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Once in a lifetime

Creating the right growth chemistry for Australian private and family businesses

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Australia is in the midst of the largest transition of wealth and leadership responsibility in our nation's history.

Over the next few years, PwC modelling estimates that more than 350,000 family and private businesses will change hands as owners retire, sell up or pass to the next generation. For many, it's their 'once in a lifetime' opportunity – a one-off chance to make the most of their hard work.

But when it comes to transition, not all owners have the same goals. While some prefer an outright sale, others want to maximise their company's growth potential before they exit or hand over the reins.

'Going for growth' can help increase the value in your business and ensure you – and your family – reap the benefits.

PwC's 'Once in a lifetime' report aims to help those owners thinking about stepping things up. It shines a light on the key issues and opportunities to consider, and explores what owners can do to take their business to the next level.

In particular, we focus on the role of 'private equity' as an option for family and private businesses looking for a path towards growth and, ultimately, a successful exit or succession.

Sanjiv Jeraj
Private Clients Leader
PwC Australia

Growth matters

The decision to grow your private or family business before you sell is an important one. Too often, owners leave 'money on the table' by going straight to a sale without considering the business's potential for growth.

But with the right expertise and the right kind of capital, many businesses are capable of getting bigger and more profitable.

There are lots of benefits to growth. The most obvious is that it can help increase the overall value of the business, and therefore the return to you and your family. But there are other reasons to consider too.

First, going for growth can assist with succession by providing pathways and incentives for the next generation to become more involved. Second, it can help you make your business work 'better' through the introduction of improved systems and processes, such as better financial reporting and governance.

Growing businesses also help the rest of the economy. PwC analysis has shown that the ***private and family business sector contributes over $600 billion to our national GDP*** and employs almost three million Australians. As these companies grow, they provide more jobs, attract inbound investment, support economic growth and a widening tax base, and increase the value of the nation's retirement savings.

In other words, growth matters, not only for owners but also for the rest of the country.

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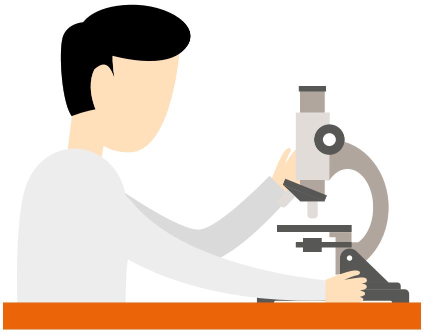

A capital opportunity

One of the biggest handbrakes to growth is the availability of the right sort of capital. Fortunately, in the current economic environment, there's a healthy supply of capital looking for a good home. ***In fact, investors globally are sitting on $1.7 trillion of 'dry powder'***[1] *– a term for money raised but not yet committed.*

This supply of capital represents a unique opportunity for private and family business owners, particularly considering the great transition of ownership that's currently underway in Australia.

But not all capital is created equal, and it's important to choose the right kind to help grow your business. The three most common are bank or corporate debt, initial public offering (IPO) and private equity.

Bank or corporate debt can provide a quick injection of funds, but usually, that's all. It comes with no additional skills or expertise, which are often just what a business needs when embarking on a growth phase.

IPOs can be an appealing alternative because, in addition to capital, they provide a mechanism for owners to sell down all or part of their share of the business. But it's not all plain sailing: both the cost and the heightened scrutiny from investors and other stakeholders that comes with being a public company can be significant. Typically, a business needs to be of a certain scale to make the expense and obligation of 'going public' worthwhile.

A third and increasingly popular growth option is private equity (PE). This form of capital typically involves a private equity fund buying a share of a private business and then helping that business to grow, and in doing so, increases the overall value of the business.

1 Bain & Company's Global Private Equity Report 2018, February 2018 http://www.bain.com/publications/articles/global-private-equity-report-2018.aspx

Benefits of PE

While private equity has suffered from a mixed reputation in the past, more and more businesses are coming to see it as a smart choice.

