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Investors get ready – the buyout is back

Equity Line

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A year ago, in the midst of the dot-com craze, the leveraged buyout sounded about as cutting-edge as the vacuum tube. Instead, aggressive execs were sprinting for Webvan and Priceline. Now the tide has turned and equity-oriented managers are looking again at leading good old-fashioned leverage buyouts as a way to create equity value.

Why is this happening? And, more importantly, how can you profit?

First, it's happening because the best managers always seek the largest equity-driven opportunities. With the Web morphing into a global black hole, the opportunities for big equity creation now lie in buyouts. Second, with lots of small, orphaned public companies trading at three to four times cash flow with no chance of Wall Street coverage, opportunities for going private transactions abound. Third, buyout firms have amassed a war chest of more than $100 billion of equity.

Leverage this equity with equivalent debt and you have more than $200 billion of buying power. With all this capital available, management talent was becoming the limiting factor in the buyout world and managers are in the driver's seat.

Buying companies is complex and challenging work that demands tenacity, lots of time, some money and even luck. So, what are the phases of the process and how can you maximize this leverage?

This is just the Cliff's Notes version of deal making, but it gives you a solid overview.

▪ **Find or create an opportunity.** You need to first find or create a company where you can best leverage your background and management skill set. First, list the criteria for your target company that are consistent with your past experience. List your criteria on one page. Then use that criteria and your bio to network in the business brokerage world among accountants, lawyers, consultants and investment bankers.

▪ **Develop a business plan.** You need a credible strategy for the company to demonstrate opportunities for growth and increased profits to potential partners and other investors. Much of the added value from the deal comes from your ability to manage the business more effectively as an independent unit.

▪ **Find a willing seller and strike an agreement.** This may sound self-evident, but thousands of hours and tens of millions of dollars have been squandered working diligently on transactions where there really isn't a willing seller. Many companies or individuals who have their companies on the block are only willing to sell under impossible circumstances. In this case, they only appear to be sellers. You've got to work hard to determine their seriousness. Once you have a willing seller, you need to strike a deal, work through price and terms to create a term sheet, and work toward a purchase agreement.

▪ **Find an equity partner and come to terms.** Once the deal is identified and the team is in place, the next stage is usually for the management and equity partners to work out an agreement to pursue the project. This agreement sketches out in general terms the relative investments of each of the parties, how equity will be divided, and how management equity will vest. This effort determines what management will get out of the deal. From a manager's perspective, make no mistake about it: This is the Holy Grail of the buyout.

▪ **Line up bank financing.** You've done some preliminary work on lining up financing at this point, but you need to make sure it is there when you are ready to close. In addition to the equity investment of the buyout firm, you need to line up bank financing, and your equity partner will take a big share of this load.

▪ **Sweat the details in due diligence.** You have a willing seller, a stunning strategy, a crackerjack management team, a good deal, and money ready and waiting. But is everything what it appears to be? Are there hidden problems? The more front-end homework you do, the fewer surprises you will have at this stage. You will need to manage a small army of experts, including lawyers, accountants, and other professionals to guide you through the details of the deal. This is where one-page agreements grow into phone-book-size legal documents.

▪ **Run with it.** When the paperwork is signed, the work is just beginning. This is the point when you have an opportunity to put your strategy into action. There is no corporate parent to blame if things go wrong, but also no one to hold you back from achieving what you know you can.

▪ **Plan your exit.** Perhaps a strategic sale or an IPO is the best way to go. It depends on the business. But one item is critical: You have to know your exit strategy before you do the deal.

▪ **Buy your yacht.** It may be that sailing is not to your fancy, but you'll have to find something to do with all that capital. Of course, you could always decide to turn it around and invest it into your next management buyout, earning an ever-increasing stake in the American dream.

The stages of a buyout do not always appear in this order (although the yacht typically doesn't sail until the end) but usually show up at some point along the way. And the pace of a deal can range from being fast and furious to completely glacial, taking more than a year to complete. You match the process to the demands of the deal. Most often many deal phases are processed simultaneously, so multitasking is an important skill in managing a deal.

While the process may look daunting, make no mistake: You can buy a company. Thousands of these deals get done each year, creating hundreds of millions of dollars of equity value for the executives. And these don't need to be flashy technology deals. In fact, they're mostly basic businesses churning out something the dot-com world has yet to understand: cash flow.

The buyout world has never been more active. Senior, proven executives have never been more valuable. Now get out there and grab your piece of the economic pie!

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