



Building Success Structuring a Private Equity Deal

By MILTON REEDER

They've got it by the millions, you want just a little of it. Money. But how much do you need? When? In what form? And what will it cost in terms of control?

Private equity deals are as varied as the companies that are involved. All employ equity in some form, but the actual deal may use one or more instruments on a spectrum ranging from common stock to convertible debt. Investments may be made at one time or over a period of months or even years.

The private equity (PE) investor will assess your funding needs throughout the second stage of your discussions, and propose a funding structure in the term sheet. The final structure will be determined through discussions of how you can build a business relationship that meets your company's funding needs and the PE firm's need to ensure the success of your business, and its investment.

One of the key considerations for the first time user of PE is the issue of control. A business owner who has devoted years to building a firm may find handing a majority stake to an investor very daunting, yet many deals require just that: As a rule of thumb, most PE deals involve a 40 to 65% equity stake. If the investor takes a stake of less than 50%, the conditions tied to that stake are likely to be more rigorous so that the investor can protect its investment and ensure that it has the ability to direct the firm to extraordinary returns in the long run. Once the equity stake is above 50%, the terms are likely to be less stringent as the investor will have a voting majority on the board. In either case, the deal will also involve board seats and management interaction to ensure that the investor can actively mentor the business owner to a successful outcome.

Whatever the level of equity involved, business owners are likely to end up wealthier after the deal. The PE firm has done its due diligence and is confident in the company's ability to grow—it would not be investing in your firm otherwise. The capital it provides is the fuel that helps to make that growth happen which, in turn, raises shareholder value. The math is simple: a smaller share of a large and rapidly growing company is worth more than 100% of a small company. And even if voting

About Accent Capital Partners

Accent Capital Partners specializes in growth equity for established small-cap and mid-cap companies (\$5 to \$50 million in value) involved in business services, light manufacturing, and real estate and finance.

We aim for long term relationships with our portfolio companies, so we invest in companies with top quality management that have a drive to succeed coupled with a vision of how to do so.

We are based in the Bay Area and can be reached to discuss your clients' private equity needs at 415.981.7200 or at www.accentcapitalpartners.com.

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control is given to the PE firm, the investors will be committed to growing your vision and keeping the senior management team intact. You and your team created the success to date, so you not only have the experience necessary for growing the firm, but are also the asset that the investor values most highly.

Many deals involve one or more of the following instruments:

- **Common stock.** While equity stakes are often taken, common stock offers less protection for the investor than preferred stock and is therefore rarely the first choice.
- **Convertible preferred stock.** Preferred stock that converts into common stock, usually upon an initial public offering (IPO) or the sale of the company. The preferred stock can be either participating (it gets a regular dividend) or non-participating (no dividends are paid).
- **Convertible debt.** A PE firm may seek to start the investment out as a loan that is convertible into preferred or common stock upon certain events.

The final structure of the deal will depend on a number of factors and may include some or all of the equity forms above, as well as a variety of terms and conditions that are based on the circumstances of the deal and the needs of your company.

Another factor to consider in the structuring of the deal is timing: when the funds are received. Generally it depends on what they are needed for; for example, funding for an acquisition will be tied to the timing of the purchase. However, funding for a management buyout may be staged over time to ensure that the senior manager being bought out remains committed to the company's future for some fixed timeframe.

Investors will aim not only to build your company in the short run, but also to sell or liquefy their investment in the long run. Most funds raised by PE firms have a 10 year time horizon and are generally more patient than venture capital funds. Typical liquidity events include selling the company to larger player in the marketplace, going public, or being bought out as the company raises substantially more equity and debt capital in the future. There are some traditional wealthy family funds that don't have any particular time horizon and consequently may stay in the investment so long as it's making economic sense to do so.

Most PE firms will consider an exit strategy at the time they structure a deal. Other investors will work to have a long run relationship with the intention of remaining a business partner until the day that a firm with much larger resources is required to take a company to the next step. In that case, the original PE firm may stay on as a minority shareholder or the new partner may buy out the first firm's interest.

The key consideration when seeking private equity is finding the right balance between realizing your vision and gaining outside help in terms of financial and executive experience. If you approach the process seeking a PE firm that shares your vision and has the resources to implement it, you are more likely to create a successful deal.