If you look at the industry's performance, it's not hard to see why. PE-backed businesses in Australia, on average, grow their workforces at a compound annual growth rate of 28 per cent over a five-year period. ***And globally, private equity has been the best performing asset class on a five, ten and 20-year basis.***[2]

But it's not just about increasing absolute returns: there are other reasons why PE makes sense for private and family businesses looking to grow.

First, it provides a level of sophistication, professionalism and expertise that private and family businesses sometimes need to take their business to the next level. This assistance may be in the form of better systems and processes, the ability to attract new talent, introductions and connections, access to new networks – both onshore and offshore, or industry knowledge and expertise.

Second, private equity provides an opportunity for owners to stay involved in the business and operate it on their terms, away from the public spotlight. Unlike after an IPO, PE-backed businesses are not obliged to disclose regularly, nor are they subject to the same level of regulatory or analyst scrutiny.

Third, private equity offers considerable flexibility. Over the past few years, PE firms have recognised the need to adjust their approach to better suit the needs of private businesses. Also, a wider variety of investors – such as ultra high net worth family offices and alternative asset funds – have entered the private equity market, investing across a wide range of asset classes and offering debt as well as equity capital solutions. As a result, PE investors are now negotiating longer-term investment periods – up to eight to ten years instead of the traditional three to five. Also, they're more willing to let owners take some money 'off the table' to de-risk the business or allocate towards personal goals.

Fourth, it's currently a 'seller's market' when it comes to private equity. According to a recent report by Bain & Company,[3] new capital is flooding the PE market and funds have ample money to spend. As a result, competition for deals is fierce and deals are being done at record high multiples. Private businesses can take advantage of the current market conditions when it comes to selecting a PE partner and negotiating terms.

2 PwC, The rising attractiveness of alternative asset classes for Sovereign Wealth Funds, January 2018 https://preview.thenewsmarket.com/Previews/PWC/DocumentAssets/498560.pdf

3 Bain & Company's Global Private Equity Report 2018, February 2018 http://www.bain.com/publications/articles/global-private-equity-report-2018.aspx

Striking a match: Patties Foods

Patties Foods, the company behind some of Australia's best-known food brands including Four'N Twenty, Nanna's and Herbert Adams, is well placed to talk about the pros and cons of public versus private ownership.

From humble beginnings as a cake shop in regional Victoria in the 1960s, the family business grew to become a major player in the food sector nationally, and in 2006 was listed on the Australian Stock Exchange.

But 'going public' was not without its challenges, as Richard Rijs, director of Patties Foods and son of the company's founders Annie and Peter Rijs, explains.

"One of the problems with being a public company is just that: being public. We were under much greater scrutiny and continually subject to the pressure of the next reporting season. It really impacted our ability to make practical, long-term decisions.

"In ten years as a listed company, we had doubled our revenue but saw our profit margin shrink. We were making less money and working twice as hard."

So in 2016, the family shareholders accepted an offer to partner with a leading Australian private equity firm.

"When we saw that the business was going backwards, we realised the only way we could capitalise on what we had was by becoming private again."

It turned out to be the right decision for both the Rijs family and the company.

"In a short space of time, our private equity partners brought in experienced, intelligent and commercial directors, who then appointed an outstanding senior management team. These people have transformed the business."

The private equity firm welcomed the ongoing advice and involvement of Richard and his brothers.

Another key advantage of 'going private' has been the enhanced ability to get deals done. In the 18 months since private equity came on board, Patties Foods has made two key acquisitions, bedded them down and immediately started to realise the synergies.

"That's just the sort of action you get out of private companies," says Richard.

"Our partners are very happy to have family members involved in the business. They are happy to benefit from our industry experience, which is important to them and important to us."

Is PE right for me?

Even though private equity offers many advantages over other forms of growth capital, it's not for everyone. Business owners need to ask themselves some tough questions to decide whether PE is the right option for both them and their business.

Consider...

