



Private Equity Groups

By Gary Papay, CBI, M&AMI

Over the past 20 years, private-equity groups (PEGs) have become key players in business acquisitions. PEGs offer flexibility as a liquidity source, giving entrepreneurs the ability to take some cash off the table, recapitalize their company or simply sell and move on.

Private equity refers to buyout groups that seek to acquire ongoing, profitable businesses that demonstrate growth potential.

The private equity market had traditionally been restricted to acquiring larger companies. But increased competition for those larger operations, greater growth potential for smaller firms and an easier path to exiting the investment in the future have played a role in attracting PEGs to smaller companies.

PEGs are typically organized as limited partnerships controlled and managed by the private equity firm that acts as the general partner. The fund invests in privately held companies to generate above market financial returns for investors.

The strategy and focus of these groups varies widely with different groups having varied investment philosophies and transaction structure preferences. Some prefer complete ownership, while others are happy with a majority or minority interest in acquired companies. Some limit themselves geographically while others will buy anywhere in the US.

PEGs also tend to have certain things in common. They typically target companies with relatively stable product life cycles; avoid leading-edge technology (this is what venture capitalist want); and have a preference toward stable and established product lines or services. Most prefer a qualified management team that will continue to run the day-to-day operations while the group's principals closely support them on the Board of Director level.

Private equity buyouts take many forms, including:

Outright Sale - This is common when the owner wants to sell his ownership interest and retire. Either existing management will be elevated to run the company or management will be brought in. A mid-term transition period may be required to train replacement management and transition key relationships.

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Employee Buyout - PEGs can partner with key employees in the acquisition of a company in which they play a key role but don't own. Sellers can receive an all cash price since PEGs tend to not rely on seller financing. Key employees receive a generous equity stake in the conservatively capitalized company while retaining daily operating control.

Family Succession - This type of transaction often involves backing certain members of family management in acquiring ownership from the senior generation. By working with a PEG in a family succession transaction, active family members secure operating control and significant equity ownership, while gaining a financial partner for growth.

Recapitalization - This is an option for an owner who wants to sell a portion of the company for liquidity while retaining equity ownership to participate in the company's future upside potential. This structure allows the owner to achieve personal liquidity, retain significant operational input and responsibility and gain a financial partner to help capitalize on strategic expansion opportunities.

Growth Capital. Growing a business often strains cash flow and requires significant access to additional working capital. A growth capital investment provides access to capital and permits management to focus on running the business without constantly having to be concerned with cash flow matters.

PEGs have become a major force in the acquisition arena. They can also be thought of as strategic acquirers in certain instances, when they own portfolio companies in your industry or a related area that addresses the same customer base. These buyers may be in a position to pay more than an industry or strategic buyer that does not have this financial backing.

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