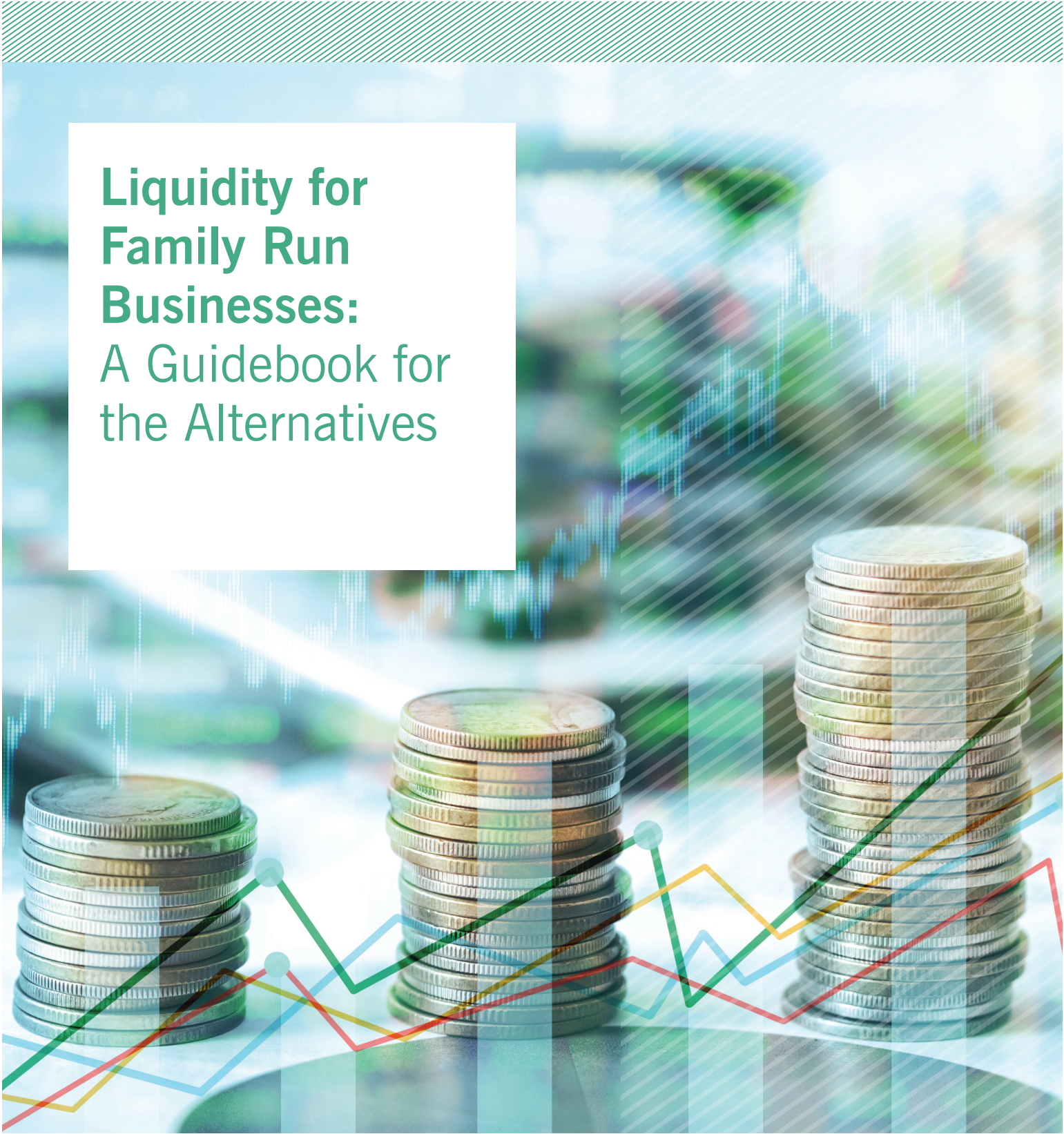


# INSIGHTS

APRIL // 2019

The background of the cover is a composite image. It features three stacks of coins (likely Euro) of increasing height from left to right. Overlaid on this is a semi-transparent line graph with four colored lines (green, blue, yellow, red) showing fluctuating trends. The background is a blurred image of what appears to be a city street or a busy office environment. A green diagonal line pattern is visible at the top of the page.

## Liquidity for Family Run Businesses: A Guidebook for the Alternatives



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David rejoined Investcorp in 2015, from CVC Capital Partners where he was a Partner. From 1999 to 2011, David was a member of Investcorp's Corporate Investment team and, from 2003 to 2005, was Senior Vice President and Chief Financial Officer of Jostens, Inc., a former Investcorp portfolio company. Prior to joining Investcorp, David was a Vice President with Donaldson, Lufkin & Jenrette.

David currently serves on the boards of directors of AlixPartners, Arrowhead Engineered Products, ICR, KS Group, Paper Source, PRO Unlimited, TPx Communications, United Talent Agency, The Wrench Group, Alex Lee and Youth, Inc.

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Kirk Fleischer is a Principal in Investcorp's Private Equity – North America group.

Kirk joined Investcorp in 2016 to focus on deal sourcing and business development. Prior to joining Investcorp, Kirk worked for seven years as an Executive Vice President of Strategy and Corporate Development at BeavEx Inc. Prior to that, he spent 12 years in investment banking at Jefferies, Lehman Brothers and Oppenheimer, and also spent five years in corporate development at Dun & Bradstreet.

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### Table of Contents

01	Synopsis
01	Introduction
06	Evaluating the Various Alternatives for Liquidity
07	Sale of Business to a Strategic Buyer
10	Sale of a Business to a Private Equity Firm in its Entirety
13	Sale of a Controlling Stake in the Business to a Private Equity Firm
16	Sale of a Minority Stake in the Business to a Private Equity Firm
18	Leveraged Recapitalization of the Business
20	Retaining the Status Quo and Passing the Business on to the Next Generation
21	Conclusion



## SYNOPSIS

This guide is intended to provide Family-owned and/or Founder-run businesses (“FOBs”) with an overview of various liquidity options available to them, including the benefits and considerations of each, and the questions to ask when evaluating potential partners.