- ***Do I really want to take things to the next level?*** Growth is rewarding but can also be challenging and risky.
- ***Do I want to be a participant in that growth?*** Private equity can be very 'hands-on', so it's important to be clear on how involved you want to be in the process.
- ***Is my business ready for private equity?*** Doing some basic housekeeping on your business can potentially lead to getting a better 'deal' from private equity. On the other hand, PE firms are expert at helping owners get their businesses ready for sale so leaving some value on the table now can be more than offset by the value realised at the point of exit.
- ***What's my preferred timeframe?*** While private equity can be flexible about timing, they generally go into deals with a specific time horizon in mind. Think about what will suit your goals and circumstances.

Top 10 tips for preparing to transition your business

Take your time	You will generally achieve a better result if you allow at least 6-12 months to properly plan the transition of your business.
Put family first	Take family objectives into account prior to embarking on a path to transition; small differences now can become magnified nearer the point of transition and put the process at risk or lead to family conflict post transition.
Know your buyer	The natural buyers of your business will typically pay the highest price; identify who they are and how they assess value so you can prepare your business to maximise valuation and competitive tension.
Make yourself redundant	If you are the key person running the business you need to step away and hire a strong CEO/GM and support team who can prove themselves for at least a year prior to transition; this will give a future buyer comfort the business won't fail without you.
Pay for some housekeeping	One of the biggest problems is a lack of investment in professionalising the business; sort out financial reporting and accounting, separate the owner's affairs from the business and tidy up legal and operational risks.
Work your EBIT	Every sustainable dollar added to the EBIT (Earnings Before Interest and Taxes) figure is worth 'x' times EBIT when you come to sell; ideally give yourself two years to realise profit improvement initiatives and demonstrate their sustainability to buyers.
Leave something for the next person	Buyers will pay more if there are opportunities for future growth, such as new products, geographic expansion, or new channels; plan and partially implement these opportunities so that buyers can believe them, and therefore be willing to pay for them.
Protect your sales proceeds	Any proceeds you make from selling your business will be after tax; make sure you have the right tax structure for sale. Also, draw up a wealth strategy for protecting your post-sale proceeds to meet retirement and succession goals.
Be prepared as timing can be everything	The M&A market in any given industry can grow hot and cold very quickly, and have a large bearing on valuation; get your business in a sale-ready condition as early as possible so you can respond quickly to changes in the market.
Above all, do your homework	You only get one shot at transitioning your business; engage the help of professionals when required; remember selling your business is very different to running your business.

Future focused: The journey of V.I.P. Petfoods

“It was a good business with lots of room to grow. And we wanted the family to stay in post the sale. My eldest son, Kent, stayed on as an employee and a shareholder.”

Tony Quinn and his family, founders of V.I.P. Petfoods, were no strangers to outside interest in their growing business. Over the years they’d been approached by trade buyers and private equity firms looking to buy into their success. But waiting for the ‘right’ opportunity proved to be worth it.

“To be honest, I was a reluctant seller. We were building factories, we were going places, we were doing things. We’d just set up a business in America. We were making good money - it was great times,” said Tony.

But Tony and the family were also interested in exploring opportunities to grow the business. After weighing up a number of options, Tony had an ‘a-ha’ moment.

“It was a really busy time. We were expanding in New Zealand and doing a lot of stuff, and I just felt that if anything happened to me – I was doing some car racing a well – there was going to be a real problem trying to run the business.

“So I said to my family ‘Hey, we’re going to sell V.I.P. Petfoods. It’s time to sell; it’s the right thing to do.’”

At that point, Tony spoke with PwC who recognised the potential for further growth and suggested exploring private equity as part of the family’s exit and succession strategy. They worked with Tony and the family to thoroughly prepare the business for a potential transaction, and then introduced the family to a number of potential partners with the right credentials and, importantly, the willingness to work with the family’s goals.

Tony and his family realised over $400 million from the sale of their business, reinvesting some of it back in the form of a minority stake.

Two and a half years later, having accelerated a program of investment and international expansion, and having acquired a number of complementary businesses, the private equity firm worked with PwC again and sold the business – now rebadged as The Real Pet Food Company – for $1 billion.

Both the private equity sponsors and the original business owners were able to realise significant value that neither could have created on their own.

