

Private Equity Perspectives

As a business owner seeking private equity funding, you need to consider many different things. Northern Trust's Robert Morgan, Mary Boehler and Robert Jank share their expertise and advice on where to begin.



Robert P. Morgan is the director of private equity for Northern Trust Global Advisors. He has invested in more than 60 private equity funds covering the buyout, venture capital, structured high yield, real estate and international markets.

Q: What should business owners do to prepare their companies before pursuing private equity financing?

Morgan: You should hire good advisors and make sure you have a good attorney because you're going to be involved in a lot of negotiation. It's also a good idea to hire a business intermediary — whether it's an investment banker or someone experienced in similar types of transactions — because the intermediary will know what investors are looking for and can help prepare a business for sale.

Boehler: To generate the best value, clean up your balance sheet and get rid of any unrelated or unprofitable lines of business, which will streamline your company to generate the best value. Negotiate contracts with any managers you want to keep; private equity firms are often looking for key managers. Do everything you can to get positive, upward-trending earnings.

Hire very sophisticated corporate transaction attorneys or investment bankers who have had experience negotiating with private equity funds and their advisors. These funds tend to have expert advisors on their teams, and you want your team to be as strong as theirs.

Jank: Get audited financial statements as early as possible; private equity companies want statements they can trust. If you have a privately owned company, bring any non-market leases on family-owned real estate up to market rate. Also, move any assets that aren't critical to the operation of your company, such as a private jet or non-essential real estate, off your books. It's unlikely the private equity firm will want or need any of those assets.

Q: How much time should business owners realistically expect to spend on this preparation process?

Boehler: That, of course, depends on what needs to be done. A year is usually a comfort-



Mary G. Boehler is managing director of Northern Trust's Family Business Division, where she works with business owners and their families to develop investment and estate planning strategies. She also works with trust investments in venture capital and various types of private equity funds.

able lead time, but a lot can be done in six months or less, if necessary. Selling or spinning out unrelated businesses may take up to a year, financial audits, valuations and environmental studies can be done in just a few months.

Q: Given today's economic environment, what advantage does private equity offer a business owner over other sources of financing?

Boehler: Private equity funds are still flush with cash, so they could do a smaller equity deal — up to \$250 million — with just a little bit of leverage. That's a big advantage today because the debt markets are so difficult.

Morgan: There aren't many alternatives to a change-in-control transaction. Private equity investors tend to have a longer-term focus. They'll buy a company and hold it between four and eight years. And in many cases, the management team can maintain some day-to-day independence versus if you sell your business to a strategic buyer or a competitor that would completely envelop the business.

Q: At what stage of development should a business owner consider private equity financing?

Morgan: There are certain private equity firms that will invest in companies in all different stages of development, from the proverbial "two guys in a garage" who need funding to develop their product to the well-established, multi-billion dollar business. It depends on the owners' or the entrepreneurs' motivation for bringing in

that private capital. In early stages, entrepreneurs want to retain ownership, and the capital is for growth of the business and to build their product. In many later stages of development, it's often for a change in control when owners want to cash out.

Q: Do certain types of businesses benefit more from private equity investors? And what types of businesses are private equity investors most commonly interested in pursuing?

Jank: Private equity firms are interested in a very broad range of companies across various industries, stages of life cycle and levels of success. While you may think they would naturally be interested in a high growth company, we've seen plenty of instances where a private equity company purchased a mature, slow growth company to add to their existing platform or stable of companies already competing in that space.

Boehler: If a business has solid earnings and growth record and prospects, a unique niche, current strong management who would like to stay involved and the business owner would like to keep some equity on the table, a private equity buyer is a good choice. Right now, private equity investors are pursuing businesses in industries where the fund has already invested in a platform company, and the subject business is a strategic fit. There is a fair amount of activity with transactions of less than \$150 million. For example, scrap metals, industrial and service businesses.



Robert T. Jank is the managing director of Northern Trust's American Banking Group for corporate and institutional clients. The group provides banking services to public and private companies.

Q: What factors do private equity funds consider before making an investment?

Jank: Private equity funds look at the predictability of earnings, the growth rate of earnings and whether they can verify the company's earnings. They'll want to determine how much of those earnings are reliant on the company's owner or certain key employees. Ultimately, they'll want to ensure that there's a system in place so the company's profitability won't suffer too much if they lose that particular individual. Also, if the private equity firm has a platform of a certain type of companies, they'll consider how well your company fits in with their other companies. Your company will be more appealing if it fits their platform.

Morgan: From a returns-and-risk perspective, most of the firms we work with are looking to earn anywhere from a 25% to 30% return on their investment, and they can get that in several ways. They can improve the business's cash flow and continue to build the company. Or, they can put a lot of debt on the business and then deleverage it over time to produce a return. In this instance, the valuation of the business doesn't have to change significantly, but deleveraging it results in a good equity return for the investors.

Q: In addition to giving up partial ownership, what other considerations should business owners weigh before entering this type of relationship?

Boehler: Business owners need to understand that they're no longer going to make all

the decisions for the company. But they can expect much more discipline in management, financial reporting and accountability. Secondly, the private equity firm will focus on building value in the business in anticipation of a liquidity event within five to 10 years.

Morgan: It's important to choose the right partner that will do what you want to do with your business. Sometimes price isn't the sole consideration. It's also about how they'll treat the workforce, whether or not they'll move the headquarters, how they'll treat confidential negotiations and other issues.

Q: In addition to consulting with their advisor, where else can business owners turn to learn more about their options, how to prepare, and what to expect when they're ready to pursue private equity funding?

Jank: They can rely on the three-legged stool of their accounting firm, their lawyers and their banks. All three have had experience in working with other business owners who have sold their companies. In addition, they should talk to fellow business owners who have sold to a private equity firm. No one can give them a better perspective on the negotiations, difficult decisions and emotional roller coaster that they are about to encounter than someone else who has experienced it.

Boehler: Northern Trust professionals can serve as a neutral resource in helping a business owner learn about the range of options and negotiate the journey from pre-planning to sale. ■