Today, FOBs represent approximately 80% to 90% of the 30 million businesses in the United States according to the Conway Center for Family Business. The US Census Bureau estimates that 1.2 million of these businesses are middle-sized (between 10 and 500 employees). Baby boomers own approximately two thirds of these businesses and, as FOB owners consider other pursuits, they are increasingly evaluating options for succession and/or the sale of their businesses.

With private equity experiencing significant growth and expanding the range of solutions it offers to meet the specific needs of FOBs, the number of potential liquidity options available for FOB owners has never been greater. Private equity firms are particularly well-suited as partners for those FOB owners who choose to retain an investment in their business, because private equity investors can provide additional financial and human capital as well as other resources to help FOBs grow, along with liquidity for FOB owners and the opportunity for additional wealth creation. In the case of FOB owners sensitive to ceding control or looking for immediate, full liquidity, certain private equity firms can provide flexible capital (minority investments or buying 100% of the equity, respectively) to help an FOB owner meet those objectives.


Beyond private equity, there are other viable partners who can provide FOBs with liquidity, including strategic buyers who may be able to pay more for an FOB due to synergies, and lenders who can provide FOB owners with a leveraged recapitalization of their FOB, allowing them to retain 100% of the equity in the FOB.

Each of the alternatives, ranging from a sale to a strategic buyer or partnering with a private equity firm to recapping the business or staying the course, has its own benefits and considerations and sets of questions that should be asked when evaluating one's options. The following paper outlines various alternatives available to founders and how to best evaluate each.


## INTRODUCTION

**It is a great time to sell ... But, for FOBs, “soft” or qualitative considerations are often as, or more, important than financial considerations**


It has never been a better time for middle-sized businesses to consider a liquidity event. Purchase price multiples are near record levels, with the average EBITDA purchase price multiple at 10.9X in 2018, according to the Bain Global Private Equity Report of 2019. These valuations have been driven, in part, by record availability of both equity and debt. Since 2013 over \$1.1 trillion has been raised for US private equity buyout and minority growth equity investments. The amount of capital available to be deployed by private equity firms (“dry powder”) in the United States exceeds \$417 billion specifically for buyouts and minority growth equity investments as of September 2018, according to the American Investment Council.



**Private equity can provide FOB owners with liquidity and resources to help their FOBs grow**



**Each liquidity alternative has its own considerations**



**It's a great time for FOBs to consider a liquidity event**

However, selling an FOB involves balancing a number of considerations. In contrast to institutionally-owned businesses that generally prioritize shareholder returns, FOB owners often think about the qualitative benefits of ownership when considering a sale of all or a portion of their FOB, as well as the financial considerations. As a result, at times, FOB owners have been cautious about selling their businesses to private equity firms despite the many benefits.

### Conflicting FOB Owner Considerations

#### Intangible Legacy Considerations

- Their own personal identification with the business
- Socio-economic benefits a business owner gains from owning their business, such as an elevated position in the community as an employer
- The personal commitments made to business partners, including the employees of the business
- The ability to sustain and expand family bonds as the business passes from one generation to the next

#### Tangible Financial Considerations

- Desire for wealth diversification. Today, most of a typical business owner's net worth is tied up in their business. It is prudent for them to consider de-risking their portfolio
- Desire for liquidity (often tied-in closely to the desire for wealth diversification). As FOB owners pursue other professional, philanthropic and personal passions, they have a need for liquid assets to support their lifestyle
- Lack of sufficient succession planning or next generation to take over the business. As FOB owners consider the future for their businesses, there may not be an appropriate alternative for taking the business to the next generation

**Private Equity is more flexible in addressing the specific needs of FOBs today**

### PRIVATE EQUITY IS WELL-SUITED TO PARTNERING WITH FOBs TODAY

The number of private equity firms has expanded dramatically since 1992, when there were 293 private equity firms, to 5,391 firms today, according to Preqin's 2018 Global Private Equity and Venture Capital Report. With the expansion in the number – and types – of firms in the market, certain private equity firms can provide flexible capital that is more varied in its ability to address the needs of FOBs.

Private equity investors can also help FOBs improve their businesses. The chart below outlines the expertise private equity professionals can provide across certain areas that are valuable to FOBs competing in the marketplace.



With flexible capital solutions and expertise to help improve FOBs, owners are becoming more open to private equity.

### LIQUIDITY OPTIONS FOR FAMILY-OWNED AND FOUNDER-RUN BUSINESSES ARE VARIED AND FOB PRIORITIES IMPACT THE BEST ALTERNATIVE LIQUIDITY PATH

Because of the growth in private equity and the availability of money from strategic investors, private equity investors, and lenders, there is no shortage of options and/or investors interested in partnering with FOBs when they decide to contemplate their alternatives. The options this paper will examine in greater detail include:

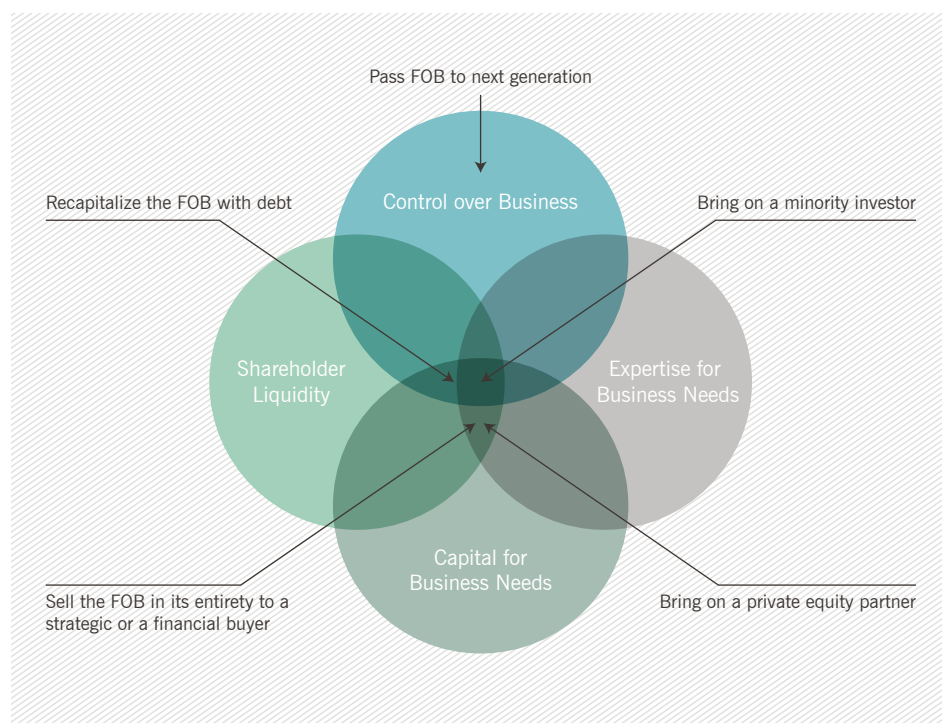
- Strategic sale of the business (usually in whole);
- Sale of the business to a private equity firm in its entirety;
- Sale of a controlling stake in the business to a private equity firm;
- Sale of a minority stake in the business to a private equity firm;
- Leveraged recapitalization of the business; and,
- Retaining the business in its entirety.

FOB owners have multiple priorities to weigh when evaluating alternatives for the future of their businesses, including an assessment of the business, its needs and the key objectives they have for their constituents (shareholders, family, employees, community and others).

### Prioritizations to Evaluate

Company Considerations	Family Considerations
<ul style="list-style-type: none"> <li>• What does an assessment of the industry in which the FOB operates look like?</li> <li>• What is the outlook for the FOB going forward including evolving competitive dynamics?</li> <li>• What does the required investment in capital and human resources look like in order for the FOB to remain competitive?</li> <li>• Does the FOB have, and will it be able to attract and retain, the talent required to win in the marketplace?</li> </ul>	<ul style="list-style-type: none"> <li>• Does the family want to maintain control and why?</li> <li>• What are the families overall financial objectives?</li> <li>• What ROI does the family expect to generate from the business and, based on the industry dynamics, is that realistic?</li> <li>• How many employees and community members are supported by and rely on the FOB?</li> <li>• What else would the family consider doing with the proceeds from the sale of the FOB in a full or partial sale?</li> </ul>

Depending on how an FOB owner answers these questions and prioritizes control over their business, shareholder liquidity and business needs, a different liquidity alternative will fit them best.



The following chart may help FOB owners consider what alternative is best for their business.

	Desire for Control	Desire for Shareholder Liquidity	Desire for Access to Expertise	Recommended Option	Notes
Business Owner	No	Yes	NA	Sale to strategic buyer	Maximizes valuation in most cases due to available synergies and, while access to expertise is less relevant since the FOB is usually selling in its entirety, there will be some expertise to help drive the business.
			Yes	Sale to private equity firm in its entirety	Provides access to liquidity and expertise, but no control of the business. Valuation may not be as high as in a sale to a strategic buyer because synergies are less available, though private equity buyers tend to move more quickly.
			Yes	Sale of a controlling stake to a private equity firm	Allows the FOB future upside in their business as well as the ability to continue to run the company, if desired.
	Yes	Yes	Yes	Sale of minority interest in business	Provides FOB with control and some liquidity. Minority investors will typically have a network of experts that can be accessed.
			No	Leveraged recap of business	Provides FOB with control and some liquidity but will likely leverage the business beyond what they've previously experienced. Access to expertise is not typical from lenders and should be sought elsewhere.
		No	No	Retain business for next generation	Keeps the business as it is with the opportunity to reevaluate options at a later date as appropriate.

Each of the alternatives dictated by an owner's priority weighting has its own set of benefits and considerations to review when determining the appropriateness of a solution.

The balance of this white paper provides FOB owners with a guide for comparing the options, understanding each alternative's benefits and considerations, and framing some of the questions to ask when evaluating potential partners. It is not intended to be all inclusive and the alternatives should be evaluated based on an FOB owner's specific circumstances.

Investcorp has extensive experience working with selling business owners to help them achieve their objectives across the various alternative liquidity options reviewed, with the exception of a leveraged recapitalization utilizing debt, and can provide flexible and patient capital. Throughout this paper, we have included examples of these partnerships.

**The best liquidity alternative for each FOB will be dictated by their own priorities**

The following chart reviews the relative likelihood of key considerations for FOB owners evaluating the alternative options and will serve as a guide in illustrating each of the liquidity alternative sections that follows:

	Business Owner Retains Control	Achieves Highest Valuation	Provides Business Owner with Liquidity Event	Provides Business with access to additional capital/ expertise	Provides continued role with Business	Opportunity to Participate in Future Liquidity Event	Business will have Increased leverage	Increased Governance/ Reporting requirements	Maintenance of culture/ non-financial benefits of ownership
Sale of the Business to a Strategic Buyer	Least Likely	Most Likely	Most Likely	Neutral	Less Likely	Least Likely	Neutral	Least Likely	Least Likely
Sale of Business to a Private Equity Firm (in its entirety)	Least Likely	Neutral	Most Likely	Most Likely	Neutral	Least Likely	More Likely	Most Likely	Least Likely
Sale of a Controlling Stake in the Business to a Private Equity Firm	Less Likely	Most Likely	More Likely	Most Likely	Most Likely	More Likely	More Likely	Most Likely	Neutral
Sale of a Minority Stake in the Business to a Private Equity Firm	More Likely	More Likely	Neutral	Most Likely	Most Likely	More Likely	Neutral	More Likely	More Likely
Leveraged Recap of the Business Utilizing Debt	Most Likely	Less Likely	Neutral	Less Likely	Most Likely	Most Likely	More Likely	Neutral	More Likely
Retain the Status Quo	Most Likely	Least Likely	Least Likely	Least Likely	Most Likely	Most Likely	Least Likely	Least Likely	Most Likely