Am I right for PE?

“We really want to grow but we don’t have the capital or know-how, is music to the ears of private equity.”

Partner
PwC Australia

Private equity firms have definite ideas about the kinds of businesses that they want to invest in.

While some firms will focus on particular industries or operations of a certain size, all tend to look for businesses that:

- Have high growth potential.
- Operate in a market or sector with strong tailwinds and are scalable.
- Would benefit from expertise, sophistication and focus.
- Would benefit from operational improvements (e.g. CRM, IT, financial systems).
- Have a founder and management team that are willing to work in partnership and are aligned around goals and objectives.

Creating a catalyst through PE partnership: Geotech Group

Bede Noonan, managing director of Geotech Group, wasn't even looking for private equity when an old mate introduced him to the director of a top Australian fund. But it turned out to be a fortuitous meeting for both parties.

Within a short period, the Melbourne-based business had grown to become one of Australia's largest civil infrastructure companies, lifting revenue from $50 million to over $300 million and employing more than 500 staff.

Bede says that one of the most important factors behind the decision to partner with private equity was the objectivity that it brought to the table.

"I recognised that in order to grow we had to take a more dispassionate view of the business. We had to bring in a professional board, as well as governance structures and processes appropriate for a growing business."

Bede also credits Geotech Group's growth to the 'de-risking' of the company that occurred once their private equity partner came on board.

"Private equity brought new skills and expertise and a large network, all of which gave us confidence to play in broader markets."

Although not necessarily evident at the time, another critical factor for Bede was the introduction of a corporate governance structure, and the 'psychological' impact of going from being an owner to one of a number of shareholders.

"Having that wider responsibility, where suddenly you're responsible to other shareholders, put me in a different frame of mind. I think it was a key ingredient in helping us really move forward."

"Private equity brought more than just financial investment. Whilst respectful of our size, private equity reinforced the importance of good corporate governance, and helped us establish a Chairman and Board to lead our growth story."

In April 2017, Geotech Group was bought by Spanish engineering giant Acciona in a deal that valued the business at more than $260 million.

Bede now heads the new company, Acciona Geotech, which brings together Acciona's future construction pipeline in Australia and New Zealand and the Geotech Group of companies.

"You need to be aligned personally – it's not just about going with the highest bidder."

Drawing on his successful experience with private equity, he has some advice for other private businesses that are considering going down that path.

"Explore what's out there and who's out there. Mostly, it's about the people you're interacting with."

Finding the perfect partnership

If you've considered these questions objectively and come to the conclusion that private equity might be right for you, the next step is to find the right partner. But choose wisely, it's probably one of the most important decisions you can make.

Here are some questions to think about when considering potential partners:

- Do they have relevant experience in similar businesses?
- Do they have a strong track record of success in similar styles of investment? If so, ask for references.
- Do they have a clear and shared vision around how the business should grow?
- What relationships and know-how (onshore and offshore) do they bring that will help drive growth?
- ***Is there chemistry around how you will work together as partners?***

"Choosing the right private equity firm for the founders is the beginning of a relationship, not a transaction."

Sanjiv Jeraj
Private Clients Leader
PwC Australia

A word from the Chief Executive of AVCAL

What private equity is all about

The business model of private equity is very straightforward: it involves professional and experienced investment managers putting equity capital and strategic support into a business to help that business grow and expand over time.

The types of businesses that generally make good candidates for private equity investment are those that have strong foundations and a track record of performance behind them, but are being held back from realising their full potential because they don't have sufficient capital, or they lack the expertise and strategic support needed to be able to establish new product lines, develop facilities to grow output, or get a foothold into new markets within the region, or around the world.

Some may see private equity as being exclusively focused on investing into large publicly-listed businesses, but in actual fact, most private equity investment in Australia is concentrated around small to medium-sized enterprises, across almost every industry sector of the economy.

Unlocking growth opportunities

Over the years, thousands of great family businesses in Australia have partnered with private equity investors to unlock and realise the growth potential of their business in a variety of different ways.

