By: GEORGE PFEIL, Managing Director
G.L. Ohrstrom & Co.

Private equity, part 1: Debunking the myth

According to Thompson Reuters, as of January more than $500 billion of private equity (PE) was available for investment in U.S. businesses. While a majority of the available capital is for larger, well-known businesses (e.g. RJR Nabisco), most of the investments will be in small businesses. So what is PE capital?

PE capital is used to invest in or purchase operating businesses. In the late 1940s, "bootstrapping" was the common way in which businesses were purchased. An individual used his own money, and that of friends, to purchase a business with the goal to increase its value and provide consistent, long-term dividends. These financiers used leverage from banks, which created highly attractive financial returns for equity investors. My firm, G.L. Ohrstrom & Co., was founded in 1946 by one such financier, and today we continue our "buy and build" strategy using capital from the Ohrstrom family and their friends.

By the 1960s, the investment returns attracted insurance companies and pension plans. PE evolved into money management in which these financiers (general partners or GPs) used little or none of their own capital and obtained the vast majority of capital from institutions. Due to the institutionalized nature of this capital, the investment periods became much shorter in duration and, today, virtually all PE firms use this model.

What does this mean? While most PE firms share a remarkably similar business model, each is unique in how it increases value so let's begin by debunking a few myths.

1. All PE firms operate the same way — False. While almost all PE firms invest in businesses and within a few years sell, during this period of time there are many ways in which a GP can "add value." Some GPs are passive and simply monitor the management team's performance but most GPs focus on what they know and buy complementary businesses. Still others might pursue new growth initiatives, international expansion or pursue expense reduction.

2. PE firms don't add value, they are financial engineers — False. There are three ways in which a GP adds value to the investment: buy low, sell high and in between add value. Historically, the PE industry was comprised mostly of financial engineers who made a good living by buying low and selling high. Today's PE market is more efficient and consequently most PE firms have specialized in certain industries or types of businesses in order to add value.

3. PE firms will take over the management of your business — False. Most PE firms are staffed by investment bankers who have never managed an operating company and do not have the time or interest to manage your business. A PE firm typically assists with setting strategy, developing the management team and identifying opportunities that may not have been available in the past.

4. Once a PE firm has invested, everyone is in the same boat together — True and False. At the outset of the investment, a PE firm will aggressively pursue growth initiatives and explore all opportunities to increase value. In fact, most business owners will be surprised by a PE firm's thoroughness and decisiveness in trying to add value. However, as most PE firms remain invested for only a few years, its focus can change quickly. Once this change occurs, a PE firm will make short-term decisions for the benefit of the GPs and their institutions to improve their investment including cutting necessary business costs and delaying capital spending.

5. Value is the most important feature of the deal — True and False. If a business owner has no further plans to be involved in the business, then true. However, in most cases the owner, their families, colleagues, friends, etc. remain involved. In the latter case, the most important goal is to *find the best partner* that will also pay a fair value.

Next month, I will discuss how a business owner can pick the best partner in "Finding the best private equity partner for your business."

George Pfeil is a partner with G.L. Ohrstrom & Co. (GLO). GLO invests in businesses that manufacture engineered products or provide value-added services to industrial and energy end-markets.

For more information, contact Pfeil at gpfeil@glohrstrom.com.

BUSINESS **UPDATE**

Investment company creates long-term value for owners

G.L. Ohrstrom & Co.

G.L. Ohrstrom & Co. (GLO), founded in 1946, invests in companies that manufacture highly engineered products or provide value-added services to the energy and industrial markets. The company invests in family or management-owned companies with owners who desire either partial or total liquidity.

GLO has a long-term commitment to the management teams of its businesses with an average investment period exceeding 10 years. Alongside its management teams, GLO develops practical, long-term strategies and provides the resources required to create long-term value.

The company's "Buy and Build" business model has been successful for more than 60 years. Three prominent examples of this success include Roper Industries Inc. (NYSE: ROP), Dover Corp. (NYSE: DOV) and Carlisle Cos. Inc. (NYSE: CSL).

GLO is owned and managed by the Ohrstrom family and is headquartered in New York, with an office in Atlanta providing coverage of the southeast and the Gulf Coast.

Investment criteria includes:

- A minimum EBITDA of $2 million, representing no less than 10 percent of sales.
- Service providers including companies that provide consulting, compliance, monitoring, testing, maintenance and repair services.
- Manufacturers of products including mechanical, electrical and electromechanical equipment used by both OEMs and industrial end users.
- 100-percent purchase or majority recapitalization.

For more information, contact George Pfeil, managing director, at (404) 995-1722, gpfeil@glohrstrom.com or visit www.glohrstrom.com.