Key

Most Likely

More Likely

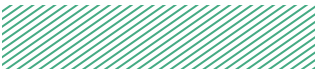
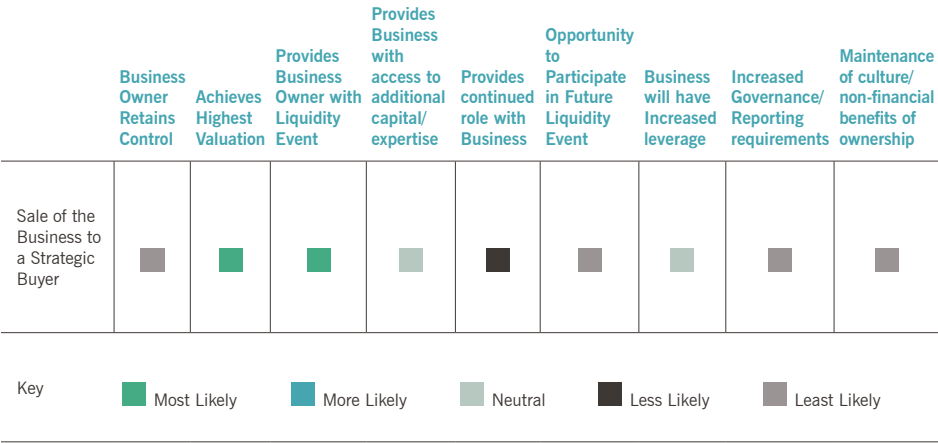
Neutral

Less Likely

Least Likely



SALE OF BUSINESS TO A STRATEGIC BUYER



Often offers the highest valuation, but with changes to the business and less predictability as a buyer

An FOB owner selling a business to a strategic buyer typically sells the entire FOB to a competitor or a company wanting to enter the market in which the FOB operates. Strategic buyers typically buy 100% of the FOB, though there are times when a portion of the consideration will be in equity of the acquirer.

Benefits

- Allows an FOB owner the possibility to sell their business and achieve full liquidity
- Buyer is able to pay more for business due to the identifiable synergies associated with combining the FOB with the buyer

Considerations

- May be a role for the FOB owner with the combined business, but that is not necessarily the case
- A non-compete agreement will be a part of the sale agreement
- Strategic buyers are less predictable than PE buyers and tend to move more slowly
- May lead to disruptions and a significant reduction in employees as a buyer seeks to achieve the synergies that support the valuation
- As a buyer seeks to incorporate a new business with their own, the culture of the FOB could be lost
- The FOB could be relocated, having a negative impact on the community

**Questions to consider when evaluating a sale to a strategic buyer:****Why does the buyer want to acquire the FOB? What are its plans for integration?**

While an FOB owner may want to sell, they often have an ongoing interest in the FOB's constituents. Understanding the motivations for a buyer and their integration plans will provide the FOB owner with insight into the combined business prospects, if there is a desire or opportunity to own equity in the combined business, as well as the buyer's objectives regarding social issues, including plans to terminate employees or move the business.

**Is there an option for the FOB owner to retain equity?**

Equity retained by an FOB owner in the combined business could be worth materially more at a later date than gaining full liquidity upfront. However, this requires a tolerance for risk, as the FOB owner will generally have much less or no control over the future of the business.

**How is the buyer thinking about deal structure?**

Acquisitions can be structured in a myriad of ways; Amongst other things, deal structure considerations might include:

- An earnout. If there is an earnout, an FOB owner will have to determine whether it is achievable and how much influence or control will they have over achieving it.
- Representations and warranties. An FOB owner will have to understand what representations and warranties will need to be made as part of the purchase agreement and what potential liabilities arise as a result.
- Tax implications. The structure of the transaction will impact taxes that the FOB owner will be liable for when the business is sold.

### INVESTCORP'S EXPERIENCE WITH A STRATEGIC SALE OF A BUSINESS

Many Investcorp portfolio companies have completed acquisitions that added to the size, capabilities and reach of the businesses. Each of these add-on acquisitions is a strategic acquisition of a business. One Investcorp portfolio company that has made several add-on acquisitions is the Wrench Group.

The Wrench Group ("Wrench") is a leading provider of essential home maintenance and repair services.















Investcorp acquired Wrench in 2016. For Investcorp, Wrench offered an exciting partnership opportunity because the company had achieved substantial growth in each of its markets while providing superior customer service. Investcorp saw an opportunity to build on Wrench's success by capitalizing on best practices across the enterprise, continuing the strong organic growth Wrench experienced in its current regions and strategically expanding into attractive markets. As part of the transaction, Wrench management stayed on board and retained a meaningful interest in the company.

To date, the company has completed three add-on acquisitions. Each of these businesses operated successful brands in their local markets and shared Wrench's commitment to quality and delivering exceptional service for customers. The selling business owners wanted to join Wrench because they believed Wrench provided their businesses with growth opportunities backed by the company's broader resources and capabilities. Each selling FOB is an equity owner of Wrench.

Investcorp and the Wrench management team have developed a sustainable platform to accommodate growth through acquisitions and integration, transforming the company into a player of scale.

Offers maximum current liquidity, but perhaps not the highest valuation

## SALE OF A BUSINESS TO A PRIVATE EQUITY FIRM IN ITS ENTIRETY

	Business Owner Retains Control	Achieves Highest Valuation	Provides Business Owner with Liquidity Event	Provides Business with access to additional capital/expertise	Provides continued role with Business	Opportunity to Participate in Future Liquidity Event	Business will have Increased leverage	Increased Governance/Reporting requirements	Maintenance of culture/non-financial benefits of ownership
Sale of the Business to a Private Equity Firm (in its entirety)									
Key	 Most Likely	 More Likely	 Neutral	 Less Likely	 Least Likely				

Similar to selling a business to a strategic buyer in its entirety, an FOB owner can sell their business to a private equity firm and gain full liquidity. While private equity firms usually prefer that FOB owners roll a portion of their equity into the new investment to demonstrate conviction in the future of the business and to align interests, there are occasions when full liquidity makes sense, such as when an FOB owner is retiring or when the company is run by non-family management.

