

Article

Critical Questions To Ask Private Equity Firms Who Want To Invest In Your Business

In my practice as a mergers and acquisitions attorney, I am often asked to help clients assess private equity firms. In the lower middle market (revenues of \$25 to \$150 million), astute business owners who want to sell a piece of their business search for “smart money” - a private equity firm that will help the business make the quantum leap to the next level. These are the questions I encourage clients to ask:

1. **Does the private equity firm have operators, successful ex-CEOs or CFOs?** This is especially true in the lower middle market, where the company's current managers may have had success running a relatively small company but haven't grown a company to \$250+ million in revenues. In the lower middle market, revenue growth is typically more important than expense reduction, and successful private equity firms know that you can't financially reengineer companies to success in that space. If you are going to sell a controlling interest in your company to a private equity firm, you need not only smart investors, but smart operators. Therefore, you should ask whether the private equity firm you're talking to has professionals with operating experience who can help take your company to the next level. Daryl Gabehardt, CEO of Dallas based Care Quest Home Care said, “the best decision I made for my company was to team up with a private equity firm who understood what it actually took to grow a business rather than a case study of financial engineering.”
2. **Does the private equity firm have a successful track record?** Everyone likes a winner. And past winners tend to continue to win. The process of taking a lower middle market company to the next level is a veritable minefield, and a truckload of dollars rarely guarantees success unless it's accompanied by the right driver. A track record of success in your industry can also be a key differentiator. Perhaps the best private equity firm is an optimal blend of operators, financial gurus and investment banker types who understand their strengths. The operators have experience building companies, the financial guys have experience managing expenses and rationalizing the company's capital structure, and the investment banker types have experience guiding the company through a sale or IPO. There is no substitute for experience.
3. **What is the private equity firm's management style?** This may be the most important question because it will determine the type of relationship you will have with the private equity firm. Make no mistake: a private equity firm will typically assert control over your company whether or not it buys a majority stake. Therefore, the right question is not whether the firm will exercise control but what management style the firm will utilize. What's right for you and for your company will depend upon many factors, including your personality, firm culture and management style and how much help you actually need. And while you're assessing the management style of the private equity firm, that firm will also be gauging how coachable you are. If they perceive that you are not open to instruction, they will likely move on to another opportunity. Finally, tough times will inevitably occur, and you need an investor with a management style you can effectively work with during those challenging times.
4. **Can you leverage the private equity firm's “assets”?** These assets could include companies in the private equity firm's portfolio that are in similar markets. You could possibly use the management or market expertise of those portfolio companies. Or perhaps you could also get discounted services or products from those companies. Relationships within an industry can also pay dividends. I have seen many investors who routinely introduce their portfolio companies to valuable resources. Many times, the most important asset a private equity firm has other than money is a network that portfolio companies can leverage.

5. Do you see eye to eye with the private equity firm on exit strategy? Private equity financing transactions bring the opportunity for a second payday: the first payday happens if the owner gets a check when the private equity firm buys a piece of the company. The second payday occurs when the entire company is sold in the future. This second payday can be huge, but the timing must be properly handled. In some situations, issues unique to a particular private equity firm can drive a sale of a portfolio company. These issues may have nothing to do with the company's business – for example, a private equity firm might decide to sell a company to generate liquidity for the firm's owners, even though it may not be the best time to sell. Therefore, you should seek a good understanding of the private equity firm's plan, process and expectations for the ultimate sale of your business.

Choosing the right private equity firm involves a substantial amount of “due diligence” on your part. While there are numerous private equity firms in the market to partner with, one firm that fits many of these criteria is Fort Worth based Ancor Capital Partners. “At Ancor we pride ourselves on being an operations focused private equity firm with a 13 year successful track record of investing in lower middle market manufacturing and distribution companies, said Timothy J. McKibben, Founding Partner of Ancor Capital Partners.

Primary Contacts



Robert Kibby

Dallas
214.855.7504
rkibby@munsch.com

Related Practices

Corporate & Securities
Mergers & Acquisitions
Private Equity, Venture Capital & Investment Funds