Privcap/ Briefing

Context for Private Capital Investment

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Entrepreneurs and Private Capital

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Entrepreneurs and Private Capital

The Panelists

Nicole Walker
Director,
Baird Capital

Walker focuses on Baird's healthcare investments and has extensive experience in strategic planning. She was previously at Abbott Ventures and ONSET Ventures. Walker holds an undergraduate mechanical engineering degree from Stanford University, an M.B.A. from the Kellogg School of Management, and an M.E.M. from the McCormick School of Engineering.

Gretchen Perkins
Partner,
Huron Capital Partners

Perkins is responsible for managing Huron's business development and investment sourcing activities. She previously led acquisition sourcing at Long Point Capital and was vice president–business development for market research firm IRN, as well as holding senior business development roles at Fleet Capital and GE Capital. She holds a B.B.A. from the University of Michigan.

Raegan Moya-Jones
Founder and CEO,
aden + anais

Moya-Jones launched the baby supplies (and PE-backed) retailer aden + anais in 2006. The company was listed in Inc. magazine's 5000 Fastest Growing Companies in 2012 and in 2013 made the Crain's Business Fast 50, with 2012 revenue of $29.9M. She was previously a sales executive at The Economist Group and holds an MBA from Macquarie University.

The Moderator

Kerrie MacPherson
Principal,
Financial Services Office,
North American Entrepreneurial
Winning Women Executive Sponsor at EY

Kerrie MacPherson of EY, moderator

I'm going to start with you, Gretchen. I'd be interested to hear you talk a little bit about how you go about aligning the interests of the investor, in your case Huron Capital, and that of the investee company.

Gretchen Perkins, Huron Capital Partners

A critical part of any successful investment is the need to discuss alignment of where you want to take this company. Do you have shared goals, you and the entrepreneur, in terms of where we all want to take this company? You need to have a lot of conversations up front. The pace of growth that a private equity firm wants to achieve might be in excess of where the entrepreneur really wants to take it. The entrepreneur may or may not be comfortable with doing add-on acquisitions. And if that's something that the private equity investor wants to do, then you need to know that up front.

The second broad category of required alignment is personality. There are a lot of options for an entrepreneur when they are looking to take on a private equity partner, and the personality of the people on the deal team with whom you as an entrepreneur will be working—and the alignment of the personality of the firm, the culture of the firm—is very important.

MacPherson

Nicole, what's your perspective on this alignment question?

Nicole Walker, Baird Capital

I wholeheartedly agree with making sure that that discussion happens early on, that you are looking to find out what the goals are on both sides of the table from the very beginning. And personality is a huge component of that. Within the venture side of things, we also tend to focus on the fact that the past will inevitably change. What we believe the first idea or the first product or service should be, and what it should look like, will change just by the nature of how we start from a napkin with an idea and then move to the eventual deliverable. So [you have to make] sure, when you're working with entrepreneurs and small teams, that they're ready for that and that they have that skill set do that: having the discussion of when it might be time to change out management teams or certain members of that team; the CEO having a discussion early on whether this is a technology-driven CEO versus a commercialization-driven CEO; how we might get through that step and get that buy-in early from the entire team so that there aren't difficult conversations down the line.

MacPherson

So Raegan, we've heard from the investor side of the equation, and I know that you've had a couple rounds of private equity. Can you first tell us a little bit about your journey and how private equity has played a role in growing aden + anais, and then touch on this alignment question?

Raegan Moya-Jones, aden + anais

I had the idea in 2003, and I ended up getting to market in 2006, which was right around the time of the recession. So my access to capital was pretty much nonexistent, even though from the day I started [the business], it was heading in the right direction, and it's always been profitable.

I have gone through two rounds of private equity. The first fell in my lap a little bit. In September of 2009, I was approached by a strategic buyer to acquire aden + anais. My initial reaction to that was no, and then they offered me more money, and eventually I said yes. I got quite far down the process and then realized that it was the wrong decision, that I hadn't even scratched the surface of what I wanted to do with this business. So I pulled out of that deal, which was fine and well but then left me standing there going, "OK, well now how am I going to fund this business?"

I did what a lot of entrepreneurs do: I went to friends and family. That's how I funded the business from 2006 through till 2010. When I got to the point where I realized that going to friends and family just wasn't going to cut it anymore, I did start putting my feelers out for private equity and got lucky with a company called Seidler Equity Partners. When I was introduced to them, we just hit it off. There was a personality connection, and they invested in my business very early on. We'd come off of just under a $2M year, and we were looking to do $4M the year that they invested. They invested around May of 2010.

And Seidler stayed involved in the business until last year, when I went through a second round of private equity, and that was a much more formal process. We went out and got a lot of initial interest. I think we got 35 initial offers of interest, which was pretty amazing.

I felt very much like we were driving the process, that they had to court and win us over, because I was ex-

Advice for Entrepreneurs

MacPherson

If there was a single piece of advice you would give entrepreneurs listening in who are thinking about private equity and how it might be relevant to their businesses, what would that piece of advice be?

