Feldman Associates
• GROWTH STRATEGIES • BUSINESS DEVELOPMENT •

A Briefing for Owners of Middle Market Companies on Private Equity Firms as Potential Acquirers/Investors

Many owners of middle market companies are relatively unfamiliar with the workings of private equity (PE) firms, and are therefore at a disadvantage when considering how and when private equity firms might be right for the potential sale of their business.

Whether or not a potential sale of the business is something that you're currently considering, this briefing document may prove helpful for when the timing is right.

The following four pages provide some background and insights regarding private equity firms specifically relevant to owners of middle market companies. Of course, the circumstances of each company and its ownership require individual analysis and counsel, which cannot be accomplished here. Nevertheless, we hope that you find this information a valuable overview, and welcome your feedback.

Joseph Feldman Associates provides acquisition and other strategic transaction consulting for growing companies and their investors. See the last page or www.josephfeldman.com for more information.

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Top Reasons Private Equity Firms Invest in Middle Market Companies

First, a caveat: "private equity investor" implies that all such investors are alike. In fact, they are nearly as diverse as the companies they invest in. Private equity firms invest money for their "investors" and have an investment specialization for which they are expected to be more successful (i.e., higher returns) than other investors. Most firms have a particular portfolio specialization, investing in firms with common characteristics such as: size of company, financial health of company, market sector, geography, and experience of the partners.

The chart below highlights several of the top reasons private equity firms invest in middle market companies:

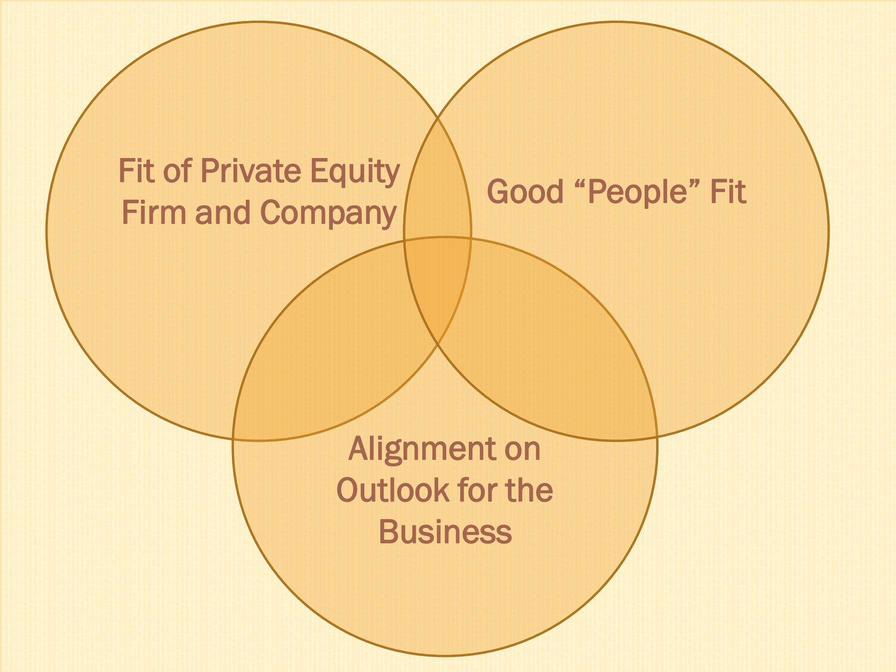
Liquidity	• Simply speaking: there comes a time in the evolution of the business and the financial needs of its owners that leads to a sale of the company
Diversification	• Opportunity for a seller to reduce concentration of wealth in a single business
Access to growth capital	• Expansion of the business may require more equity than the current ownership is prepared to invest, or that can be secured from bank loans or other capital sources • New capital can support expansion of manufacturing capacity, sales/marketing team, new supply chain, new products/technology, acquisitions
New growth opportunities	• Potential for combining multiple business may enable new growth prospects: customer access/leverage, sourcing, channel access, employee recruiting/retention Potential access to enabling expertise, such as: cross-border sourcing, international expansion, lean manufacturing, debt financing alternatives
Absence of viable succession plan	• No "family" member is suited or interested to succeed the current CEO • Potential internal buyers (i.e., members of management) cannot secure capital to buy the business; sale by earn-out over time is deemed too risky or inappropriate for current owners
Alternative to liquidation	• For distressed or otherwise troubled companies, sale to a private equity firm may be the most advantageous way to retain/salvage value

In summary, mutually-beneficial timing can make a private equity sale attractive for a variety of reasons:

- Private equity firm interested in investing in your sector, and paying competitive valuations;
- Private equity firm offers the company access to capital, executive talent, industry connections, new products/technologies;
- Seller interested in liquidity; and
- Post-closing role of management agreeable to current owners, whether transitional only or an ongoing role in management of the company.

