10 Key Questions to Ask Before Choosing a Private Equity Partner

It's time for the next stage of business ownership: Bringing on an investment partner. Finding the right fit is an inexact science – some combination of due diligence, reference checks, and "gut feel." These ten questions can help sellers find the right match for their personality, business style, and future goals.

1. Does the private equity firm proactively provide complete references?

A potential partner should offer access to the management of all companies with whom it has worked over the years, whether or not the transactions have gone well.

"Sellers should be able to choose which references to call," said Prospect Partners' Principal Brett Holcomb. "Like a marriage, the dynamics of the relationship can be hard to gauge until you get deeper into it. For the best window into what the investor is really like as a partner, hear a variety of experiences. Talk to companies that experienced steady growth, and those that hit some bumps along the way."

Such information also can help set expectations about what might unfold in the years ahead. What is the partner like during good times? How did it handle a downturn? What are its hot buttons?

2. Are references being checked early enough?

Start reference-checking immediately after investor groups have been narrowed to a manageable number of top contenders.

"A lot of owners make calls only late in the process, during or even after the final Letter of Intent stage, and use those references to reinforce a decision they already made, rather than help them make a considered choice," Holcomb said. "It's better for everyone to initiate open-minded conversations earlier on."

The dialogue can give owners a better sense of 'who I want to work with', how each private equity firm supports management, and help the team prioritize the top criteria that matter. That ranking, in turn, can clarify other priorities – which may or may not be the ones the owner initially expected.

"Price was important, but finding the right fit was equally important," said Earl Rose, President of Owen Equipment Company, a provider of street sweepers, sewer cleaners, and other infrastructure maintenance equipment of his thought process before he recapitalized his business with Prospect Partners. "I wanted our partner to have the same business philosophy for growth and exit as I did as an owner, so there would be no surprises."

3. Are the right questions being asked?

Write down all questions, and make sure none go unanswered.

"Most important to me was knowing the history of the firm and the types, frequency and number of transactions it had performed. Were they experienced and active in deal-making, or were they learning as they go?" said Kurt Bland, President and CEO of Bland Landscaping Company, Inc., a portfolio company of Prospect Partners that provides commercial landscaping design, installation and maintenance services. "What relevant qualifications did the firm have to make my business successful? Would they let us run the business but participate meaningfully at the Board level?"

Each seller will have a different set of "right" questions depending on his or her personal style and professional goals. Regardless, everyone should also ask references: Would you ever do business with this firm again?

4. What is the firm's track record with similarly-sized companies?

According to Erik Maurer, a Principal of Prospect Partners, this answer is more important than the private equity firm's prior experience in the specific industry the company inhabits.

"Regardless of their industry, smaller companies share many overlapping needs as they grow into middle-market businesses," Maurer explained. "In recapitalizations, private equity firms back strong management teams that are experts in their market segment. Management knows their industry very well, but often needs strategic and financial guidance to scale the business for growth. That's why learning what the firm has been able to do with other like-sized companies can be telling."

Possible questions to ask include: Has the private equity firm done most of its deals in the seller's revenue size range? Is it "dipping down" or "stretching up" to work with the company? Was its prior fund (if there was one) working with similarly-sized companies?

Said Bland: "We also we wanted to know the firm's investment management style after closing – would it make capital available for both organic and acquisition-type growth? Not all partners do. We also talked to other management teams in the portfolio and asked them about their growth path after closing."

5. What does the potential partner offer beyond capital?

In addition to financial resources, what other relevant value-added tools are available to management? For example, can the private equity firm help with strategic planning, management team recruitment, business development or negotiations for add-on acquisitions, and/or with other areas of business-building? Is the firm committed to helping management build a bigger and better company over the long haul?

"Great partners offer more than just a checkbook," Holcomb said. "The ability to help management think through the many challenges that come with growth and provide expertise outside of the leadership team's scope of experience often contributes the most significant value over time."

