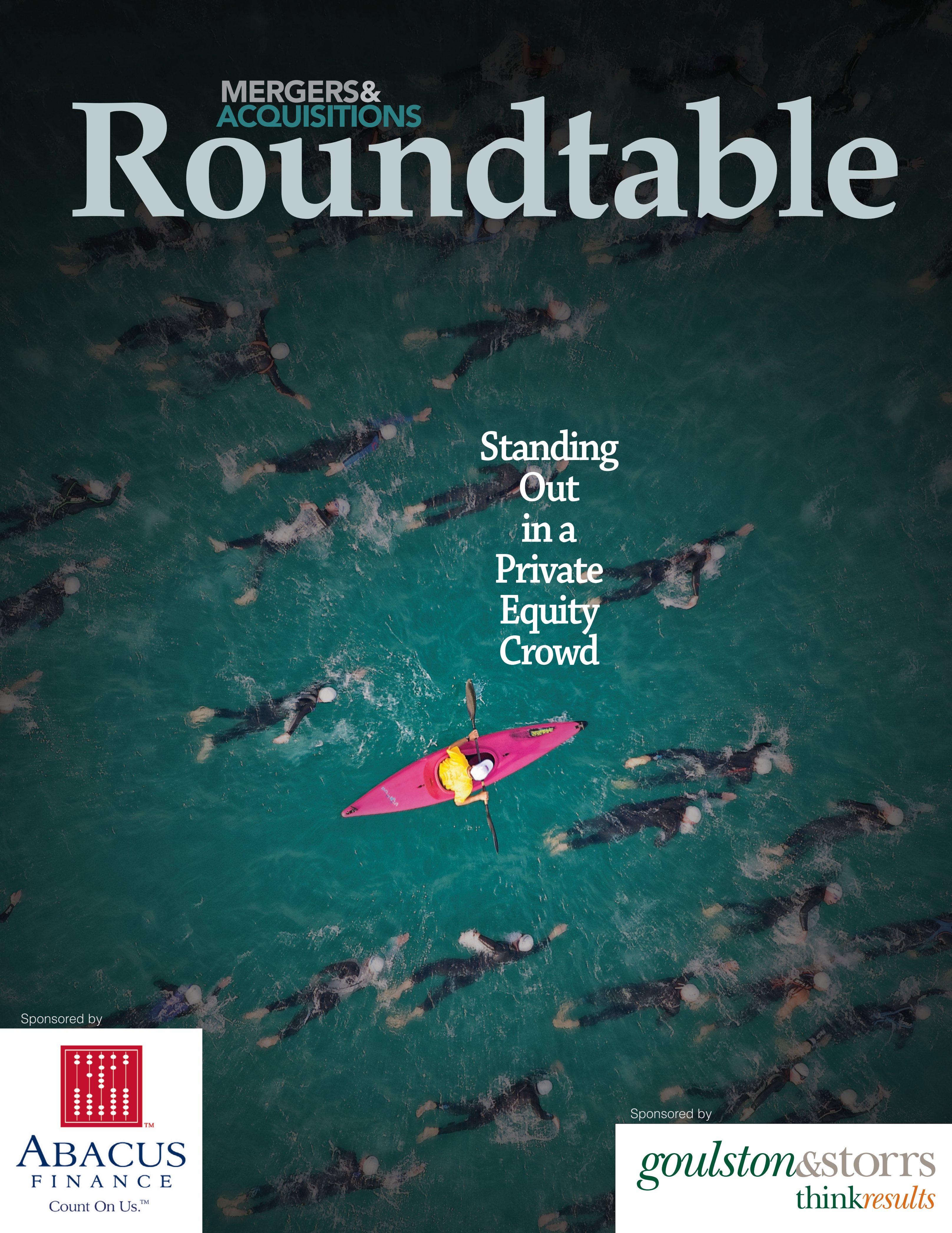
MERGERS& ACQUISITIONS

Roundtable



Standing Out in a Private Equity Crowd

As the private equity industry has grown and entrepreneurs have become more aware of their options when it comes time to sell, competition among PE firms has intensified. For many firms, differentiating themselves has become the biggest challenge. To discuss the issue, *Mergers & Acquisitions* hosted a special roundtable, sponsored by Abacus Finance Group LLC and Goulston & Storrs P.C. To reflect a range of perspectives and views, we brought together a handful of prominent lower middle-market dealmakers, including three private equity investors, an investment banker, a lender and a lawyer.

Mary Kathleen Flynn: Let's start by discussing the competitive landscape for private equity firms.