What to Look For in a Private Equity Investor

Business owners considering the sale of their company to a private equity investor generally will (a) **maximize the value** of the transaction, (b) support their confidence in the sale process including completing the deal, and (c) facilitate any ongoing relationship with the new owners, when the three areas of fit/alignment shown below are met vis-à-vis the private equity investor:



	Key Benefits
Fit of PE Firm and Company	• Common understanding of market, dynamics, etc. • Most likely to close the deal (familiarity = lower risk of surprises) • Shared view of value drivers
Good "People" Fit	• People you can do business with: before and after the deal
Aligned Outlook for the Business	• Especially relevant if you continue in a management role after the sale • Avoids surprises, mis-alignment • Common time horizon

What to Expect in a Sale Process – Frequently Asked Questions

Q1: How can I maximize the value realized in the sale of my business?

A1: A tough one for generalizations, but below are a few ideas:

- Be prepared to demonstrate the value of the business and its potential: market trends specific to the company, financial results, customer/product understanding, growth opportunities
- Work with a knowledgeable buyer (i.e., knows your industry), with access to capital (i.e., avoids financing risk), and a good reputation.
- Anticipate and respond to a buyer's uncertainties and perceived risks about your company; this will minimize unnecessary valuation discounts; be appropriately supportive in due diligence

Q2: What information will be expected during "due diligence"?

A2: The basics you should anticipate include: financial statements; incorporation/ownership documents; agreements with customers, suppliers, employees; regulatory documents (e.g., permits). More importantly, anticipate information specific to your company that a buyer will want to confirm their understanding of value and to reduce/eliminate their perception of risk.

Q3: How long will a sale process take?

A3: It depends… Still, much of the process is in your control, for example: availability for meetings with buyer, turn-around time for due diligence documents and follow-up questions, as well as timely decision-making throughout the negotiation and contract finalization phases.

Q4: What if I'm not sure if I want to stay on after the sale?

A4: When the time is right, candidly discuss your post-closing plans and concerns with the buyer… and earlier is generally best. Many investors are keen for the company's owners/managers to continue with the business, perhaps even to retain an ownership stake.

By the Way, What's a Private Equity (PE) Investor?

The short answer: A "private equity investor" commits money for ownership of companies that are not publically traded. Unlike venture capital firms (which invest in start-ups and "ideas"), a private equity investor buys established companies.

Some common features of private equity investors:

- PE investor typically focuses on companies in particular industries, geographies, financial stability (e.g., growth vs. turnaround), and enterprise value. Start-ups are the domain of venture capital, *not* private equity investors.
- The focus of a PE firm is driven by the experience of that firm's managers; their particular expertise and experience typically increases their likelihood of success in a given area of interest.
- Through private ownership, companies owned by PE firms avoid disclosure requirements (e.g., SEC, Sarbanes/Oxley) and the quarterly earnings orientation of public companies. For some firms, public ownership is simply unavailable due to their size or other factors, and PE firms are a suitable alternative.

A few follow-up questions:

Where do they get the money to invest?

- Private equity firms typically are managing investments on behalf of: pension funds, insurance companies, wealthy individuals/families, university endowments, and the fund's managers (investing their own money)

What are the fund investors' expectations?

- Investors in PE funds are extremely sensitive to the fund managers' track record, so expectations are high regarding financial return, consistency, and maintaining focus on areas known best by the fund management team

Isn't the investment horizon for PE firms short?

- As a rule-of-thumb, PE firms expect to own a company for 5 – 7 years, though some firms retain ownership longer.
- The investment horizon is driven by the expectation of their investors for "completing" the investment cycle.
- You could say that their investors' expectations motivate action to realize a company's value (i.e., to sell).

About Joseph Feldman Associates

Joseph Feldman Associates provides acquisition and other strategic transaction consulting for growing companies and their investors:

- We combine "large company" know-how and discipline with "start-up company" practicality, resourcefulness, and urgency.
- We deliver timely and effective results for our clients

Projects may include all or some of the following activities, determined on a case-by-case basis to meet client requirements:

Acquisition Project Management

- Strategy development
- Deal flow generation and introductions
- Outreach to targets, bankers, and other resources supporting potential deals
- Development of internal and external presentations for communicating the strategy

Opportunity-specific Work:

- Evaluation of strategic fit
- Contacts with targets
- Deal valuation
- Due diligence
- Negotiation support
- Documentation and closure
- Integration planning

Why Clients Engage Joseph Feldman Associates?

- Outstanding analytical capabilities, from strategy development to financial modeling
- Extraordinary resourcefulness
- Substantial cross-border transaction and operating experience
- Outcome-driven project management