Moya-Jones

Choose carefully. As both Gretchen and Nicole mentioned, you're going to be working very closely with these people for at least four, up to seven, years. So it's very important that you pick the right partner and make sure that their vision for where they want the business to go aligns with your vision. Otherwise it's not going to be a very pleasant relationship. And follow your instincts—they're usually right.

Walker

Don't be afraid to fail. Sometimes your biggest lessons are going to come from the failures of it. That's actually one of the things that we will look for in some of our entrepreneurs.

Perkins

The relationship is key from both sides. From the entrepreneur's side, they have lots and lots of private equity firms to choose from. From an investor or private equity side, there are lots of companies in which we can invest. We all have lots of options, and so the relationship fit personality-wise is key.

tremely confident where I was taking this business. In terms of the type of partner that I was looking for the second time around, I knew how to take a business from zero to $40M. I wanted to bring on a partner that had firsthand experience with taking a business from $40M to $150M. I was looking for somebody that had experience in consumer goods and had a proven track record of that kind of growth projection, as well as a personality connection with the individuals, because I had no intention of going anywhere. I still wanted to run the company day to day.

MacPherson

Nicole, can you talk about how involved you expect to be in a company in which Baird invests?

Walker

On the early-stage side of things, from the very beginning, we go into it believing that we will probably spend a fair bit of time on working with the company, because our early-stage deals usually involve first-time CEOs. They're technologists who have a really fantastic idea. They know the science. They know the market but are probably not as strong in building a company and really what it means to work towards commercialization of a product or a service. So we'll spend a considerable amount of time either helping them build their team or helping to build a board or a strategic advisory board who can work with us and be that extra support system for both the CEO as well as the entire team.

I might spend two or three days a week on a particular company if it's early-stage. On the other side are our growth-stage companies that usually have stronger management teams. With those teams I can usually spend maybe a day a week checking in, seeing where they need my support, either in making introductions to potential bankers for acquisition or an M&A transaction, or if they're trying to get in front of other strategic acquirers or people who they would want to build relationships with.

MacPherson

Gretchen, what's your level of involvement when you're making an investment?

Perkins

We have 13 portfolio companies, and that's probably a good number. For any fund, we'll have between 10 and 15 portfolio companies, depending upon size. And we have three, maybe four deal teams here. Each deal team has a handful of companies for which we're all responsible. There's generally daily interaction between ourselves and the companies. We are not on-site with the companies at all. It's not like we take people from Huron and insert them into the management team at our portfolio companies. We're investing in businesses exactly like Raegan's, where the entrepreneur nine times out of 10 has no intention of retiring and exiting the business. They're looking for a partner for growth.

> "I always tell entrepreneurs to really do their homework about what it means to take on financing. Once you move out of that friends-and-family realm, if you're moving on to angel financing or even venture capital, [think about] what theat means for you in terms of the extra responsibilities associated with it."
>
> *–Nicole Walker, Baird Capital*

So we have quarterly board meetings in person. We have daily phone and email contact, monthly reporting and conversations about what's going on in the business. There are daily interactions, bouncing things off each other. We're there to provide resources to our businesses to help them grow faster than they could have otherwise, but we don't need to be there to help them run the business.

MacPherson

When we spoke the other day, Raegan, you said that you thought that Seidler, your first private equity investor, had really helped to shape you as a business owner. Can you talk about that?

Moya-Jones

Absolutely. They were way more than just a private equity investor for aden + anais. They became a true business partner for me. I was a self-taught CEO, and I was learning as I went. My background is sales, so I was always focused on revenue in terms of top-line revenue. And Seidler came in and really explained to me that they've seen companies go off cliffs and not grow the right way, and they really just taught me how to build a very healthy business, a successful top-line—and then even more successful bottom-line—business. I probably would have worked it out myself eventually, but they saved me from making a lot of mistakes.

MacPherson

Nicole or Gretchen, can you talk about this need to build structure and, as Raegan talked about, to understand that it's not just about top line, it's about healthy growth? And how much of the time that you spend with your investee companies is to help them build that infrastructure?

Walker

Building out the management infrastructure is a key part of every one of the businesses in which we have invested. When we partner with these entrepreneurs, most of their businesses are somewhere between $30M and $100M of revenue, and the entrepreneur has worn most of the hats and is still functioning at high levels wearing all the hats. Many of these businesses have a controller and a CEO, and that's the management, that's the C suite.

One of the first things we always do is insert a CFO. We're going to be bringing debt to the company in a fashion that's probably more organized and more robust than they've had in the past. Lenders are certainly willing to lend more to a business that has private equity backing, so you need a sophisticated finance executive in there to be able to deal with the lenders in the business.

Then there are other portions of the management team that need to be built out. One of our businesses we've invested in is an engineering-services firm, a really nice business with 16 locations throughout the United States. But that was basically all this company had in terms of employees. It had a collection of engineers, and the CEO was an engineer. They were all billing their own time, and it was very inefficient. Helping that business grow to be bigger, more real in terms of management infrastructure, is something that we've done. We've brought in a chief financial officer. We've brought in a VP of sales. They didn't have anybody generating sales. They were just all engineers who had relationships that were picking up the phone and responding to inbound requests for their business. And we brought in a chief operating officer, to help manage all of these multiple locations.