There are many examples of family businesses that, having been nurtured through their growth by the founders over the course of one or maybe two generations, get to a point where their capacity to grow further is constrained by one or more factors.

"Businesses that generally make good candidates for private equity investment are those that have strong foundations and a track record of performance behind them."

Yasser El-Ansary
Chief Executive
Australian Private Equity & Venture Capital Association Limited

It might be that the business doesn't have sufficient capital to fund the next phase of growth, or it could be that the strategic support they need to define and execute their expansion plans is not available within the existing management team. These are the types of situations where private equity investors can add considerable value as a long-term investor and partner in the growth of the business.

One of the very important attributes of private equity investment – which is uniquely different from all other forms of equity investment – is the fact that the investors can take a 'hands-on' approach to helping to grow the business with the founders and management teams. There is considerable flexibility about the approach they can adopt to doing that. Some private equity investors will look to take a majority stake in the business, whilst others will be looking at opportunities to be a minority shareholder: different strategies can be used to achieve the business's long-term objectives, and much depends on the circumstances of the business, and the in-house capability that might already exist within the management team.

Private equity investment can be a very effective mechanism by which to manage succession and leadership transitions within a family business. Having an outside strategic investor like a private equity firm partner with the founder can ensure that the right skills are brought into the business. This can help maximise the potential of that business to continue to grow in a sustainable way once the founders of the business move out of executive roles. Private equity investors can help to nurture second or third generation family members to step into management roles within the business, benefitting from the stewardship and guidance of experienced business executives.

A strong partnership

Success in any business venture generally comes about from a foundation that is built on a partnership between people who bring together skills and experience to make the whole: private equity investment is no different.

As a business owner, you should ensure that any private equity investors you bring into the business are a good all-round fit for what you need. Take time to meet with the potential investors on many occassions over a period of time, and in those discussions you should explore the specifics of how the investors will bring strategic support to help grow the business. Ultimately, the private equity investors need to be able to demonstrate the skills and experience they can bring to you, and share examples of how they have delivered value to the businesses they invested into in the past.

There should be a really strong personal connection between the founders and management team, and the private equity investors. It's critical that each side understands the challenges, concerns, and objectives of the other. It's a bit like trying on an item of clothing - have a look at the options, but in the end make sure you go with the option that is the best fit for what you're looking for.

Yasser El-Ansary is the chief executive of the Australian Private Equity & Venture Capital Association Limited. Yasser is a chartered accountant and has spent more than two decades working closely with a wide range of small, medium and large businesses across a variety of industry sectors.

Busting PE myths

Despite growing awareness about private equity, there are still a few myths and misunderstandings about the industry that need to be busted.

Myth	Fact
All funds are the same	PE funds tend to specialise and target specific sectors as well as businesses of a particular size. They also have their own unique cultures and personalities, approaches to investment (for example, hands-on versus a light touch), preferred investment timetables, preferred level of shareholding, and varying levels of offshore connections.
Funds can be hard to work with	The best funds have great relationships and make decisions collaboratively. This should not come as a surprise as it's in their interest to be like that. In fact, it's not uncommon for managers that have worked with private equity to say the experience was positive and they learned a lot from it.
Funds are out for themselves	Because both the fund and the owners have equity in the business, **it's in everyone's interest that the growth strategy works**. But it's important that owners also recognise that private equity is ultimately investing with the goal of seeing a return on their investment within a particular timeframe. That's why it's critical that there is alignment on both sides around goals and expectations.
PE is an expensive form of capital	The 'price' of private equity reflects their risk as a shareholder and takes into account many factors, so saying that it's expensive is an oversimplification. In fact, there are plenty of examples where PE was competitive with or paid a higher price than trade. Private equity will pay a fair price for the right business because, in the long run, they expect to see a return of two to four times the original value of their investment. And, of course, this means that the owner's share is also greater than would have otherwise been the case.

Take the next step

You only get to sell your business once. If you think that there might be more growth and value in it, then don't go out wondering – do something about it.

If you want to continue the conversation about 'going for growth', please contact:

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