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Going Private Wisely and Profitably

By Elizabeth Judd — March 25, 2008

Companies struggling with Sarbanes-Oxley compliance, shareholder activists, and turbulent credit markets often dream of some private equity firm swooping in and whisking them away from it all. Finding a buyer to do that, however, can be a harsher reality.

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Foremost, private equity experts say companies looking to go private must put in a lot of hard work. The PE firms that usually spring to mind are the giants of the business: Kohlberg, Kravis and Roberts; the Blackstone Group; the Carlyle Group; and the like. But the vast majority of firms are smaller boutique shops. Hellman & Friedman, for instance, targets financial services companies, while United Max International concentrates on small- and mid-sized acquisitions. To reach those firms, companies must be ready to reach out to them first.


Levin

Cold calls from CEOs, for example, are welcome in the private equity world. Jack Levin, a senior partner at the law firm Kirkland & Ellis who often works on private equity deals, says that a company placing itself on the auction block doesn't need "a slick agent" the way an athlete or author might. Rather, he says, "Private equity funds often prefer to deal directly with the company rather than dealing through investment bankers and brokers."

Robert Friedman, chief counsel at Blackstone Group, agrees. He notes that a personal call from the CEO can even make a company more alluring from the buyer's perspective: "The deal looks better to us, because if they're calling us, it's not likely they're calling hordes of other people, too."

Blackstone says it makes its purchase decisions based on analytics, not glossy brochures and sophisticated sales pitches. That being said, the majority of approaches do come from professional matchmakers. In a typical year, Friedman estimates, 90 percent of the calls Blackstone receives are from investment bankers and only 10 percent are from public companies themselves.

According to Thomson Financial, 1,700 private equity firms managing 3,700 separate funds operated in the United States last year. Many have their own Websites, and it's little more than an afternoon's work to create a list of firms worth approaching based on their investment histories.


Furnari

"Private equity funds have very specialized criteria, and each has different criteria," says Stephen Furnari, managing partner of the law firm Furnari Levine. "The private equity community is pretty small, and it's not so difficult to make inroads." Furnari notes that lawyers can often make "warm introductions" between the company and the PE firm. Companies can also attend any of the numerous private equity conferences proliferating in major cities, where they can introduce themselves to potential buyers.

Private equity firms can also make the first move, contacting public companies that look attractive, says Chuck Nathan, co-head of mergers and acquisitions at the law firm Latham & Watkins. Even when rebuffed, the firm may continue making overtures, he says: "Private equity funds often cultivate companies for very long periods of time."

A public company that has been courted in the past also looks more attractive to PE firms, and going back to an old suitor is an excellent way to start, Levin says. "If you're a target company and you've had a private equity fund pursuing you, then obviously you have a contact and you should use that contact," he says.

The Courtship

For large companies, the next step would be to ask internal analysts within the corporate development or M&A department to recommend possible private equity matches. In these brainstorming sessions, companies shouldn't restrict themselves to any single source of capital. Levin notes that in a high-stakes situation such as the leveraged buyout of a company, management should approach both private equity firms and "strategic" buyers, or companies within the same or related industries that might be interested in an acquisition.

Another question will be whether to use an investment banker to arrange financing with the buyer. Such assistance isn't cheap: Investment bankers typically charge a fixed fee to orchestrate the deal—whether it actually closes or not—and a success fee that can be 1 to 2 percent of the final payoff. In 2006, for example, investment-banking kingpin Goldman Sachs helped arrange the $21.6 billion buyout of Kinder Morgan and was one of the acquirers, along with the Carlyle Group and Riverstone Holdings; Goldman earned fees from both the buyers and the seller.

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Latham & Watkins


Faust

Quentin Faust of the law firm Andrews Kurth warns that finding an investment banker or broker can be as labor-intensive and fraught with peril as finding an actual buyer. "Looking for a good match for someone to find you the money can be harder than finding the money," he quips. Faust also notes that many match-making contracts include a "tail," which is a fee for creating buzz about the company—even if the company does a deal with someone else, after the match-making contract has expired.

On the other hand, Nathan cautions that most companies don't have the cachet and skills to bypass investment bankers altogether. "Does Warren Buffett need external bankers? Not often, because people come to him 24 hours a day, seven days a week, with ideas," he says. "But most companies can't afford to have an internal investment bank and don't have the credentials and marquee name of a Berkshire Hathaway."

A Bidding War

Companies often turn to investment bankers or brokers in the hope of sparking multiple offers. Last year, for instance, a fierce bidding war for Equity Office Properties Trust drove up the price by $3 billion; Blackstone ultimately walked off with the prize at $38.9 billion.

Typically, investment banks canvass dozens of private equity funds, prepare a lengthy brochure about each of them, and then act as intermediaries to gauge and promote interest, Levin says. Investment bankers really peddle the deal to buyers, something public companies may be ill equipped or reluctant to do.

Securing multiple offers obviously puts companies in a strong position, able to decide which firm or strategic buyer is the best match and pressuring them to raise their offers. "As a seller, you wouldn't just pick one private equity fund and hope for the best," Nathan says. "You'd typically go to eight or 10 or 15 possible buyers to find out which one is, in fact, better."

Getting multiple offers—or just working with an investment banker generally—also helps insulate the company's senior executives and board from accusations that they didn't find the best deal possible for shareholders. "Negotiating without an expert on your side is incredibly naïve," Nathan says. "CEOs who pick a private-equity horse to ride without first consulting at least their key directors very often get in trouble with their boards."

The Mating Dance

Roame

Everyone agrees that setting up initial meetings with private equity funds doesn't take long. "You can find the right doors to go through and set up meetings in 30 days," says Chip Roame, managing principal at consulting firm Tiburon Strategic Advisers.

Determining which deal is best, however, can be more time-consuming.

Companies might need to resolve antitrust worries, regulatory hurdles for foreign buyers, and even personal concerns about how a deal might change managers' work lives. In roughly equivalent bids, most companies choose the party that seems most reliable. "Which guy," Nathan asks, "do you think is going to show up at the finish line?"

Next, deals do face some regulatory hoops. Any merger valued at more than $63 million has a waiting period of 30 days under the Hart-Scott-Rodino Act, to allay antitrust fears. The buyer and seller might also need shareholder approval. All told, Levin says, the average private equity deal takes three to six months to complete.

While credit is tighter nowadays, experts agree that companies with solid financials and strong management won't encounter much trouble finding a buyer; private equity firms still have plenty of cash, and they're eager to put it in companies they consider safe, promising, and competent. "At the end of the day," Roame says, "if you have a good business plan, the private equity funds are going to invest."

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