has meant going deeper in fewer sectors. Today, it's principally healthcare, technology, consumer and business services. We want all the DNA of the team maximised against a tighter set of opportunities. Within these sector areas, we are very focused on themes. When we talk about software, we are really talking about theme areas such as cybersecurity or DevOps. When we talk about healthcare, we talk about different parts of value-based care and how we want to play in that ecosystem. The focus we have created allows us to go deeper and unpack second and third derivative themes within our sectors, which allows us to uncover more interesting investment opportunities.

On deal types, the main focus over the last several years has been on transformational deals. It can often be carve-outs, or it could be a buy-and-build platform. Either way, it is a growth-oriented transformation

Q What do you expect from the next five years of private equity investing?

NR: The last five years have been, industry wide, more about beta-oriented returns, meaning markets have generally gone up. Multiples have generally increased as interest rates have declined, and so if you have had levered equity exposure, you have generally done well.

I think the next five years are going to be more about alpha than beta, meaning, what is the differential change you can bring to a company? I do not think you can rely on multiple expansion to drive returns. And for us, where do we find alpha? It is in sectors and themes and getting to those before they are broadly appreciated. It is in nooks and crannies of cybersecurity and nooks and crannies of post-acute healthcare. Identifying those themes early based on our depth allows us to generate alpha, because if you are early, then the rest of the tide comes in after you and you have a chance to outperform.

The second way we generate alpha is through transformational deals. Almost by definition, you are creating alpha and change by going in and taking a division and making it a standalone company, or by bringing in world-class management and providing them the capital to grow organically and inorganically.

Sometimes when everything is going up you can't tell how much investments are outperforming, but we are excited about the next five years, because we feel good about our strategy in light of how the markets are likely to change.

that we try to drive at our portfolio companies.

Q Private equity investment into healthcare more than doubled in 2021 to $151 billion, according to Bain & Co. How is that affecting opportunities?

JR: We have developed a playbook for how we go about developing investment opportunities. It's something we have worked on for 20 years. As the market has become more competitive, we haven't fundamentally changed our playbook, we have just been more disciplined about how we stick to it and evolve it where needed.

We are hyper-focused on thematic investing in neighbourhoods we want to be in, knowing all the companies, all the management teams, and having deeper insights into the way those industries are evolving and the health of the companies. By so doing, we are not just looking at financial statements, but we are able to understand the role that company plays in its subsector and the way that has evolved over time. That means that, even in this intensely competitive environment, a large number of our deals are proprietary. That is the result of us being viewed as a good partner.

It is a market where participants are looking for the right partner to help them achieve their goals. That is someone who is deep in an area and can be a true thought partner to CEOs, management teams and corporates who are trying to navigate this new environment.

When health insurer Humana wanted to pull off the largest strategic acquisition it had ever done – acquiring healthcare services company Kindred Healthcare – the company turned to us because of our partnership mindset and business-building capabilities, as well as our depth of knowledge in this area.

When Pfizer had a critical project in oncology and wanted a partner to help jumpstart it outside of Pfizer, the company turned to us. The same is true outside of healthcare – blue-chip, industry-defining companies are trying to find a partner to help them achieve their goals in this competitive environment. That creates interesting investment opportunities, even in a competitive environment.

TS: These companies look at us as bringing value beyond capital, because we operate as patient, long-term investors driving growth. When you are in a situation where you do not have a buyer and a seller, you just have two parties trying to figure out how they can create growth over a certain time period, the dynamic is really flipped on its head. That is when you want to have the right credentials as a growth investor and a thought partner.

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> **NEHAL RAJ**

Q How does that partnership mentality carry through to exit?

NR: We have been striving to create businesses that are interesting for strategic buyers to own.

The most recent example of that is software company Wind River. We reoriented the business through our transformation to be much more growth-oriented and retooled the technology to orient it more towards where the industrial software industry was going. We ended up investing a lot more in research and development than the company had been doing previously, and we took EBITDA down for a period to accomplish that.

In the last year of ownership, we created a number of corporate partnerships with large potential strategic buyers, and we would go to market together. That is a way of creating a 'try before you buy' situation, where you have a number of people in the ecosystem getting accustomed to what your software provides, and appreciating the value of it.

We suspected that what might happen is someone would raise their hand and say, instead of partnering with you, can we own you? Effectively, that is what transpired with Aptiv, a public company in the industrial space, that ended up buying Wind River for its strategic value. It is that sort of long-term curation process that is critical to driving a strategic exit.

Q How has the recent macro environment influenced your approach to dealmaking?

TS: For investments we have made over the last year or two, we anticipated an economic downturn, but we still were seeking proprietary, differentiated types of deals. In our expectation, the secular growth within the areas we were pursuing would balance a potential dip in the economy. These are the types of investments that we would make in any economic environment, late cycle or early cycle. ■