

What is Private Equity?

Type	Cost	Risk Tolerance	Change of Control?
Seed/Angel	\$\$\$\$	High	Sometimes
Venture	\$\$\$\$	High	Sometimes
Growth	\$\$\$	Moderate	Sometimes
Mezzanine	\$\$	Moderate	Unlikely
Bank / Sr. Debt	\$	None	Never
Private Equity	\$\$\$	Moderate/High	Usually

What is Private Equity?

How Private Equity Firms Operate

- Committed funds provided by passive investors (e.g. insurance companies, endowments, pension funds) to investment teams
- Typically 5-year investment window with additional 5 years to “harvest” which leads most investments to be liquidated in 3-7 years
- PE fund managers generally receive 2% annual management fee on committed capital and 20% “carried interest” of capital gains

Market Trends

M&A Environment

- Currently, there are two major dynamics causing a significant increase in sponsor-backed leveraged buy-out transactions and higher valuation multiples:
 1. A drastic supply-demand disparity of private equity capital as a result of:
 - The significant amount of capital raised by private equity funds in the last three years
 - More private equity firms have entered the middle market heightening the level of competition
 2. Credit markets have loosened and leverage has increased as a result of:
 - Positive economic factors including strong GDP and production levels and low unemployment and interest rates
 - Increasing performance of companies across a wide range of industries
 - New unregulated entrants in the credit market including: Goldman Sachs, Madison Capital, Merrill Lynch, and Patriot Capital

Valuation 101

Business Valuation Metrics

- Importance of EBITDA/cash flow
- Financing structure of a buyout
- Evaluation Criteria
- IRR and Return on Invested Capital requirements
- Value Creation Variables

Valuation 101

Evaluation Criteria

- Management
- Size of business and potential equity investment
- Business growth prospects
- Ability to improve operations / profitability
- Defensibility / competitive positioning
- Predictability of earnings (i.e. past performance)
- Industry trends and underlying dynamics
- Recent comparable transactions
- Credit market conditions and “financeability” of transaction
- Exit options

Valuation 101

IRR and Return on Invested Capital

- IRR is the **Internal Rate of Return** on capital invested by a private equity fund is the common metric by which funds are judged (the annual compounded rate of return)
 - Most funds target a minimum irr of 20%
- Return on Invested Capital is an equally important metric (i.e. “3x our money”)
 - Most funds target a minimum of 2.5x invested capital
- A fund’s return performance determines how much capital the fund managers raise for the next fund, and how they are compensated

Should I Consider a Private Equity Partner?

Benefits of a Private Equity Partner

- Can assist creating value through operational and strategic input
- Can attract more capital at favorable rates if needed
- Can attract talented management if needed
- Can attract high caliber third party professionals as needed
- Can access a wide network of contacts that may be able to help the business in a variety of areas (customer, supplier, etc.)
- Have a thorough and current understand the acquisition marketplace, thus should be able to identify the best path and time for exit