

PARTNERING WITH PRIVATE EQUITY AS AN EXIT STRATEGY: A GUIDE FOR BUSINESS OWNERS

As a business owner, there will come a time when you will need to decide how and when to exit your business. It may be for retirement, to pursue other interests or to free up capital for other ventures. Whatever your reason or timeframe, forming an exit strategy is critical to ensuring your company's ongoing success and your financial future. Selling a portion of your company to a private equity group as an exit strategy can help you accomplish many of the goals most business owners have when considering their transition out. After all, your company is your life and your employees are like family. You've worked hard and you need to be sure that you, your company and those who have helped you build it are protected.

When you think of exit strategies you may think of traditional selling arrangements where competing or complementary businesses take over and you leave the company. However, depending on your goals, particularly if you are not ready to retire and are concerned with maintaining your company's culture, this may not be the best solution. That's why it is important to know you have options beyond an outright sale of your business. The strategy that is right for you may not include a total or immediate exit from your company and can instead help you accomplish multiple goals such as maintaining operational control and bringing in growth capital.

Selling a percentage of your company to a Private Equity Group (PEG) is a way to deliver on these goals while protecting your company culture and employees. This guide will discuss what PEGs are and how they work with business owners — a valuable resource for any business owner who wants to explore exit options.

The Right Option for Your Goals

Creating an exit strategy is not the end; but it is a crucial part of an overall business planning process that can enable you and your company to meet your specific goals — be they raising growth capital for expansion, freeing up some of the equity you have built in your company or ultimately transitioning out of the business. Every business is unique — what works for one business owner is not necessarily the best solution for another. That’s why you need a solution that is structured specifically for you and that may include selling a percentage of your business to a private equity group (PEG).

Before you can determine whether selling a portion of your company to a PEG is a viable option, you need to consider the following questions:

1. Do you want access to growth capital and other resources without having to provide it personally or personally guarantee a bank loan?
2. Do you want to diversify your net worth by liquidating some of the equity in your company, allowing you to invest in other assets?
3. Do you want to continue to lead the day-to-day operations of your company, while positioning yourself for an eventual exit?
4. Do you want to reward key employees with ownership in the company?
5. Are you willing to sell a majority interest in your company while maintaining a board seat and operational control?

If you’ve answered yes to any of these questions, a PEG partnership may be right for you. While a “no” answer to any of these questions does not necessarily disqualify your company from considering a private equity partner, most private equity transactions include these characteristics. The next few sections will answer questions about what PEGs are, what kind of companies they want to invest in and how they work with business owners.

Understanding Private Equity Groups

A typical private equity group or PEG is a fund of capital raised by group of managers to invest in operating companies. Their goal is to earn greater returns than those generated by the large public markets. A single PEG may hold interest in many different companies. Unlike venture capital groups, most PEGs purchase a majority share in their partner company and generally don’t work with start ups. They look for profitable companies with a historical positive cash flow, and they allow the shareholders to take cash from their investment off the table rather than requiring it stay in the company to fund operations and growth opportunities. They accomplish this by recapitalizing the company, using their own equity and outside debt to provide “buy-out” capital for the business owner.

PEGs make money by partnering with successful management teams to help them to grow their companies through organic expansion or acquisition. They also help

management find operational efficiencies, making the company more profitable. They are experts at developing and executing growth strategies which may also include expanding sales and marketing, increasing production capacities, and developing new products and distribution channels. In fact, recent studies have shown that PEG-owned companies tend to be more successful than those not backed by private equity.

- On average, PEG-backed companies substantially expand their capital expenditures over the three years following acquisition by an average of over 14% per year.
- Companies purchased by private equity groups outperform national and industry averages in total sales growth.
- PEG-owned firms create new jobs – their labor force grows, on average, over 8%, versus 5% for non PEG-owned businesses.

Case in Point

The owners of a restaurant chain sold 80% of their company to a private equity group. Before the sale, they were opening 1 new location a year, primarily due to the owners approaching retirement age. After the sale, the private equity partner provided enough growth capital to triple the number of locations opened each year. One year after the sale, the PEG purchased a smaller restaurant chain, folding its stores into the larger company. As a result of the increased store openings and acquired stores, the value of the company increased dramatically in a short period of time. The 20% ownership retained by the owners was now worth substantially more than when they sold the 80% interest, all without any personal capital or risk of the original owners.