### Benefits

- Allows an FOB owner to sell their business outright and achieve full liquidity
- In the short run, FOB owner can be assured that the private equity firm will need the management team and will retain them to ensure industry/ business domain expertise and continuity
- If there are plans for the management team to stay in place on a longer-term basis, the private equity firm will establish an equity incentive plan for the management team
- Private equity owner will be able to provide the FOB with increased access to growth capital and subject matter experts that might not otherwise have been available

### Considerations

- Unless FOB owner has an ongoing management role, will have no equity interest or involvement in the business
- A non-compete agreement will be a part of the sale agreement
- Greater reporting requirements and more governance
- Business will likely have more leverage
- The culture of the FOB could be lost
- Though unlikely with private equity, the FOB could be relocated, having a negative impact on the community
- Valuation could be negatively impacted versus a sale where the FOB owner retains equity and continues with the business



**Questions to consider when evaluating a sale to a financial buyer in its entirety:**

The most common questions an FOB owner should ask focus around the ability of the buyer to complete the transaction and the structure of the transaction, rather than social issues.

**What is the experience of the private equity team in the sector (for due diligence purposes)?**

The private equity firm should have experience owning or, at least reviewing in depth, businesses in the relevant industry sector or analogous sectors. This will reduce the likelihood that general industry issues derail the process.

**Do the buyer's investment criteria match up with the characteristics of the FOB?**

Private equity investors usually have pre-defined criteria by which they invest. These include specific industries, financial parameters, cash flow characteristics, capital intensity, strength of management team, etc. The FOB should fit these criteria.

**How is the buyer thinking about deal structure?**

As with a strategic sale, the deal structure proposed by a financial buyer is important. The factors to be considered include the achievability of an earn-out (if proposed), the required representations and warranties that the FOB seller needs to make and the tax consequences of any proposed structure.

An FOB sold in its entirety to a financial buyer as a platform company will remain independent and there will be some certainty, at least initially, for the employees and management team. Questions around post-sale social issues, such as management retention programs, are addressed in the section "Sale of a Controlling Stake in the Business to a Private Equity Firm."

### INVESTCORP'S EXPERIENCE WITH A SALE OF AN FOB TO A PRIVATE EQUITY FIRM IN ITS ENTIRETY

While most private equity firms seek to partner with FOB owners or management who are interested in rolling a portion of their equity over into the new investment, Investcorp (and others) can provide flexible capital and will, in certain instances, buy 100% of a business from FOB owners. KS Group is one such example.

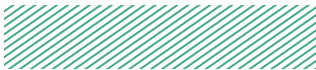
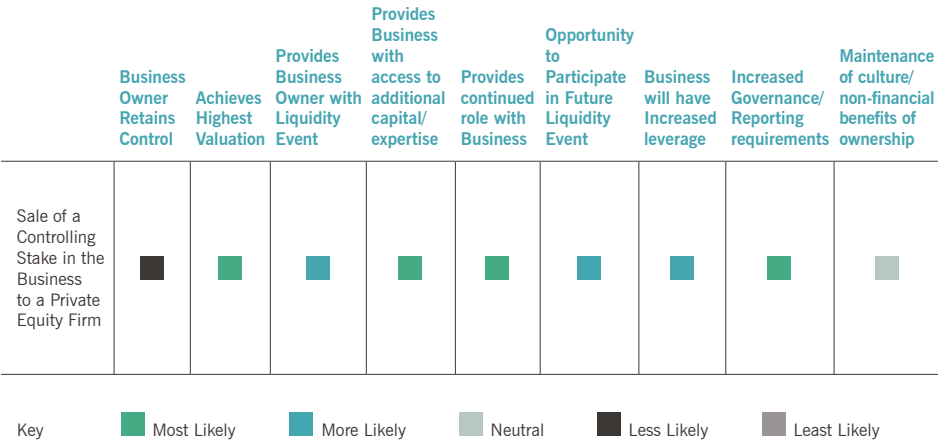
KS Group ("KS") is an industry-leading distributor of quality replacement auto body parts servicing over 10,000 collision repair shop customers across 25 locations in 14 states.

In March 2018, Investcorp acquired KS Group. The KS Group FOB owners wanted to retire and gain full liquidity and Investcorp was able to meet that objective. The FOB owners received proceeds from the sale in the form of a significant upfront payment coupled with a smaller and relatively short duration earn-out based upon achieving certain objectives and certainty of a smooth transition to Investcorp. The remaining management team received options in a new option program designed to incentivize them for the growth in the value of the business.

Investcorp hired a new CEO who brought experience in both privately-held as well as publicly-traded companies and who has held leadership roles in the automotive aftermarket industry since 2007. In November 2018, KS completed its first add-on acquisition.

Investcorp sees an opportunity for KS to grow by expanding geographically, through the opening of greenfield locations, continuing to pursue acquisitions, establishing stronger relationships with existing customers and adding new customers, including multi-shop operators (MSOs).

SALE OF A CONTROLLING STAKE IN THE BUSINESS TO A PRIVATE EQUITY FIRM



Provides an FOB owner with a high valuation, a significant amount of liquidity, access to resources and the opportunity for upside as a result of retained equity

When selling a controlling stake in an FOB to a private equity firm, an FOB owner retains a portion of their equity and becomes a minority investor in the business. An FOB owner should consider their relationship with the private equity firm acquiring a controlling stake in the FOB carefully. It is a long-term relationship and being aligned on the company’s strategic objectives and the path to achieve them are critical to a successful partnership and a financially rewarding investment.

