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FOR EXECUTIVES SEEKING TO BUY, SELL, OR RECAPITALIZE BUSINESSES

Is Private Equity The Right Option For Your Business?

What Private Equity Investors Look For In A Company

To understand what Private Equity Groups (PEGs) look for in a company, one needs to understand the meaning of Private Equity. So, what is Private Equity?

Private Equity is long-term, committed capital provided in the form of equity to help private companies grow and succeed. If your growing mid-market company is looking to expand, Private Equity could help. Private Equity could also help if you are trying to recapitalize the company, exit the company, or transition the company to new management.

Unlike debt financiers who require capital repayment plus interest on a set schedule, irrespective of your cash flow situation, Private Equity is invested in exchange for a stake in your company. After the equity infusion, you will have a smaller piece of the pie. However, within a few years, your piece of the pie could be worth considerably more than what you had before.

Private Equity investors' returns are dependent on the growth and profitability of your business. If you succeed, they succeed. If you fail, they fail. PEG's capital infusion and involvement have proven beneficial to companies and many companies have gone much further with Private Equity than they otherwise would have. PEGs will seek to increase a company's value, without having to take day-to-day management control. In some cases, PEGs bring in their own management team and facilitate a management transition. Given the high amount of risk these investors incur, and the duration of their investment, PEGs invest in the business on the strength of the manager's business plans, knowledge, trust and negotiations with him.

Generally speaking, unless a business can offer the prospect of significant growth within five years, it is unlikely to be of interest to a PEG. For some high growth companies and companies with limited "hard" assets, Private Equity may be the only option for capital.

However, Private Equity is not for every business. Private Equity may not be suitable for companies with limited capital needs, for companies with stable cash flow, or for companies with substantial hard assets. For these types of companies, debt financing may be a better alternative. Many small companies whose main purpose is to provide a good standard of living for their owners are also not suitable for Private Equity investment, as they are unlikely to provide the necessary financial returns to this type of investor.

Assuming the company is suitable for Private Equity investment, investors look at several criteria before providing the equity for your business.

Strong Management team

Unless the intended purpose of the equity transaction is management transition, the quality of the management team is by far the most important criterion for many Private Equity investors. Most investors do not invest in a company unless they are satisfied with the management team.

Growing Market Segment

The value added by Private Equity in many cases is their ability to grow the "pie" and in that context the growth potential in the target market segment is a very critical factor. PEGs also want to ensure that the company is well positioned to grow within the target market segment.

Realistic Growth/Expense Plan

Unrealistic planning will create a doubt in investors' minds about the management's business skills. Similarly, under budgeting for material, labor and equipment costs will reflect poorly on the management team.

Exit Route

The PEGs are in the deal for the long term but they need a workable exit to get their money back. The exit could be business sale, management buyout, IPO or something else. PEGs need to have the confidence that there is a clear, planned path to their exit.

Security

Unlike debt, equity investment does not come with any overt security collateral. To mitigate risk, PEGs typically require a seat on the company's board and a codified management plan to protect the PEG's interest.

Contingency Planning

No business grows without hiccups. Understanding what could go wrong and putting contingency plans in place to deal with specific situations can go a long way in gaining a PEG's trust.

Reputation

PEGs check the business credit rating, the management team's reputation, and enthusiasm and determination of the team before they invest. The best business ideas are not worth much without good people and PEG's want to make sure that they are getting a strong, positive team with good marketplace reputation.

Good Rate of Return

When everything else checks out, it comes to terms. PEGs look for a good return for the capital they are risking on your venture. The return a PEG is willing to accept is a direct function of how desirable your deal is and how much competition exists for your deal.

In summary, PEG investors must be assured that the capital being deployed by them will yield the returns they are seeking. If the investment is considered worthwhile then there will be competition to do your deal. Competition often means you get a higher valuation, better deal terms for your company and more cash proceeds for you.

Chak Reddy is a Mergers and Acquisitions Advisor with Elite Mergers & Acquisitions, Inc. Elite Mergers & Acquisitions specializes in selling and recapitalizing businesses with revenues between $5 million and $100 million - Businesses too large for business brokers to adequately handle but too small for the national M&A firms. Mr. Reddy is a business M&A and Marketing expert, and is the chief deal maker at Elite. You can reach Mr. Reddy at 916-220-3052 or by email at creddy@elitemanda.com .

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