How you can attract private equity investors

At a time when publicly owned companies are finding it extremely difficult to access the capital they need to make acquisitions, private equity groups (PEGs) can still be an option for some business sellers. PEGs tend to be less constricted because they're not as reliant on the credit markets, and many are looking to put their ample funds to work.

Attracting the attention of these investors, however, requires some understanding of how they work and what they look for in an acquisition target.

Back in the game?

PEGs typically are funded by third-party investors, including individuals and institutions. They make money for their shareholders by acquiring companies, and then "flipping" them after a holding period of several years. PEGs either sell their holdings to new buyers or initiate a public offering, ideally realizing gains.

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For much of the past decade, PEGs have been major players in the M&A market, their aggressive acquisition tactics spurring global M&A volume. As has been the case with the entire financial sector, the global economic slowdown has sidelined many PEGs over the past year.

Although some of these investors seem to have retreated for the foreseeable future, others appear to be waiting for an opportune moment to get back into the M&A market. PEGs have continued to raise new capital, and some appear to be stockpiling their balance sheets in anticipation of a future buying boom.

Private equity firm Audax Group, for example, recently announced that it would buy debt-collecting business URS. And Kelly Capital LLC, a San Diego-based PEG, agreed to purchase automotive paint and collision repair company Earl Scheib Inc. for $8 million — roughly $2 per share.

Appealing qualities

These recent PEG acquisitions highlight the characteristics of companies that are successfully selling these days. In a recessionary economy, positive cash flows and competitive market shares are more advantageous than ever. And companies in relatively insulated and low-risk business sectors, such as accounting and debt collecting, also have an advantage.

Whatever your industry, several factors can boost your company's appeal — in both rough and rosy M&A markets. They include:

Highly capable management. Many PEGs aren't interested in immediately replacing their acquisition's management team, unless, of course, the company is financially distressed or organizationally troubled. PEGs, therefore, look for companies with skilled and seasoned management made up of individuals looking to transition out of the business eventually.

Low debt. PEGs typically fund acquisitions with a combination of equity capital and large amounts of leveraged debt — intending for the acquisitions future cash flows to repay that debt. If your company has a relatively low debt burden that a PEG could add to its balance sheet, you have a big market advantage — particularly in a credit crunch.

Aggressive growth plans. Because PEGs plan to sell their acquisitions after a period of several years — or, once the company achieves hoped-for returns — these investors tend to prefer higher growth businesses. You're in a good position if you have strong future earnings projections, a rapidly growing customer base and an increasing market share.

Meet the players

As is true in much of the business world, it's not just who you are, but whom you know. The PEG world is no exception and is built heavily on personal relationships. In fact, many PEGs staff their advisory boards with former executives of their past acquisitions who, in turn, advise the PEGs on future purchases.

Access to private equity investors is one of many good reasons to work with an M&A advisor when selling your company. An experienced advisor will already know the private equity market and its major players, including board members.

Your advisor also will know which PEGs specialize in your industry or type of business and will have some idea of the company characteristics favored by particular PEGs. This will help you market your company to their criteria and increase the likelihood that you'll receive a lucrative bid.

Explore your options

Corporate acquisitions have slowed significantly as credit has dried up, and these buyers are likely to stay out of the M&A market for a while. PEGs, however, may still be an appealing option if you're ready to sell now. Many PEGs have retained their appetite for acquisitions and, more important, have actual money to invest. Private equity may not be the solution for every seller, but you should discuss this option with your advisors.

Smart shopping: PEGs and retailers

As the financial woes of major U.S. retailers — including stores as disparate as Circuit City, Sears, Office Depot and Linens 'n Things — attest, moving merchandise is extremely challenging in the current economic environment. Depressed company values in the sector, however, are piquing the interest of some private equity groups (PEGs).

PEGs may be attracted to retail, according to a recent CNNMoney.com report, because these businesses tend to generate cash and often own real estate that can be sold. And although Americans have cut back on their spending in the last year, consumers still need to buy essential goods. PEGs, therefore, are likely to look for fundamentally sound companies in good markets and offering core products that could benefit from restructuring.