Benefits	Considerations
<ul style="list-style-type: none"><li>• FOB owner reduces their wealth concentration by selling a significant portion of an asset that is likely their largest investment</li><li>• FOB owner retains upside in business through an equity ownership stake</li><li>• Control investments by private equity firms are typically linked to equity incentive plans for the management teams</li><li>• Provides the FOB with incremental access to both capital and subject matter expertise from the investor as well as its network of consultants and other advisors</li></ul>	<ul style="list-style-type: none"><li>• FOB owner remains a shareholder, but is not the majority owner</li><li>• A non-compete agreement will be a part of the sale agreement</li><li>• Greater reporting requirements and more governance</li><li>• FOB will likely have more leverage</li><li>• The culture of the FOB could change over time</li><li>• The new investor and the FOB owner may not agree on the time horizon for a subsequent sale of the FOB</li><li>• Upon a subsequent sale of the FOB, the FOB owner may have influence, but not control over the selection of the next buyer</li></ul>

**Questions to consider when evaluating a sale of a controlling stake of a business to a private equity firm:**

**What is the buyer's history of investing in FOBs?**

It is important to understand the investor's track record with FOBs. FOBs have their own nuances (as we've discussed here) and an investor in them should be sensitive to these considerations and be prepared to address them.

**Can the selling FOB owner speak with references for the private equity firm?**

Others who have sold their business to a particular private equity firm (and the individuals the selling FOB owner will be working with) will be able to provide a clear perspective on what it is like to work with the firm.

**What is the private equity team's experience in the sector or what functional expertise does it have?**

The firm should have specific expertise either in the sector in which the business operates or with relatable experience. Alternatively, expertise in areas of focus for the business, such as growth through acquisitions, is also valuable.

**Is the firm more operationally focused or are they more focused on being an investor allowing the team to manage the business?**

**How is the buyer thinking about deal structure?**

An FOB owner should consider the achievability of an earn-out (if proposed), the required representations and warranties that the FOB seller needs to make and the tax consequences of any proposed structure, among other issues where advisors provide guidance.

**Is the deal team the same team that will be working with the business following the investment? What is the seniority of the team managing the investment?**

The FOB owner should ensure that they have a strong working relationship with that individual leading the investment for the private equity firm, regardless of whether that individual was involved in the "pitch". The team should be able to deliver the appropriate resources and attention, and possess a broad set of experiences that can be related to specific matters facing the FOB.

**How much capital does the buyer have for add-on acquisitions or other needs, if necessary?**

If completing add-on acquisitions is an important component of the strategy for the FOB, then the private equity firm should have the capital necessary to complete those acquisitions. If the business requires equity for another reason, having available capital to address those specific business needs could be even more important.

**What is the expected time horizon for the investment? How patient is the investor's capital? What is the investor's typical hold period?**

Investment hold periods for many firms are contracting and many firms are seeking returns more quickly. Partnering with a firm providing patient capital and more flexible hold periods may be an important consideration.



**For retained equity, how does the private equity firm structure their equity pools? Do all investors own the same security?**

Some private equity firms treat the equity they contribute into an investment differently from the equity retained by FOB owners.

**What do their equity incentive programs look like?**

The new investor should implement an equity incentive program that provides management with significant upside to be realized if the investment is successful.

**What kind of governance protections will the FOB owner have?**

**What is the firm's philosophy around leverage?**

Some private equity firms seek all available leverage while others lever the businesses in which they invest more conservatively.

### INVESTCORP'S EXPERIENCE WITH A SALE OF CONTROLLING STAKE IN THE BUSINESS TO A PRIVATE EQUITY FIRM

Most of the investments that Investcorp makes are controlling stakes in businesses, where the selling owners/management retain an equity stake. One current example in Investcorp's portfolio is ICR.

ICR is one of the largest independent strategic communications advisory firms in the United States. Initially founded as an investor relations firm, the business has expanded its service offering to include PR, crisis management, transaction advisory services, digital media and branding services.

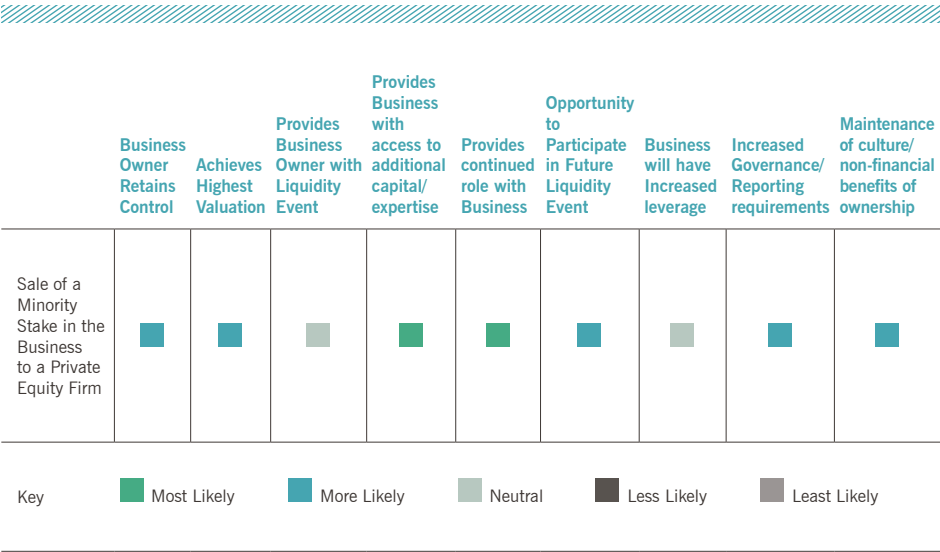
In March 2018, Investcorp acquired majority ownership of ICR. ICR had grown its business over 20 years and was seeking a partner to take the business to the next level. Investcorp determined that ICR was well-positioned to broaden its service offerings and that Investcorp could help to accelerate and enhance the already strong growth trajectory of the firm.

ICR represented an attractive opportunity to partner with management and the company's founders to accelerate organic growth. ICR's management – including the CEO (founder), President, and other key team members – retained a significant financial ownership in the firm.



Provides FOB owners with some liquidity and control over the company, access to financial and human capital, as well as the opportunity for a future liquidity event.

SALE OF A MINORITY STAKE IN THE BUSINESS TO A PRIVATE EQUITY FIRM



When an FOB sells a minority stake in a business to a private equity firm, the FOB owner retains control of the business.

