

Private equity recapitalization

How to lucratively exit a business in three to five years **Interviewed by Jerry Roche**

A few years ago, private equity recapitalization was a small percentage of the way owners exited their businesses, but today, its popularity is growing fast.

“Sixty to 70 percent of what we do now involves private equity firms,” says Joel J. Guth, an advisor in the Citigroup Family Office at Smith Barney. “It is a very attractive option. You can continue to work for a few more years but also secure your financial future by taking a good amount of money out of the business today.”

Smart Business asked Guth questions about the best way for an owner to exit his or her business by using a private equity firm.

What kind of companies do private equity firms consider recapitalizing?

They want to bring some expertise to the table in terms of access to capital, new ideas and access to sophisticated, savvy investors who will help the company grow. To that end, they look for well-run businesses with strong ownership that is willing to stay in place for three to five years and an experienced management team. They want the company to be in a good industry that has attractive growth with historical, strong, consistent profitability.

Contrary to what you might expect, private equity firms prefer not to interfere with the integrity of the business, which usually means that employees can stay in place, job descriptions and responsibilities will not change, and employees will still report to the owner. They do not want to get into the business of running companies on a day-to-day basis. When they conduct their due diligence upfront, they are looking for a good partner.

What kind of owner can benefit from private equity recapitalization?

Consider an owner in his late 50s who would like to retire in three to five years. He has a good business and a fairly large net worth. He knows he can continue to grow his company, but he has to infuse capital — without risking his own financial future.

With a private equity recapitalization, the



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owner typically retains 10 to 30 percent of the business. The private equity firm will create a very lucrative stock option plan for the senior management team, so that if the company can realize its growth plan and stay profitable, senior management will be able to take money out.

What are the inherent dangers to using this option?

One, there is a potential loss of management control, both financially and operationally, because the owner is giving up majority ownership in most cases. Two, somebody will be scrutinizing results and possibly questioning the owner's management — and that can be tough for a lot of entrepreneurs. And three, there are potential conflicts in culture and chemistry. If results start to suffer, investors are going to want more of a voice in how the business is run. They could even ask the owner to change long-held policies and practices.

What happens to the company when the owner does call it quits?

In that three to five years, the private equity firm is hoping to sell the company again, at which time, the owner will retire

fully. If the owner wants to retire prior to that, the private equity firm would work with the owner on a succession plan. Normally, owners want to stay until that second liquidity event because they still have their money invested in the business.

How does an owner find a private equity firm?

Most owners are getting phone calls every week. Very rarely will an owner get a maximum price for the company by talking to one private equity firm because it is trying to buy the business at a price that will maximize its return. The best way for the owner to realize his objective is to create a competitive auction process with four to five prospective buyers. If the auction is run correctly, it will increase the sale price.

However, when choosing a private equity firm, the money is only one consideration. The second is finding a high level of comfort. If you can get the right match, your odds of success at eventually exiting the business in good financial shape go up dramatically.

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