Jamie Elias: Everybody likes to talk about the companies in their portfolio and the areas of expertise their firms possess. That's all fine and good, but you need to be able to look at enough balls coming over the plate before you swing at one, and so at Trivest we focus on that front end of the business, in terms of trying to generate quality opportunities outside of the traditional investment banking auction process. Private equity is much more competitive than it used to be, and there are more and more firms every day. You don't necessarily know who your competition is on a particular deal, but you know that there are other firms knocking on the door, because word spreads fairly quickly when a business owner is thinking about doing something. They have attorneys, accountants, private wealth advisors, and everybody starts talking. The key to success in this business is to be in that first grouping of people that the business owner talks to when he or

"Find the deal before it finds you."

Jamie Elias

Roundtable Participants

Matthew Carroll, WestView Capital Partners

Timothy Clifford, Abacus Finance Group LLC (sponsor)

Jamie Elias, Trivest Partners

Mary Kathleen Flynn, Mergers & Acquisitions (moderator)

Philip Herman, Goulston & Storrs P.C. (sponsor)

Devin Mathews, Chicago Growth Partners

Tom Wylly, Brentwood Capital Advisors she is ready to move forward with a transaction.

Timothy Clifford: As a lender, we often see multiple private equity firms which are going after the same transaction that we're looking at, and it's interesting to see how the private equity firms are differentiating themselves. One might bring in an operating partner, or another might differentiate itself by structuring the equity in an innovative way.

We often do that as a lender. For example, we can offer a senior-stretch term loan, whereby we provide more structural flexibility as an alternative to a senior-mezzanine execution. We have a stable and significant source of capital, secured by an FDIC-insured depository base, which allows us to offer reliable cash flow and financing flexibility, providing certainty of close. This was the case with the WestView eSolutions deal – helping WestView to differentiate itself.

Matthew Carroll

> **“You've got to let everyone know you want the deal.”**

Matthew Carroll: This business has absolutely gone from a gatherer business to a hunter business. There used to be so few private equity firms that when I was an analyst in investment banking in a private capital-raising group, I knew the names of every partner. I didn't know these guys, but I knew the names of every partner at every private equity fund in the country because I maintained a database, and often times we sent a book to every one of them and that was in

Lower middle-market dealmakers come together to talk about how private equity firms play the differentiation game

1995, 1996. Then I shifted into private equity, where I've been basically ever since, and now it's more than ten times the firms, more than ten times the capital. I think years ago you could just wait for the phone to ring and most investment opportunities would come your way. Now you've increasingly got to get out and find them, because no one Brentwood needs any one WestView. They just don't. We all hope we have angles, industry experience or focus on minority recaps in WestView's case, and that absolutely helps, but getting in front of deal flow is something that needs consistent daily focus. We have to first make sure we see the opportunity and then make sure we differentiate ourselves. You do that by getting up and getting out there.

Devin Mathews: It used to be, back in the day: a couple of guys would get a call from a banker, and they'd call a couple of other private equity guys, and all four of them would do the deal together, and the entrepreneur would have no choice. What's happened in the last 15 years in the private equity industry is that entrepreneurs have gotten very savvy about the process of selling their businesses. They might have 100 percent of their net worth tied up in this asset. All their eggs are in one basket, and they should have choices. They should be able to pick their partner. They should get good advice. And they should be able to get top dollar, or the best relationship, or whatever it is they want out of the transaction.

Devin Mathews

"Entrepreneurs have gotten very savvy about the process of selling their businesses."

Philip Herman: I have a question for Tom. When you're sending out books or seeking firms who might be interested in a deal, to what extent do you segment them and do much match making? As attorneys, when we represent our clients who are looking to partner with a private equity firm, we're very much trying to figure out the objectives that the client has and then we look for the match.

Tom Wylly: We do segment and match up our clients with the appropriate private equity firms. There are so many firms, and most are good actors – although there are a few bad actors -- but even within the good actors, you've got different industry expertise and behavior patterns. You have track records of how aggressive they've been. You also have track records of how good they've been with their companies in terms of what have they been like to live with. So not only are price and up-front terms critically important, but what the firm and the partner leading the investment is going to be like to live with on the back end is also an important element.

The other thing is that we urge our clients not to fall in love with any one firm. We have examples where the CEO fell in love with a PE firm early in the process, and that PE firm thought they had an edge. But they were light on their bid and too heavy on the structure, and we told them, "You're not there. You're out." They didn't believe us and they lost the deal. I learned this lesson a very hard way as a banker many years ago from a client who said, "Tom, the relationship begins when the price is right." I said, "Say that again?" He said, "The relationship begins when the price is right." I was too high on my fee for a particular M&A assignment. And so what that means for the private equity firms is if these guys are all together and around the same price and the same terms, then we're into a lot of other important value-add and relationship factors, but if one PE firm is 15 percent higher than the other, as much as our client might love the other firm, the client's going to say 15 percent is a lot of love.