Benefits	Considerations
<ul style="list-style-type: none"><li>Achieves a level of liquidity for FOB owner's equity position</li><li>FOB owner maintains control of the business</li><li>FOB owner has future liquidity options</li><li>The sale of a minority stake can be a precipitating event that encourages business owners to develop equity incentive programs for management</li><li>Provides the FOB with incremental access to both capital and subject matter expertise from the investor as well as its network of consultants and other advisors</li></ul>	<ul style="list-style-type: none"><li>Greater reporting requirements and more governance</li><li>Investor will have board representation</li><li>Investor will need a pathway to liquidity for their investment</li><li>Investor may require a capital structure that includes additional leverage</li></ul>

**Questions to consider when evaluating a sale of a minority stake in a business to a private equity firm:**

There is substantial overlap with the questions under the prior section, “Sale of a Controlling Stake in the Business to a Private Equity Firm,” as they also apply when an FOB owner is considering a minority investor. As a result, the questions have not been repeated here.

When selling a minority stake, an additional critical question to consider is what governance requirements and protections the minority investor will need from the FOB owner and how those requirements align with the goals and objectives of the FOB owner.

**INVESTCORP’S EXPERIENCE PARTNERING WITH A BUSINESS THROUGH A MINORITY INVESTMENT**

Investcorp works with the businesses with which it partners to find the optimal ownership structure. In some instances, the selling business owners want to maintain a controlling interest in the business. Investcorp can accommodate those objectives with appropriate governance protections.

United Talent Agency (“UTA”) is a leading global talent and entertainment company. It is the third largest talent agency in the world representing writers, directors, actors, musicians, news and sports broadcasters.

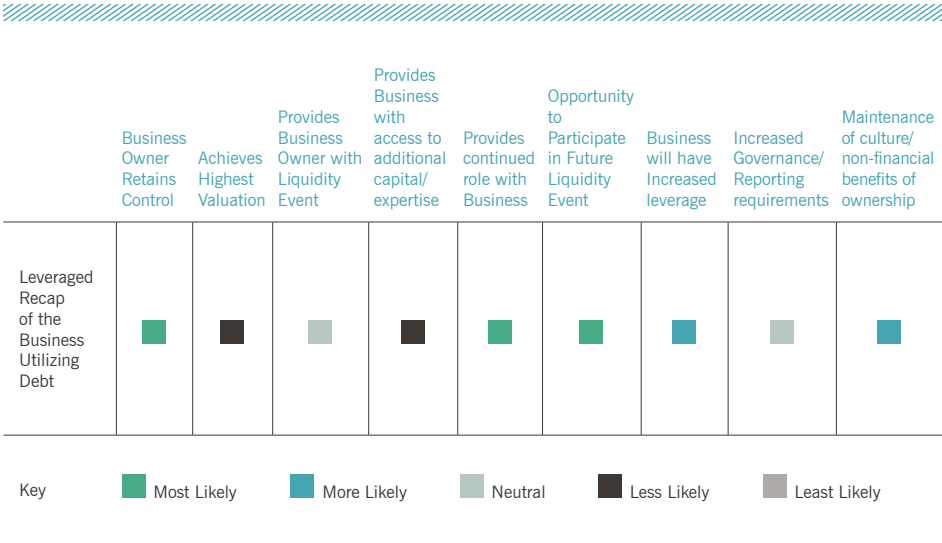
Investcorp was first introduced to UTA in 2017 through one of its Advisory Directors. UTA wanted to maintain majority ownership and control of the company. They were seeking a minority investor(s)/strategic partner that had relationships and financial resources to help UTA grow both organically and through acquisition. In addition, they wanted to raise capital to provide some liquidity for investors and to refinance the largest shareholder’s existing investment. Investcorp took a minority equity stake in UTA alongside PSP Investments in 2018.

For Investcorp, UTA was an opportunity to partner with a world-class management team leading a large-scale independent talent and entertainment agency and to help them achieve success in the next phase of their growth.



Provides FOB owner with capital to invest in the business and/or for a dividend in the form of a loan

LEVERAGED RECAPITALIZATION OF THE BUSINESS



In a leveraged recapitalization of a business, an FOB owner typically borrows money secured by the stock and assets of the business with the proceeds used to invest in the business and/or for a dividend to the FOB owner.

Benefits	Considerations
<ul style="list-style-type: none"><li>• FOB owner maintains control without diluting their equity ownership position</li><li>• Can provide liquidity for shareholders or can be utilized to provide growth capital for the FOB</li><li>• Can be structured in different ways to address specific FOB needs, including as an interest-only payment</li><li>• Usually a cheaper form of financing an FOB than selling equity</li></ul>	<ul style="list-style-type: none"><li>• Offers none of the benefits available from partnering with a private equity firm – provides capital in the form of a loan</li><li>• Amount of liquidity will not be as much as would be available from selling equity</li><li>• If the FOB is unable to meet its debt obligations, there is a risk that the FOB could be lost to the lenders</li><li>• Cash interest on the loan is a drain on cash from the FOB -- Rather than using that cash to invest in the FOB or to provide additional liquidity to shareholders, it goes to service outstanding debt</li><li>• Lenders will typically require information and reporting</li><li>• Restrictive covenants could limit certain actions of the business, such as placing a cap on capital expenditures or limiting distributions to shareholders to preserve cash flow</li></ul>



**Questions to consider when evaluating a leveraged recapitalization of a business utilizing debt:****Has the lender taken the time to understand the business?**

A lender should understand the specific dynamics of a business and how it operates. This will reduce the likelihood of surprises arising from ordinary course cyclicalities, new business start-up costs or other regular business issues the FOB could experience.

**How patient is the lender in the event a business experiences challenges?**

Some lenders are more flexible than others when a business experiences a downturn, whether due to economic cycles or more specific business issues, and will work with the business to find a solution. Other lenders can be less flexible and can make a difficult situation worse. In the worst of all cases, an FOB owner could lose their FOB entirely if a lender is not willing to work with them.

