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Private Equity Investment Criteria

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What is private equity? It is about building better companies.

Basically, businesses are acquired, held for a period (typically five to seven years) and then sold. During this time the investor has played an active management role in partnership with the executives with the objective of enhancing the value of the business.

The investment approach will vary but mainly it is to provide the strategic and analytic resources needed to build and grow sustainable businesses.

So what criteria are applied in these investment decisions?

1. **CASH FLOW**

- Sustainable EBITDA
- Look to boost this number
- Then on-sell the business at a premium

2. **PROFITABILITY**

- Documented strategies and business plan
- Initiatives already taking place to get there

3. **GROWTH PROSPECTS**

- Certain industries identified as too risky
- Some investors avoid start-ups and turnarounds
- Check competitors and industry specific metrics
- Benchmarking

4. **INDUSTRY**

- Experienced
- Competent

5. **MANAGEMENT**

- Avoid non-profitable contracts
- Look at the margins in each product

6. PRODUCT ANALYSIS

- Check expense control measures
- Cost management

7. EXPENSES

- 5 to 7 year time horizon
- 25% - 50% equity position
- Investment size ranges
- Will normally require a funding component
- Active involvement and representation on the management board

8. INVESTMENT

- Key executives encouraged to hold equity
- Due diligence

9. RISK MANAGEMENT

- Should be stipulated upfront
- Sale to another investor or back to the original owner
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EXIT

Private equity firms are successful in building quality businesses because of the alignment of interest with management. Their active participation in the running of a company and partnership with management are key factors.

And the simple answer to "why private equity?" is that they outperform and deliver higher returns than listed equities.