

## Position your business to attract interest from private equity firms

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By James S. Cassel

There comes a time in almost every middle-market business owner's life when attracting interest from a private equity firm or strategic buyer becomes important. Private equity firms look for certain criteria when evaluating candidates for acquisitions or recapitalizations, so it is important to plan ahead and take the right steps now to put your business in the best position.

The business decisions you make today can position your company for future growth, recapitalization or sale. Following are some of the key characteristics that private equity firms most commonly look for in companies. While all private equity firms are somewhat unique and may have their own sets of criteria and preferences, the criteria listed below are a good starting point to keep in mind.

James Cassel is co-founder and chairman of Cassel Salpeter & Co., LLC, an investment-banking firm with headquarters in Miami that works with middle-market companies. . .

- **Good people.** Having a good senior management team is important. The team should be properly trained, incentivized and moving in the same direction.

- **Recurring revenue and margins.** For some businesses, long-term contracts are a great way to guarantee future revenue streams. Other equally beneficial options might include service contracts, subscription services, membership



clubs or adding lines of consumables to what you already sell. Many private equity firms look for businesses with margins of 10 percent or better.

- **Large market potential.** Market size is one of the top criteria that private equity firms look for when buying companies. A \$25 million player in a \$100 million market will not be as attractive to a private equity firm as a \$25 million player in a \$1 billion-plus market. Just as important, you should be in a market where the leaders do not control a large proportion of the industry. In some cases, niche businesses that are ancillary to other businesses can be attractive.

- **Solid growth potential.** Having a defensible market and strong growth characteristics is vital. The better your growth rate, the higher your valuation. Beyond your previous growth, your realistic projected future growth is important.

- **Appropriate financial documentation.** Proper accounting systems and financial reporting is critical. It is important to show a history of keeping all necessary documents in appropriate order. Sound and accurate record keeping will help protect your valuation when financial due diligence is being performed.

- **Strong product and service offerings.** Keeping a close pulse on changing market trends and conducting strong research and development is important. This can help you maintain a strong pipeline of new products and ensure your products or services meet the needs of your customers and prepare you for the future. Private equity firms like businesses with a low risk profile in the short term to avoid technical obsolescence.

- **Fragmented industry.** Being in an industry with M&A opportunities is always good. In addition to organic growth, growth by acquisition can be very beneficial to expanding your business.

- **Good customers.** Private equity firms look for companies that have a strong customer base with adequate distribution of customers and lack of customer concentration. If a majority of your revenues come from one or two customers, private equity firms will be concerned about what may happen to your business if those customers depart. Generally, a single customer should

be responsible for no more than 10 percent of your revenues. Being the market leader, or at least among the top three in your market, is helpful.

If your business does not meet all the above criteria, do not assume that private equity firms will not be interested. Some private equity firms are open to enhancing businesses by addressing any areas that might be deficient. In today's market, the better and bigger companies might sell for multiples in excess of 10 times [EBITDA](#) (earnings before interest, taxes, depreciation and amortization), while those with less attractive business models or industries might sell for values of five times EBITDA or less.

Achieving the goals listed above requires time and effort and may not be done overnight. By taking the right steps now, you can help position your firm to attract interest from private equity firms or strategic buyers willing to pay top dollar in the future.

*James Cassel is co-founder and chairman of [Cassel Salpeter & Co., LLC](#), an investment-banking firm with headquarters in Miami that works with middle-market companies.*

*He may be reached via email at [jcassel@casselsalpeter.com](mailto:jcassel@casselsalpeter.com) or via LinkedIn at <https://www.linkedin.com/in/jamesscassel>.*

*His website is: [www.casselsalpeter.com](http://www.casselsalpeter.com)*