**What are the debt terms? What is the interest rate? What kind of covenants are included and what kind of covenant cushions are there?**

The terms of the loan will partially drive whether it makes sense for the FOB. The costs of the loan could outweigh the benefits if the interest rate is too high or the amortization schedule too rapid. Restrictive covenants could also hamstring the business and create a difficult environment in which to operate.

**Are there any personal guarantees required?**

Personal guarantees on loans are commonplace for FOBs. An FOB owner should understand whether they are responsible for the loan on a personal basis and measure the risk of default.

**In addition to the questions an FOB owner should ask of a prospective lender, an FOB owner should evaluate their own business carefully by considering the following questions:****Is the FOB owner comfortable with the incremental debt? Does the FOB owner have experience operating in a leveraged environment?**

Managing an FOB with a focus on cash flow for debt service purposes is a learned skill. FOB owners should be certain that their business can support the cash flow requirements of a leveraged environment.

**How should the additional capital be utilized - either as a dividend to shareholders, an investment in the business or some combination of the two?**

Adding leverage to a business for liquidity purposes is somewhat more aggressive than adding leverage to an FOB to grow the business. An FOB owner should consider whether the liquidity they generate for themselves is worth the incremental risk and covenants necessary for that liquidity.

**Should a debt advisor be considered?**

A debt advisor can provide an FOB owner with guidance into the complexities of borrowing capital and can help find the right solution and partner. Unless an FOB owner is fluent in the details of debt issuance, the cost of such an advisor is well worth it.



Allows the FOB owner to continue to run the business as it has historically operated.

RETAINING THE STATUS QUO AND PASSING THE BUSINESS ON TO THE NEXT GENERATION

	Business Owner Retains Control	Achieves Highest Valuation	Provides Business Owner with Liquidity Event	Provides Business with access to additional capital/ expertise	Provides continued role with Business	Opportunity to Participate in Future Liquidity Event	Business will have Increased leverage	Increased Governance/ Reporting requirements	Maintenance of culture/ non-financial benefits of ownership
Retain the Status Quo	Most Likely	Least Likely	Least Likely	Least Likely	Most Likely	Most Likely	Least Likely	Least Likely	Most Likely
Key	Most Likely	More Likely	Neutral	Less Likely	Least Likely				

In this situation, the FOB owner continues to run the business with no change. This alternative preserves all liquidity options in the future, depending upon business performance and/or market conditions.

Benefits	Considerations
<ul style="list-style-type: none"><li>• FOB owner and management team continue uninterrupted</li><li>• Vision for the FOB remains intact with no near-term risk</li><li>• Many of the socio-economic benefits that are important aspect of FOB ownership are retained<ul style="list-style-type: none"><li>– Family members retain their attachment to the FOB</li><li>– As the FOB transitions to the next generation, there is an opportunity to deepen family bonds</li></ul></li><li>• FOB owner can consider a liquidity event at a more appropriate time for themselves and their family</li></ul>	<ul style="list-style-type: none"><li>• Most FOBs do not survive past the second generation - requires careful long-term planning, with identification of a successor</li><li>• Can put significant strains on the family if there are disagreements over who should take over management of the business</li><li>• Limits the liquidity opportunities in the near-term for the shareholders</li><li>• Limits access to additional growth capital – requires industry and subject matter expert resources be developed elsewhere =&gt; could impact competitive position in the market and drive the FOB owner to seek these resources</li></ul>

The questions to ask when evaluating the status quo and passing a business on to the next generation will be unique to each FOB and are beyond the purview of this white paper. Rather than questions to consider when evaluating a potential partner, these considerations will revolve around succession planning, resource availability and an FOB owner's ability to address their own liquidity and investment diversification needs. Many articles have been written to address this alternative.

## CONCLUSION

### **While Private Equity is a Great Alternative, the Only “Right” Answer is What is Right for Each Family-Owned, Founder-Run Business Owner**


Private equity has matured over the years and offers nuanced solutions that are a good alternative for FOB owners. Private equity can provide FOB owners with full or partial liquidity and certain firms can provide flexible capital to meet the specific needs of the FOB and its various constituents.

Private equity also provides expertise and capital to grow the business and offers future wealth creation opportunities to FOB owners who choose to retain a portion of their equity in the new investment, career advancement opportunities for the management team and others remaining with the business as well as new job opportunities for the community. However, as discussed in this white paper, other solutions, such as a sale of the FOB to a strategic buyer or a leveraged recapitalization may be better suited to the individual priorities of an FOB owner.

All FOBs are unique and each FOB owner needs to assess what is most important to them before making a decision. Achieving the optimal result begins with a clear view of one's goals and objectives, both financial and non-financial. Whatever the ultimate decision, it is only by understanding the benefits and considerations associated with each alternative and how they match up with one's own prioritization and circumstances that a seller will be able to determine the right path forward.



**Along with future wealth creation opportunities, private equity firms can provide liquidity, capital and expertise to grow an FOB.**



**Every situation is unique, based on what is most important to the FOB owner.**



## ABOUT INVESTCORP

Investcorp is a leading global provider and manager of alternative investments, offering such investments to its high-net-worth private and institutional clients on a global basis. The Firm generates investor and shareholder value through a disciplined investment approach in four lines of business: private equity, real estate, absolute return investments and credit management. As at December 31, 2018, the Investcorp Group had \$22.5 billion in total AUM.

Since its inception in 1982, Investcorp has made over 185 Private Equity deals in the U.S., Europe, the Middle East and North Africa region and Asia, across a range of sectors including retail and consumer products, technology, business services and industrials, and more than 600 commercial and residential real estate investments in the US and Europe, for in excess of US \$59 billion in transaction value.

Investcorp employs approximately 400 people across its offices in Bahrain, New York, London, Abu Dhabi, Riyadh, Doha, Mumbai and Singapore. For further information, including our most recent periodic financial statements, which details our assets under management, please refer to: [www.investcorp.com](http://www.investcorp.com).

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