Elias: We have a model that says, "Find the deal before it finds you." There is a perception out there that the only way to buy a company is through an investment bank, and that is just flat out not correct. There are over 200,000 businesses in the U.S. alone with revenues between $10 million and $250 million, 90 percent of which are owned by founders. Many of these founders are baby boomers who are set to retire in droves in the next five to 10 years. So we try to outpace or outflank the investment bankers. About 10 years ago at Trivest, we put in an outbound calling program that says everybody -- from our entry-level associates to partners -- make 25 to 30 connected calls to deal generators per month. The vast majority of deal generators are business brokers. They might not have the fancy Park Avenue addresses, but these individuals are spread all around the country and oftentimes generate telephonic relationships with business owners. In addition to business brokers, we call on lawyers, accountants, insurance brokers, and anybody that we think has a relationship with a founder owned business. We do an outreach program to constantly remind them that we want an introduction to a business owner. All the intermediary has said to me is, "Call this business owner at this phone number, he's expecting your call." If that introduction leads to Trivest investing or purchasing that business, we pay buy-side fees equating to one percent of the purchase price, plus $100,000. In more traditional auction oriented situations, the business owner pays a fee to the investment bank. One program we started doing about five years back that has definitely caught people's attention is that we give an S class Mercedes Benz, in addition to that buy-side fee, as an additional thank you and incentive.

Clifford: It's a terrific analogy between an investment bank selling a company for a seller, and a private equity firm buying it from that seller. The difference can be seen in how valuation is affected: What is the PE firm's entry multiple? How much did the PE firm

Timothy Clifford

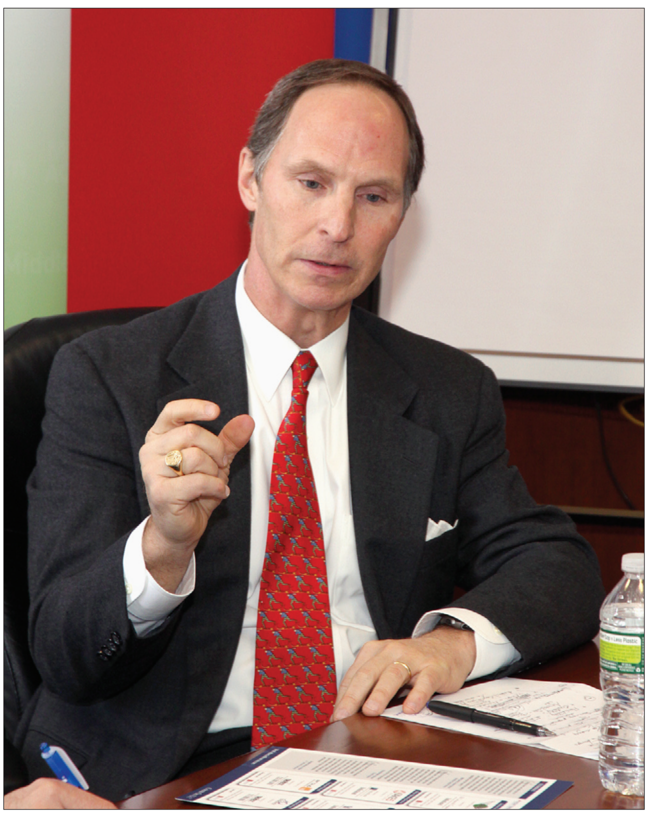
pay for it? Then the offset to that is, How does what the PE firm paid impact the lender? Because the lender looks at that. The PE firm is hopefully not paying as much as it perhaps may pay with a full auction, which would lessen the leverage requirement. Therefore, we, as the lender, can probably take more comfort in putting less leverage into that transaction. So you can see, depending upon how the transaction was originated, how valuation and leverage levels can be affected.

On the investment banker's side, in an auction situation, certainty of close can be a differentiator. As a lender, this is where Abacus helps private equity firms to differentiate themselves with the seller and the investment banker. When a PE firm is putting in a bid, it has got to know that it has the financing to back up the bid. A lot of it is: How solid is the financing? How strong a commitment is it? That's why speed to close is so important.

"Certainty of close can be a differentiator."

Working with Trivest on its Group III International deal – they're a designer and manufacturer of the highly recognized Wenger Swiss Army brand – we put our partnership strategy to work. By this we mean speed, certainty of close, experience in the branded consumer products industry and flexibility in transaction structuring. We also offered to introduce Trivest and Group III to another branded name in the sports-equipment arena, which could help with revenue growth. Industry knowledge and relationships are two other differentiators for us.

