

Private Equity Groups Major Players in Today's M&A

By Adam Landa

With the recent announcement of the largest leveraged buyout (LBO) in history – the proposed \$33 billion buyout of HCA – many are intrigued by the private equity groups that are making deals like this happen. In fact, private equity groups have been active acquirors of or investors in some of the more well-known companies in Nashville, such as Captain D's and Thomas Nelson. On a national scale, familiar names such as Hertz, Baskin-Robbins and Toys 'R' Us are now portfolio investments of private equity groups.

Generally speaking, private equity groups (also referred to as LBO funds) are entities that have raised millions, and in many cases billions, of dollars (equity capital) from investors for the sole purpose of investing this equity in acquisitions. Funds are typically raised from investors (referred to as limited partners or "LP's") which include pension plans, endowments and wealthy individuals.

At the very basic level, private equity groups utilize their equity capital dollars together with significant debt (and thus the term "leveraged" buyout) to acquire companies and then rely upon the cash flows from the company and/or asset sales to repay the debt over time. The intent typically for private equity groups is to sell the acquired business within a few years and, because of the leverage, realize a relatively high return on investment of around 30% or more in today's market.

Private equity groups, and the amount of capital they have at their disposal, are a significant driving factor in today's capital markets and are fueling the current boom in mergers and acquisitions. And they come in all shapes and sizes with different areas of focus. Some focus on select industries whereas others are more generalist in their investment strategy. Some pursue buyouts of companies whereas others prefer to make investments and support current ownership/management in their future growth of the business. Finally, another differentiating factor is the size of transactions that a group is willing to pursue, which is largely driven by the size of their fund.

In the case of the proposed HCA transaction, KKR, Bain Capital and Merrill Lynch Capital are well-established, extremely large private equity groups that have raised and invested billions over the years. KKR is widely recognized as the forefather of the industry, having popularized LBO's in the late 1970's and 1980's and reaching fame with the acquisition of RJR Nabisco in 1989, the largest LBO in history prior to the HCA announcement.

For owners of companies looking for an exit strategy, a sale to a private equity group may be an attractive alternative; however, whether management is in place, or whether the group can bring in new management, can be a determining factor in their interest for a transaction. Without management in place, most groups will only be interested if a transaction can be structured whereby current ownership sells a majority of their interest

in the company, but continues to operate the business until new management can be groomed internally or brought in. If current ownership is going to continue to run the business while maintaining a minority interest, it is critical that ownership is comfortable with their new financial partner. One attractive feature of selling to a private equity group is that unlike some instances when businesses are sold to a competitor, the likelihood for significant layoffs or management turnover is minimal.

While some private equity groups outwardly state their approach to become actively involved in managing and improving the business, most groups remain on the sidelines and monitor the business and their investment from a board level position. However, if the business begins to decline, performance measurements are not being met, and especially if lending covenants are breached, then you can fully expect that the group will become more involved to ensure that their investment is being well tended. Remember, while private equity groups control large sums of money, it is not their money, but rather funds that have been entrusted to them by large institutions, pension funds and high net worth investors. As such, at the end of the day, the group will be required to explain to their investors what is going right or wrong with each of their portfolio companies.

One additional benefit worth mentioning when entering into discussions with a private equity group in either a sale with continuing interest or investment situation is the ability to leverage their relationships. For example, many groups maintain advisory boards consisting of former senior executives from the industries in which they invest who now provide consulting services to the private equity group and, when called upon, their portfolio investments. For a CEO of a portfolio company, the ability to draw on this experience can be extremely advantageous when making strategic decisions. Furthermore, such relationships can also be mined to open doors to potential new customers or beneficial relationships.

There are literally thousands of private equity groups in the U.S. canvassing the country in search of potential investment opportunities and the appetite within the private equity community has never been higher, a significant benefit to a business owner considering the sale of their company. Trying to identify and qualify the best groups for your business and your purpose takes a significant amount of time, which is why many business owners look to investment bankers to assist them with conducting a formal process. In addition to providing a value-added service, the involvement of an investment banker allows ownership to continue focusing on its top priority, running the business.

Adam Landa is a Vice President with Harpeth Capital, LLC, a Nashville-based, middle market investment banking firm providing mergers and acquisitions, private placement of debt and equity, and corporate financial advisory services to public and private companies. The firm's clients participate in a broad range of industry sectors, many of which are undergoing some measure of consolidation or experiencing significant growth. For more information, visit www.harpethcapital.com.