And, since PEGs have ready access to capital, they continue to be attractive buyers even in a depressed economy with tightened credit markets when bank financing is harder to come by.

When a PEG takes ownership in a company, they typically look for a majority interest and board control. However, it would be impractical for PEGs to involve themselves in the day-to-day operations of a company. First, they do not know your business or even your industry like you do. Second, the number of investments they make generally far exceeds their personnel's ability to do more than serve on the board of directors and act as advisors to the management team. That's why business owners who want to continue working in their businesses for three to seven years are ideal partners for PEGs.

The Working Relationship

When you sell a majority interest in your company to a PEG, your daily work life looks a lot like it does now. The impact on your employees and your corporate culture is minimal because the goal of the PEG is not to implement sweeping changes. After all, your success is what attracted them to your business in the first place.

There are literally thousands of these groups in the U.S that focus on many different industries and different sized companies. Each PEG has its own investment mandate and management style. That's why it is imperative to find a PEG that has a vision and goals that are compatible with you and your company. Company owners should meet and consider multiple groups to find the right fit, as well as maximize the value they receive from their business.

Because PEGs generally realize a return on their investment through the growth of the company over the lifetime of their investment, an ideal partner company has growth avenues, both within the company and through potential synergistic acquisitions. By partnering with a PEG, a business owner can more aggressively pursue growth opportunities with increased capital and other resources, with little to no personal risk. Partnering with a PEG enables you to essentially cash in on the investment you've made

in your business, benefiting you personally. It also ensures the continued success and growth of your business, benefiting you and your employees professionally. You can structure your sale to include a final exit from the business down the road at which point your remaining shares could be sold to the PEG or to another party at the then current market value. Many business owners find that the smaller percentage of ownership they maintain after an initial transaction is worth more than the larger percentage they sold once they exit completely from their company. Since PEGs are only active at the board level, they rely heavily on key company employees to drive the success of the business. For this reason, they typically set aside a pool of equity that key managers earn, rewarding them with company ownership and motivating them to grow the value of that company ownership.

How do I find a PEG?

If you enter the term “private equity groups” in a search engine, you will find almost 4 million results. Finding the PEG that is suited to your industry and a good match for your corporate culture and vision without an experienced mergers and acquisitions advisor in your corner is akin to looking for that proverbial needle in a haystack.

What’s more, you don’t want to find just one PEG, you want to evaluate several to ensure you have options. You need to choose the partnership that provides you not only with the transaction value, but also the right business relationship with a unified vision for the future of your company. Without options and an experienced guide, it is easy to lose control of the negotiations. And when we’re talking about your business, that’s the last place you want to be.

Using a knowledgeable mergers and acquisitions advisor gives you a number of advantages, chief among them — control.

Putting you in Control

A mergers and acquisition advisor is an individual who helps business owners sell all or part of their business. An M&A advisor represents your interests and can bring multiple buyers/investors for your consideration. This alone is critical to negotiating a successful transaction. However, a good M&A advisor, working in conjunction with your other trusted legal and financial advisors, can be extremely valuable to you for a number of additional reasons.

1. **Creating the Right Exit Strategy.** Many M&A advisors have been business owners and understand the challenges and choices you face. Their experience can help you when creating an exit strategy that fits you, your business and your short and long-term goals. Your exit strategy may include partnering with a PEG or selling outright. When evaluating M&A advisors, ask about their experience in the whole range of transaction options available to business owners.

Case in Point

An owner of an industrial products distributor was contacted by one of his competitors about purchasing his business and tendered a purchase offer. Because they were in similar industries, it sounded like an easy solution. Fortunately, this owner consulted an M&A advisor for a valuation of his company. He found the market value was considerably more than what his competitor was offering. The advisor was able to generate five other competitive purchase offers. While the company was ultimately sold to the competitor, the M&A advisor gave him the leverage he needed to get a 25% higher price for his business.