Wylly: The selfish argument for hiring the investment banker is, we spend six months to six years cultivating relationships with sellers. We spend a lot of time getting to know the company before we get hired, and we usually have to compete to get hired. A key element of this process is setting expectations of value and terms. So what hopefully a banker brings is, while we may make the buyer pay more than he would pay on a proprietary basis, no question, but we bring him something that will close.



Tom Wylly

"We urge our clients not to fall in love with any one firm."

Flynn: What are some other strategies PE firms use to stand out?

Carroll: I think you've really got to declare yourself to a company and its advisers. In football, there's a defensive term when you really commit, which is you've got to "sell out," and you do, you have to "sell out." It's not the bad use of that term, it's the good one. You've got to let everyone know you want the deal. "I want this investment. Our entire firm is behind it." You still absolutely need to do thorough due diligence but every little thing you do along the way needs to show your level of focus and commitment. Things like knowing the industry super well, making potential customer and strategic intros before you are even selected, right down to who you choose as a lender. You bring a lender who cares about the deal, someone who knows the sector, asks good questions, and someone you've already vetted yourself. For example, in my most recent investment, in eSolutions, I brought in Tim, because I trusted him. I knew he'd close, he had financed other healthcare IT/outsourcing investments for me, and I knew he had hospital relationships that complemented mine. You have to paint the picture for the management team of what he/she can expect from the entire team you are bringing to the table.

Clifford: The theme here is: How do private equity firms differentiate themselves? It is similar to how lenders differentiate themselves. At Abacus, we're generalists by background, but there are a couple of areas where we have a lot of experience, including healthcare. In the example of eSolutions, and knowing how much our private equity sponsor wanted to win a really nice investment opportunity in a sought-after sector, I considered, in addition to capital, what else can we do for WestView Capital Partners and eSolutions? Where Abacus added value here was in our deep knowledge of the healthcare industry and in our long-standing relationships in that industry. We were able to leverage those relationships, introducing WestView to hospitals across the country, which enhanced WestView's positioning in the eyes of management.

Carroll: Too few people in our business have a healthy respect for who's really making it happen, and it's the entrepreneurs, not us. There are a lot of people in our business who think they're smarter than the entrepreneurs. Private equity can get a bad name in the minds of entrepreneurs, and often, we have to overcome that when we first meet a management team. Unfortunately, proving that out to a CEO can be difficult, it's a very soft and fuzzy topic and can sound too salesy. So, for example, I push existing portfolio company CEO references early and often. And I'm not saying just call mine. I'm saying, please call references on whoever you get down to the short strokes with. I'm very comfortable with how I treat my CEO's so if I can get a prospective management team to make these reference calls, I'll take that bet any day.

Mathews: Unfortunately for entrepreneurs, a lot of people in our business still take the approach that they've got the checkbook, so they've got the power. Sometimes the biggest differentiator is, "Don't be a jerk." How about this? Don't pull out your BlackBerry and start checking messages five minutes into a management meeting. Do your homework, have good questions, show that you actually care about the business. Don't show up in a Hermes tie and don't have the limo waiting outside. Even better, don't be that guy who even takes a limo.

Elias: Without a doubt private equity has definitely, in the last five to 10 years, developed a reputation for having very sharp elbows. For the opportunities Trivest deems highly attractive, the firm markets a flexible deal structure coined, "Just Say No." This highly effective campaign counters the industry's typically rigid structure and has been increasingly embraced by many founders and deal sources. We "Just Say No" to what all these other private equity firms have told the owner is just the way things have to be done in a transaction. It's part of our secret sauce so I'm not going to go through what the elements of the campaign are, but the program relates to the level of founder reinvestment, the type of capital structure, escrow indemnifications, working capital adjustment and re-trading. We're comfortable doing it because we've done it for so long that we know what works and what doesn't work. We have a lot of flexibility.

Philip Herman

"We figure out the client's objectives and look for a match."

Flynn: Lets hear from the lawyer in the room about how flexibility gets translated into deal terms.

Herman: As lawyers, we're bound by the deal that has been agreed to. I mean, it gets tweaked. It gets fleshed out, so there might be some changes at the margins, but when a PE firm comes to us and says, "Find the creative, flexible way to do this," we do. And it involves a bunch of diligence up front.

Wylly: There are two things the owner is thinking. Is this going to close, and is this going be a partnership, or is this guy going to be a pain in the neck? It's about that simple at one level. The owners who want to stay in are looking for a partnership. They're not looking for a dictator. They built this company. They built the value. M&A