

CEO ROUNDTABLE: RAISING GROWTH CAPITAL

RAISING CAPITAL: HOW PRIVATE EQUITY WORKS

November 20, 2008

Author: Jacoline Loewen

At this deep stage in a negative market, Canadian private equity has pools of capital that are substantial. This seems to the business owner an enviable position but private equity needs to place their capital with companies that can deliver a strong return or, in these markets, at least a positive return. The private equity players in Canada are looking for those business owners who are clear that they want to grow and those who will be able to be a team player. Company owners want to know that they will not lose their businesses to private equity. Mark MacDonald, C.A. Bancorp, spoke about the value private equity brings to an owner at the CEO Roundtable "Raising Growth Capital: Resilience in the Global Marketplace."

David Simpson, who teaches entrepreneurship at Ivey, led the CEO Roundtable discussion, and began by asking how private equity and business owners could interact.

Mark MacDonald, C.A. Bancorp, noted that there is \$500B of family businesses due to be sold or transitioned over the next five to ten years, as baby boomer owners enter their retirement years. What this means for owners is that you will have a great deal of competition in the next decade.

What you read in the paper about private equity tends to be about the buy outs where private equity funds buy the whole business. The formula is simple. It is a leverage game. Private equity investors in buyouts typically employ 70% to 80% leverage, seek to grow the business by 7% and get out in three to five years. This investment plan has relied on the availability of cheap bank debt which has now ended with the current credit crisis.

Having a minority investment in a company that is willing to grow is of great interest to C.A. Bancorp. Many owner managed companies are more comfortable with this model. "We work with individual owners in a minority position. We mostly take on operational risk and we need mutual understanding that we will need a liquidity event within three to five years."

Executive Summary:

As business owners transition the ownership of their companies over the next ten years, they will face a great deal of competition. How can they maximize the value of their company? Private equity can definitely bring a great deal to the process.

Mark MacDonald, C.A. Bancorp



David Simpson, The Business Families Centre at Ivey



Brace Yourself for Due Diligence

"We are rigorous and it's our normal course to do in-depth due diligence so we are used to the process, but it can be a real cold shower for owners." C.A. Bancorp sees itself as partners but they know what they do not know and they want the owners to get on with running the business. "We do expect to be consulted," says MacDonald.

David Simpson asked: "What does private equity bring to the table?"

MacDonald observed how his team touches many businesses. "We make a big call on management and we seek to work with the best people. For example, if your CFO is not up to speed, we can help with finding a new one. We know the big economic picture. We have broad networks. We know where talented people are and we can bring them to your company. We can look at your company and ask the right questions. *Have you thought of that...?* Although we are not in the business, we can bring a strategic perspective."

Clarity about the exit strategy

Also, the private equity fund does expect to have a board position and is an active partner. "We get to know the business and see what needs to get done. We push for execution," says MacDonald. Many owners find this discipline helpful. There is a 180 day plan developed with management, which may include improvements to accounting on manufacturing processes, on assistance with human resources, on acquisition related issues. This laundry list of things to get done is established as a team and there are no surprises after the deal is signed.

Even with this economy, private equity is ready to partner with those companies ready to raise capital and grow.

- Mark MacDonald,
C.A. Bancorp

Also included is the agreement about the exit strategy.

MacDonald explains, "We only get paid upon our exit so we will make sure our exit needs match with the owner's, which may include a sale back to the owner, an IPO, or a sale to a strategic buyer."

How do I Find Private Equity?

The owners wanted to know how to find private equity. Mark MacDonald said, "Companies that come to us with an agent (financial advisor) will have far more success in achieving their financing goals. The more you can educate us upfront, the less likely we will be surprised through the due diligence process. Loewen & Partners prepares the owner and produces for the private equity fund a highly detailed offering document that is about the best in the industry. Being this prepared means you will pass due diligence far more easily."

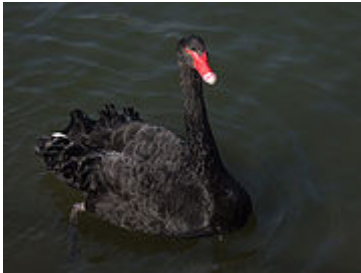
Do I Need to Identify the Exit Strategy?

"Sure, I can take yours and then I will build on it," says MacDonald. "Obviously, C.A. Bancorp examines exit strategies far more often than an owner. If you are in the telecommunications business, we will speak with Rogers, Telus or Bell to see if there would be interest in buying the business if you want to sell. When it comes to defining an exit, we will help you develop more alternatives than you could on your own."

MacDonald said the fund wants to make sure the owner gets the exit that they want too. The only constraint is the unexpected.

Expect a Black Swan

Always be prepared that markets will go down. MacDonald discussed the book by Nassim Nicholas Taleb, *The Black Swan*, which describes random events that suddenly appear and shock everyone because they are impossible.



In his book, Nassim Taleb regards many scientific discoveries as black swans—"undirected" and unpredicted. He gives the rise of the Internet, the personal computer, World War I, as well as the September 11, 2001 attacks as examples of Black Swan events. The term black swan comes from the commonplace Western cultural assumption that 'All swans are white'. In that context, a black swan was a metaphor for something that could not exist.

The 17th Century discovery of black swans in Australia metamorphosed the term to connote that the perceived impossibility actually came to pass."

MacDonald stresses that every owner needs to build their business to be ready for random events. Private Equity may currently be sitting on the sidelines but there is a great deal of money to get invested. "There is the opportunity for decent firms to raise capital. Look at Warren Buffet with Goldman Sachs. Yes, private equity is ready to partner with those companies ready to raise capital and grow."

The CEO Roundtable was sponsored by **The National Post** and **Loewen & Partners**.

About the author



Jacoline Loewen raises capital for business owners and is the author of *Money Magnet: How to Attract Investors to Your Business*.

www.moneymagnetbook.ca

About Loewen & Partners

Loewen & Partners works with private companies to raise growth capital. Our goal is to match owners of companies with suitable investors who understand the business and can add significant value. Over the past decade there has been a significant shift in the sources of financing available to small and medium-sized companies. This is primarily a result of the rise of private equity as the best place to access capital.