2. **Determining Your Company's Value.** Many business owners have a sense of what their company is worth to them, but the key is finding out what your business is worth to potential buyers. While your accountant or attorney can provide critical financial and legal information, you will benefit by having a professional M&A advisor value your business. A skilled advisor will base his valuation on key financial data, market trends, intellectual property, recognized brand, among other determining factors; all weighed against current M&A market conditions. When evaluating M&A advisors, ask how they determine value.
3. **Keeping Your Business Information Confidential.** Discretion and confidentiality are critical when you are considering major decisions about your company. If competitors, customers or employees hear rumors of a sale, it could adversely impact your business and the negotiations. Using an M&A advisor keeps your company information private and provides legal protection through non-disclosure agreements as you explore potential opportunities. You control your information. When evaluating M&A advisors, ask how they maintain your privacy and the integrity of your business information.
4. **Finding Multiple Buyers.** You know the key to creating the best deal: let demand outweigh supply. When you have multiple parties interested in your business, you remain in control and can better ensure your needs are met. You can also make the decision based on what factors are most important to you — and it is not always price. A good M&A advisor has working relationships with many types of buyers, including PEGs, and access to many more through relationships and marketing efforts. When evaluating M&A advisors, find out how they will find buyers best suited to meet your company and personal goals.
5. **Managing the Negotiation.** This is a critical but often overlooked reason to rely on an M&A advisor — especially if you are partnering with a PEG. After all, you'll likely work with your buyer for a period of time — maybe years. It is vital to your success to maintain a productive relationship with your buyer. Sometimes negotiations are tough and emotions run high. That's why having an M&A advisor who can work with your other transaction advisors on the details and mediate any potential concerns is important to preserving relations while maximizing the value and terms of your transaction. When evaluating M&A advisors, find out what your role and their role will be in the negotiations.
6. **Sealing the Deal.** The deal is never done until it's done. The worst position to be in is in the middle of a deal that is falling apart in the eleventh hour — especially when you've started making plans and are invested in the process. Having an experienced M&A advisor handling your transaction will enable you to avoid many deal-breaking pitfalls and protect you by having other buyers at the ready should something unforeseen happen. When evaluating M&A advisors, find out how many transactions they have successfully completed.

Case in Point

A father and son, owners of an eyecare products manufacturer, hired an M&A Advisor to find a private equity partner who would allow the father to retire and liquidate his ownership, while allowing the son to lead the company and maintain significant ownership. Eight PEGs expressed interest and made purchase proposals. The owners were able to not only maximize the value of the transaction, but were able to choose a partner that best fit their and their company's goals and culture.

Partnering with private equity groups gives you a flexible, powerful option when you consider the future of your company and your exit strategy. Beyond the immediate personal financial benefits, PEGs bring significant expertise and the all-important growth capital that could enable your company to expand and profits to increase. Having an M&A advisor on your team will allow you to create the best possible outcome for you, your company and your employees.

About Coldwell Banker M&A

The Mergers & Acquisitions division of Coldwell Banker Commercial represents profitable, established companies with revenues between \$5 and \$100 million, in all industries across the U.S.

Coldwell Banker M&A is active in the market and has access to many different types of buyers including PEGs and strategic companies. Coldwell Banker M&A will professionally package and market your company through a variety of media to ensure the best possible offer. At Coldwell Banker Mergers & Acquisitions, confidentiality is paramount. We protect sensitive information throughout the course of a transaction.

When you work with a Coldwell Banker M&A advisor, you put an experienced guide on your side who will protect your interests. Your Coldwell Banker M&A advisor has seen the challenges and pitfalls that can impact a transaction and knows how to avoid them. And, as former business owners, your Coldwell Banker M&A advisors understand what your business means to you and will help you develop an exit strategy that does what is best for you, your company and your employees.

Free Valuation of Your Business

If you are ready to consider an exit strategy or to simply get a sense of the current market value of your company, we're ready to help you explore your options and provide a confidential valuation of your business at no cost, or obligation.

Contact:

Garit Lawson

801.209.5700

garit.lawson@coldwellutah.com