Exploratory Note 19

Later Stage Options – Sources and Strategies

**INTRODUCTION**

For almost a month, we have explored early-stage financing sources. In this second note of the evening, we shift attention to the sources of financing and capital strategies available to and developed for later-stage firms with a particular emphasis on acquisitive approaches. This information should be of interest to entrepreneurs as it presents some of the options available once significant growth has been achieved, details strategies that can be employed in earlier stages, and illuminates a host of larger entrepreneurial opportunities for those with a financial flair.

**PRIVATE EQUITY**

When you make the jump from early- to later-stage, we more-or-less enter the world of the buyout firms—often referred to as private equity (PE). How are buyout firms structured? What type of investment horizon do they have?

How are the management teams of buyout firms compensated? How do the fund’s investors make money?

***Leveraged Buyouts (LBOs)***

Though buyouts fall across a number of categories, most can safely be classified as leveraged buyouts (LBOs). What is an LBO? How does it work? How are returns generated?

Why is the use of debt so important?

In the third note of the evening, we return to this topic as I lay out a specific LBO example which explains the basic mechanics of such a deal in the context of an undervalued firm.

***Rollups***

Another somewhat common buyout strategy is the rollup. How does a rollup work? How is value generated in a rollup?

Can this strategy be utilized with early-stage firms as well?

Outside of the PE arena, smaller firms sometimes utilize the public equity markets to fund rollups as well.

***The Players***

There are many buyout firms in the marketplace; however, a recent top-25 list based on dollars raised over the last five year (in millions):

1 The Carlyle Group Washington DC $30,650.33

2 Kohlberg Kravis Roberts New York $27,182.33

3 The Blackstone Group New York $24,639.84

4 Apollo Global Management New York $22,298.02

5 TPG Fort Worth (Texas) $18,782.59

6 CVC Capital Partners London $18,082.35

7 General Atlantic Greenwich (Connecticut) $16,600.00

8 Ares Management Los Angeles $14,113.58

9 Clayton Dubilier & Rice New York $13,505.00

10 Advent International Boston $13,228.09

11 EnCap Investments Houston $12,400.20

12 Goldman Sachs Principal Investment Area New York $12,343.32

13 EIG Global Energy Partners Washington DC $11,345.18

14 Warburg Pincus New York $11,213.00

15 Silver Lake Menlo Park $10,986.40

16 Riverstone Holdings New York $10,384.26

17 Oaktree Capital Management Los Angeles $10,147.28

18 Onex Toronto $10,097.21

19 Ardian (formerly AXA Private Equity) Paris $9,805.25

20 Lone Star Funds Dallas $9,731.81

21 Bain Capital Boston $9,066.90

22 Hellman & Friedman San Francisco $8,900.00

23 Stone Point Capital Greenwich (Connecticut) $8,842.06

24 BC Partners London $8,590.11

25 JP Morgan Asset Management New York $8,207.87

**ACQUSITIVE GROWTH – ATTRACTIVENESS, RISKS, AND RETURNS**

Looking broadly at mergers and acquisitions across the spectrum of firm development, there is much that needs to be understood—from the attractiveness of acquisitive growth to the risks and potential (as well as realized) returns.

***Attractiveness of Acquisitive Growth***

Why is acquisitive growth attractive? What is it that acquisitive growth strategies offer?

***Risks of Acquisitive Growth***

For larger firms, a premium typically has to be paid if it is to be acquired. Why?

Now, acquirers frequently overpay for target firms. Why? What is the potential downside of overpayment?

For smaller (especially private) firms, this should be of less concern—though it is certainly still common enough. Why?

Deal price aside, what challenges are present when an independent firm is absorbed into another?

***Returns from Acquisitive Growth***

Acquisitive strategies have a somewhat checkered history; however, it is interesting to note that quite a few academic studies suggest that buyout firms appear to have somewhat consistently generated alpha as an asset class in the past.

**CONCLUSIONS**

In the third and final note of the evening, we return to several of these topics in the context of distressed investing.