MacPherson

One thing we talk about in the EY Entrepreneurial Winning Women program is that an entrepreneur must determine what the things are that only they can do and to focus on those. So really work on the business rather than in it. As Raegan talked about, when you start out at the kitchen table, you're doing all of the jobs, and that's clearly not sustainable in the long term to get the kind of growth that both investors and entrepreneurs are looking for.

Walker

That's a really important point, and it goes back to the discussion we had earlier about knowing your fit with the firm across the table. Because I've seen it both ways where you have a novice team. Maybe they have never started a business before, but they're passionate about what they're doing, they know their technology, they know their market, and they're just driven to be successful—and as their investor, all I have to do is get out of their way and give them as many resources as they can to get there. The flip side of that is, I've seen many successful people roll out of large multinationals who now want to start their own businesses, and they get stuck sometimes, because it's a different mindset, where you have to have on many different hats and be really flexible.

MacPherson

So given that the title of this series is "Women in PE," in your experience, Gretchen, is there any difference between going down the investment road with a female entrepreneur and a male entrepreneur?

Perkins

Well, my data points on assessing female-entrepreneurially-owned business are more minimal than are opportunities with male-owned businesses, and that's unfortunately a fact. It's absolutely changing—and specifically for the two verticals that we invest in, consumer products and healthcare, you're seeing more women-owned businesses. There's not a lot of difference from an investor standpoint. We're looking for the same things in any entrepreneur: passion and knowledge and vision and enthusiasm and an ability to create a culture in an organization that wants to follow her or him.

If the business is specifically a product or a service targeted at women, we'd better see some women in the C suite. An example of a business that we looked at within the last year was a nail-art business—little stickers that you put on our nails for manicures—and it was two men who owned a business, and one was more the CEO/marketing guy and one was the numbers guy. There were no women in their management team, and we asked about that, since their product is clearly for women. They said, "Our wives give us a lot of information. They're really our link to the market." But they weren't at the company. In that case, we thought, "Well, there needs to be a female in the C suite of this business. The product goes directly to women."

MacPherson

Nicole, anything to add?

Walker

No differences in terms of what we're looking for from the entrepreneurs. Within the early stages of investing, from a numbers perspective, there still aren't a lot of women either as founders or as the heart of the early-management teams, and that's especially true for me on the healthcare side of the business, where we're not seeing as many women come through—more so if it is healthcare IT or healthcare services. In the traditional areas of devices, diagnostics, combination tools, you rarely see a female team or someone on the senior team who is a female. I'm hopeful that that will start to change.

MacPherson

Forgetting about whether it's a man or woman, is there a piece of advice that you two investors would give an entrepreneur who is looking to attract you as an investing partner?

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> *–Raegan Moya-Jones, aden + anais*

Perkins

Provided your business meets the size parameters that I outlined—minimum EBITDA of $5M and above—there's a lot you can do up front to properly tee your business up. That's something that entrepreneurs don't do on a consistent basis. They don't think years in advance. Sometimes it's responsive to something that's going on organizationally; maybe they have a shareholder, there's some dispute and one wants to be bought out, and so they're in the moment, saying, "Yes, let's go out and get a private equity partner so we can buy out my partner and I can take this business where I've really wanted to take it."

But there are people like EY who actually can do pre-sell-side due diligence on your business. They do a lot of the analysis of your cash flows and the sustainability of such, and add-backs that are able to be considered from an investor standpoint to really make your numbers solid and unassailable, because nothing destroys value more than us getting into a process and then finding out that the numbers that were presented to us initially actually are not accurate.

I would encourage any entrepreneur to make sure your numbers are solid on the front end. That's probably the biggest thing. Then, having a certain number of your management team in on your thoughts, which I know many entrepreneurs don't always want to do.

MacPherson

Nicole, anything to add?

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Walker

I always tell entrepreneurs to do their homework about what it means to take on financing. Once you move out of that friends-and-family realm, if you're moving on to angel financing or even venture capital, [think about] what that means for you in terms of the extra responsibilities associated with it.

Ownership, like Gretchen brought up, but also understanding who the firms are that you want to partner with, how they operate, and what they've brought the table for some of their other portfolio companies or people that they've interacted with, so it's not just a one-sided conversation.

MacPherson

It sounds like you'd suggest that an entrepreneur do some reference checking with other investee companies.

Walker

Absolutely. Not only from the perspective of finding out how the mechanics work, but also what some of the personality dynamics are and how that firm typically drives towards success. Other management teams, portfolio companies, or entrepreneurs that they've invested in in the past would give you tons of information on that. The second piece of advice that I always tell entrepreneurs is to really be able to articulate your story in a succinct manner. So you should know exactly what the need is, what benefit you're bringing, what differentiation you're providing to the market, and then how a potential exit would happen. And you should be able to get through that in about a minute, minute and a half. ◆

Webinar / Entrepreneurs in Private Capital

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