Seeking private equity funds: It's wise to be proactive

Private equity investors have grown less willing to do huge deals, hut many are still interested in buying smaller companies.

ALMOST EVERY DAY, it seems, another buyout by a private equity firm makes news. Most of these are megadeals, with the purchasers paying hundreds of millions or even billions of dollars for large companies. The purchase of an 80% interest in Chrysler Corp. by Cerberus Capital Management for $7.4 billion is just one of those huge deals.

But some other high-profile transactions have been jeopardized by the current credit crunch. Thus, you might be led to believe that there's no way a private equity firm would be interested in buying your family business. If so, you're wrong. Some of these firms do indeed seek out and buy smaller companies; it's just that these deals are done under the *radar* of the media.

That doesn't mean that private equity investors are going to come knocking on your, door next week or next month. Unless your company is quite prominent in its industry, you'll need to be proactive in your quest for a private equity buyer.

Untapped potential is a powerful lure for these investors, because they have huge amounts of money to invest and generate growth.

The right criteria

Before you start looking, you should know that private equity firms have certain minimum requirements. These investors generally look for profitable companies—specifically, businesses that have an absolute minimum of $1 million in EBITDA (earnings before interest, taxes, depreciation and amortization).

If your company meets the EBITDA test, private equity investors will want to delve deeper into the mechanics of your company. They'll want to see a dependable source of revenues and a consistency in earnings growth. What they *don't* like is reliance on one or two major customers—especially since these customers may go away should there be a change of ownership.

Perhaps most important, a private equity investor will want to see potential for substantial further growth. The objective of any private equity group is to make its portfolio companies increase greatly in value so they can get at least a 20% annual return on their investment when they sell a company—usually in three to seven years. So untapped potential is a powerful lure.

Just how much might your business be worth to a private equity investor? Some large acquisitions today are being made for 10 to 12 times EBITDA, but it's improbable that a private equity investor will offer anywhere near that multiple for your business. Chances are, the initial proposal will be for just three to four times EBITDA. But if you're an astute negotiator, you might be able to sell for a substantially bigger multiple of EBITDA.

Preparing for *a*

What must you do to take advantage of today's market, to make your company an investment that commands top dollar?

First of all, you should—if you don't already—have your financial statements audited or at least reviewed by a CPA firm to make sure they're accurate and comply with generally accepted accounting principles.

Next, you should tighten your operating and financial controls so a buyer can be assured that the tools are in place to drive" the company to still higher levels of profitability.

A third preparatory step should be to identify any areas for potential cost savings. Even if you don't make any cuts now, a buyer will appreciate knowing where savings can be realized. You may also want to consider dropping any lines of business that are unprofitable or are otherwise acting as a drag on your bottom line.

When you're ready to start looking for a buyer, you'll need a professional intermediary—someone who has dealt with private equity firms and can advise and guide you through the search and negotiating processes.

You can play an active role in this process by reading industry publications and looking for news about mergers and acquisitions. If you see

that a private equity firm has bought a business similar to yours, that firm might be interested in acquiring your company too.

After you've identified and attracted the interest of one or more private equity firms, the hard part begins. You can be sure that any potential buyer will do everything imaginable to keep the purchase price at rock bottom. Thus it would behoove you to have a ready response to any negative points about your company that buyers may bring up.

Pointing to your financial statements, the buyer may say, "Your asking price is too high because this decline in revenues two years ago shows that your revenue stream isn't dependable." Your position will be greatly improved if you can answer, "No, it doesn't show that. The falloff in sales was caused by a shortage in raw materials that year. That isn't likely to happen *again."*

Or let's say that sales and earnings of almost every company in your industry were off in a recent year. You might allay a buyer's concerns about that if you could respond, "Yes, but our sales were off only 5% percent while the industry as a whole was off 8%."

Although you might like to sell and enjoy retirement, a buyer probably will not accord you this luxury. You will probably be required to stick around for two or more years, until the buyer either sells the company or has found a permanent new CEO.

Perhaps you would like to sell just a portion of the company and remain in control of it. Sorry, but with a private equity buyer that's probably not going to happen. Private equity buyers sometimes will buy less than 100% of a very large firm—witness the purchase of an 80% interest in Chrysler—but they're almost certain to insist in buying all, or at least a controlling percentage, of a smaller company.

You may be wondering whether a private equity firm would micromanage your company, getting involved in every management decision and undercutting your authority. Rarely will this occur. Private equity people are basically financial engineers, not managers. They're not noted for any acumen in running businesses; rather, their strong suit is financing and leveraging companies to make them more profitable.

It would behoove you to have a ready response to any negative points about your company that buyers may bring up.

But a private equity firm isn't going

Continued on page 39

Seeking private equity funds

Continued on page 35

to stand idly by if a company in which it has invested doesn't meet stated goals or, heaven forbid, starts losing money. In that situation, the private equity owners' first step would be to hold intense discussions with management about how to deal with the problem. If that doesn't work, they would most likely bring in a consultant who has management experience in the same industry to provide advice and re-evaluate management's qualifications.

In the worst-case scenario—if the former owner simply can't get the job done or just seems to have taken early retirement without telling anybody—the private equity investors will certainly make a change to protect their investment. Often the consultant who was brought in to analyze the situation will be made the acting CEO while a search is conducted for a permanent replacement. Remember, the money they've invested in a company is not their own; it's their investors' and they've got to show some positive results.

Court strategic buyers, too

What if you've done everything possible to hook a private equity investor but haven't succeeded, or haven't been offered what you think your company is worth? Don't fret; there's another path to potential buyers.

In the financial world, there are two types of entities that purchase companies: financial buyers, such as private equity firms, and strategic buyers, which are operating companies seeking to expand their own business through acquisitions.

When you determine that you want to pursue a sale or a liquidity event, you should be looking for strategic buyers while you're courting private equity firms. Late in 2006, a gourmet food maker that had been negotiating with several private equity firms offering about ten times EBITDA wound-up selling to one of the world's largest food processing companies for 15 times EBITDA.

Although private investors have become less willing to do the huge deals that made headlines a few months ago, many are still interested in buying smaller companies. The opportunity still exists for owners of small businesses to sell on very favorable terms.

William J. Battison *is president of Angeles Capital Group LLC, a Los Angeles investment bank that provides advisory services and represents middle-market companies in mergers and acquisitions (www.angelescapital com).*

Fonte: Family Business, vol 18, n. 3, p. 34-35, Spring. 2008.