

Private Equity Funding: *A Ready Source Capital, But is it Right for Your Company?*

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Today's capital markets provide business owners with a wide diversity of funding sources. However, the diversity of options can create confusion as to which is the best for a specific firm at a specific point in time. One such available option is private equity funding.

Private equity, the general name for pooled capital resources managed by investment professionals for the purpose of investing in privately held companies, is an often talked about but misunderstood funding source. Many business owners are unclear as to what these funds are, when a private equity fund should be sought, what the role of these funds could be, and how to contact them. Most importantly, business owners often find it difficult to answer the question; is private equity right for my company?

Who Are They?

Private equity funds are pools of committed Limited Partner ("LP") money. LPs include institutions (pension funds, insurers, etc...), wealthy individuals, and corporate entities. The LP seeks to diversify its own investments, and to benefit from the expertise of the funds' managers. Each fund and its LPs will define a set of criteria for the investments that they will consider.

Typically private equity funds will seek to invest in established companies, with positive and steady cash flows. As opposed to venture capital investors, who want to get in early and focus on technology and proprietary position, a private equity fund will often be more comfortable in basic industries. While the specific sector is not of concern, the fund manager wants to be able to understand the business, and thereby bring greater value to the company. The margins of the company need not be particularly large, but a positive cash flow will be critical to the private equity fund manager.

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The fund would seek to add both equity, and debt to the balance sheet, so the current capitalization and cash flow should be such that a new and sensible structure can be supported. Most funds prefer to maintain continuity in management, but will often seek a control position and a board seat. The goal of the private equity investor typically is to buy and grow the company. The growth period, typically over 5 to 7 years, increases the value of equity for both the fund investors and the business owners. The private equity fund would then seek to exit the business through a sale of equity to another fund (recapitalization), another company, employees, or the public market.

When Should Private Equity Capital be Sought?

In addition to meeting the criteria set by private equity funds, business owners need to understand if this type of funding is right, both for the company and for themselves. The decision to sell all or part of a privately held company to an outsider is a difficult one, and it has to make sense for everyone involved. It is also best to make that decision during good times rather than bad.

The benefits accrued to the company owner from inviting private equity participation can be great. In doing so, the owner:

- increases available growth capital,
- diversifies his own risk by taking some of his personal wealth out of the company,
- gains the additional expertise and network of contacts available to the private equity fund manager,
- continues involvement as a company principal, and benefits from potential future upside.

However, additional factors should also be considered. The private equity investor will seek to enhance the value of the company by working along side and assisting business owners. Therefore, a positive working

relationship must be in place for the sake of all investors, and the company. Some factors to consider in identifying a positive match are:

- the fund managers industry experience,
- the working style of the fund manager,
- the strategic vision of the fund manager as compared to that of the business owner.

These are crucial ingredients for the owner. One agribusiness owner who had worked alongside a private equity investor for several years told us, "I didn't go with the fund that offered me the most money. I went with the second highest bidder; the one that I felt I had formed the best relationship with, and who had a strategic vision closest to my own."

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bank can be important. Identifying the best deal, both in financial terms and in terms of a good match of style & personalities, requires a familiarity built over time. The role of an investment banker is to look after the business owners best interests throughout the process. In navigating what for most company owners is a new world with its own culture and language, an investment banker provides the map for moving from the early decision making process to closing a transaction.

Early in the process, the owner and the investment banker will work together to decide *if* the company should follow a private equity path, and the best strategy for getting a good deal done. Having

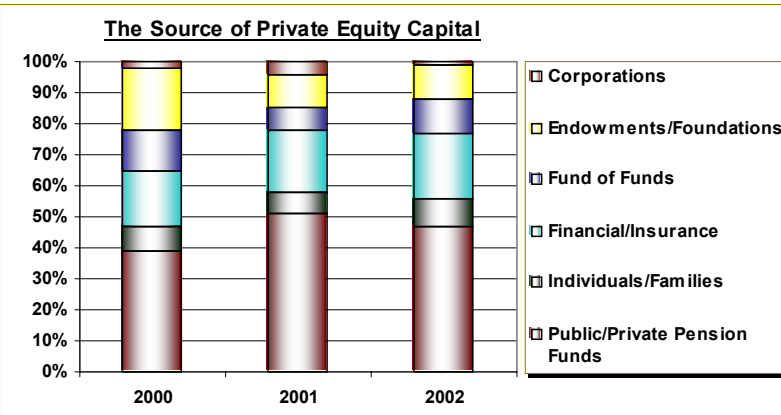
decided to move forward in seeking private equity funding, the investment banker:

- establishes expectations for the owner,
- helps set the value parameters of the company prior to seeking investment,
- defines a process so as to minimize disruption to the company's ongoing operations,
- brings an established set of contacts within the private equity community,
- positions the company in the marketplace so as to maximize value to the business owner.

Will the Fund Come to Me?

Private equity investors are always looking for quality companies in which to invest, but that doesn't mean that when the time comes, the right private equity firm will be at the owner's doorstep. Seeking not just a fund to invest, but the *right* private equity investor can be a difficult task. This is where the advice of an investment

A smooth process for soliciting and negotiating a private equity investment establishes a precedent for a quality working relationship between business owner and the private equity fund professional. When structured correctly, and handled in an orderly fashion, an investment from a private equity investor can be rewarding for the owner, and a partnership of growth for the company.



If you would like to discuss this material, or any other issues related to corporate finance and the agribusiness & food sector, feel free to contact Bill Goodbar (goodbar@agricapital.com) or Doug Sterkel (sterkel@agricapital.com) by phone or e-mail.



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