6. What team will management work with, and is this team empowered to make decisions?

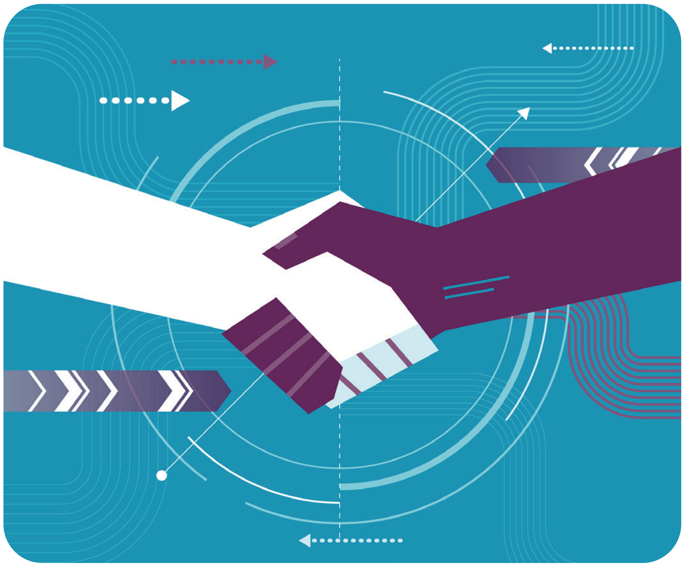
Different private equity firms use different models when staffing deal teams for their investments. It is important to understand in advance what model they are using and how it will work for the seller. Does the deal get passed from a deal generation team to an execution team to operating partners, or does the same team stay with the investment through its entire life cycle? How much authority does this team have, and how quickly can they act when needed? The ability to be thoughtful and decisive can significantly increase the likelihood of getting the transaction past the finish line, and can be tremendously helpful through the life of the investment.

"We got a significant amount of comfort from the fact we worked with the same people throughout and after the process of getting our deal closed. We had built a lot of trust and confidence in that team, trust that has only been reinforced over time as we've been able to make timely decisions that have helped us grow the business by adding people, systems, and locations," said Joseph Lynch, CEO of Minuteman Security Technologies, Inc., a provider of enterprise security technology solutions, and a portfolio company of Prospect Partners.

7. What are the firm's communication style and expectations after the deal closes?

How do communications work between the private equity firm and the portfolio company? Is the reporting process formal or informal? Some firms hold weekly calls or meetings that follow specific agendas. Others operate more ad-hoc, with interim calls as-needed in between board meetings. And speaking of board meetings – how frequently do they occur, and where are they held?

"While there's no 'one-size-fits-all' style, the communication processes should feel like a comfortable cultural fit that is aligned with how the business naturally operates, and management should feel at ease with the team with whom it will interact," said Holcomb.



8. Has the firm invested through economic and business cycles?

A private equity firm's longevity is one signal of its ability to provide support during inevitable downturns. Another is the kind of financial partner and advisor the firm has been to other management teams when the going gets tough. Find out how many cyclical contractions it has experienced across different portfolio companies and industries, and what happened to those businesses during those times. Was the firm realistic about economic issues beyond management's control? Further: Is the potential partner able to provide the robust capital structure the business needs to withstand the challenges that arise if the economy or industry takes a hit?

9. What does the exit transaction look like?

Get a sense of Phase Two before the ink dries on the current transaction, recommended Bill Zaruka, President of Wedgewood Wedding & Banquet Center, the nation's largest independent provider of weddings and special events, which did just that before it partnered with Prospect Partners.

"My father and I want to stay actively involved running Wedgewood for a long time," Zaruka explained. "So we asked what other owners experienced in their exit process. We wanted to know how the financials worked out for them, of course. But also how much influence they had in picking the next partner. How closely they were tied to the business in the next transaction. These questions all mattered to us."

And then, a final gut check:

10. Can you see yourself having fun together?

The buyer and seller should genuinely like and respect each other. They will be spending a lot of time together in the years to come, said Holcomb, and should look forward to developing a strong business relationship and an enduring friendship.

Added Bland: "As an operator and president of a company in a niche industry, I didn't know a lot about private equity going in. There are a lot of misconceptions about this space, and I continually run into people who dubiously ask me how I'm getting through the partnership. The honest answer is I'm having a ball. The private equity support has allowed us to grow faster, stronger and more aggressively. We couldn't have taken the risk to do so on our own. I'm thoroughly enjoying post-close because we did the work and truly picked the right partner for our company."

About Prospect Partners

Prospect Partners is a leading private equity firm investing in smaller lower-middle-market companies. We focus exclusively on management-led leveraged recapitalizations and acquisitions of niche market leaders with revenues typically under $75 million. Since 1998, Prospect Partners has completed more than 150 transactions in the building of over 50 platform companies in widely diverse niche manufacturing, distribution, and specialty service markets. Prospect Partners manages $470 million in committed capital across three private equity funds.

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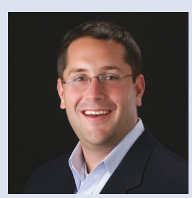

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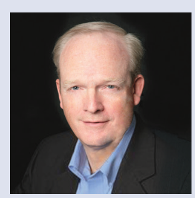

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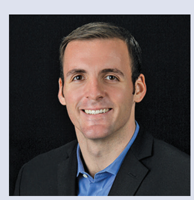

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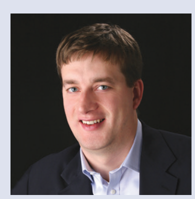

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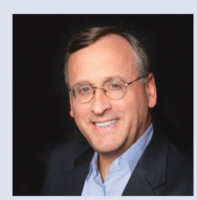

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