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Private Equity Bake-Offs

Investment bankers can differentiate themselves through a thorough and frank presentation, but winning mandates goes beyond the pitch

By Mark Jones

According to the dictionary, a "bake-off" is defined as "a contest in which competitors gather to prepare their specialties for judging." For purposes of this composition, the competitors are investment banks; the specialties are their "recipes" for selling companies; and the judges are private equity investors and their portfolio company management teams. Luckily for all involved, the process is certainly not tantamount to the reality show "Hell's Kitchen," but the pressure, especially in a slow M&A market, is conspicuous all the same.

As a partner in a 20-year-old-lower-middle market private equity firm, I am often asked by investment bankers to articulate the qualities we seek in the bankers we hire. That's an easier question to ask than to answer as each sale mandate carries its own set of unique issues: What's the industry? What's the company's size? What are the personalities of the management team? Distinguishing characteristics aside, there is much commonality to PE portfolio company divestitures as the primary goal of a PE firm is to sell companies for a substantial premium to their acquisition cost, preferably in an organized and prompt manner that is beneficial to their management teams.

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When River Associates, in concert with a management team, is ready to explore the customary "strategic options," we typically invite three banks to pitch. Our rationale for the number of invitations is influenced by our desire to involve management teams in the process as they are our partners and we think they can benefit from a few perspectives. Limiting the numbers means that each bank has a fair shot at winning the mandate.

How does a banker get on this "short list"? The quick answer here is relationship. But under the header of relationship, I would include such bullet point questions as: Have we seen enough sell-side transactions from the banker so that we understand their process and the quality of their product? In the deals we have seen from them, is the information straightforward and concise with the key issues clearly presented? Are our initial questions answered in a responsive and lucid manner? If we have attended a management meeting on one of these deals, is the team prepared and is the presentation impressive? Has the investment bank made an effort to get to know the majority of our firm, not just one person? Is the firm deep enough in personnel and resources to handle the assignment? And do we hear positive comments about the firm from our peers?

When decisions are being made from impressions formed in a short meeting, detailed preparation is paramount. Preparation is not limited to quantitative modeling. Preparation means the formulation of a comprehensive and engaging presentation and a clear declaration of why the firm feels that the company is an important and "center of the plate" opportunity for which the bank will achieve an exceptional valuation.

Preparation means asking questions about more than the data given to an investment bank since key attributes may not initially be obvious. Every company has unique characteristics and having a strong handle on the individual value drivers is a sure way to impart a favorable impression. Preparation means understanding the motivations of management as well as the PE firm. Also, in regards to management, they may not all be deal veterans. This last point is something to keep in mind when the conversation burrows deep in the weeds of M&A vernacular.

Most investment bank "pitch books" are similarly organized in that they generally provide an overview of the bank, initial thoughts on positioning of the portfolio company in the market, possible acquirers,

expected valuation ranges and an overview of the bank's process. Organizational similarities accepted, the maxim about "it's all in the delivery" is as valuable to an investment bank as it is to Jay Leno.

Candidly speaking, less is often more and everyone has limited attention spans. A four hour pitch is not necessarily twice as impressive as one lasting two hours. A well orchestrated and compelling pitch can easily be delivered in two hours or less. Two and a half or three may be fine, but at some point "TMI" — "too much information" — becomes the applicable texting abbreviation.

Further, please keep in mind that a pitch book should never be read to the audience. The presentation should be referenced in a casual, conversational style that conveys familiarity and preparation. Speaking of presentation, it should come across as practiced, not robotic. Talking points should smoothly transition from one banker to the next as that style conveys experience and teamwork. The presenters should be the bankers that will shepherd the deal from start to finish. The written and verbal presentation should come across as customized to the audience at hand, never canned.

In its overview, the bank should remember its audience. Years of experience are good. Years of experience with transactions and companies having similar dynamics as the one at hand are better. The key is to articulate why this assignment is important, why it is in keeping with the focus of the bank and why it will get senior level attention in all aspects of the process (the latter being a point that cannot be overstated).

Talking through a few "success story" tombstones can be informative, especially if those deals are analogous to the transaction on the table. Industry knowledge is an attribute, but certainly not the only factor. If a firm does not have transactional experience in a specific industry space, that's not a deal breaker. Certain sectors are part of a larger industry. If you have worked within the broader industry, then say so. And experience in business types (manufacturing, distribution, retail, business service, et cetera) is often portable to related businesses. As such, highlight the applicable sector. The bottom line is that I may be just as willing to hire a banker who clearly presents the key value drivers of my widget company as one who has multiple tombstones in the widget industry. If there is something unique about your shop, speak up. PE firms are often looking for "tie breakers."

Positioning of the company in a sale process is a key aspect to any pitch. In a sense, the banker is taking a first pass at writing the executive summary for a confidential offering memorandum (COM) and thus highlighting the most appealing characteristics of the company. Admittedly, this is a chance to pat the management team and equity group on the back for presumably a job well done. What has made the company successful historically and what core competencies are sustainable so as to ensure future success? One investment banker friend said it best in that "you gotta have some sizzle for the next guy."

Similarly, be forthright about potential detractors of value and, if possible, suggest how those weaknesses might be mitigated in a process. These issues may be aptly termed "areas for further discussion." Easy to read charts and graphics can be quite helpful in this regard. The discussion of potential future strategic and financial partners can be a time for the investment banker to shine in that past experience with the relevant buyer universes can be highlighted. A word of caution here is to periodically check to make sure the financial buyer list is up to date. PE groups can sniff out a dated list as it's a small world.

I confess my guilt on the crime of skipping ahead in more than one pitch to the section on valuation. After all, what PE professional is not curious about their potential carry? To say the least, this is a tricky subject to address. A banker wants to win the assignment and realizes that there is a competitive process afoot, but also knows that he is speaking to an informed audience that will expect him to deliver on his appraisal. As such, the valuation needs to be realistic. Most pitches utilize a variety of valuation measures: LBO, comparable transactions and public companies and discounted cash flow analysis. These methodologies are further influenced by the then current macro-economic drivers, specific industry dynamics and the general capital markets environment.

Today for example, the dearth of cash flow oriented senior debt providers can be a particularly relevant influence on purchase price for a financial buyer of a company that has few tangible assets. I typically see a valuation range with the width of that range varying from banker to banker. In a recent pitch, two bankers had a range that spanned a 1x multiple of sales (i.e., a range of 6x to 7x Ebitda) while the other had a range of a 0.5x multiple. I'm sure each banker has individual rationales for the range they choose as the estimates are one part science and one part art.

One issue worth mentioning here is that no one can spend a valuation. It is simply a set of numbers on the paper. Many sellers believe that the market will ultimately determine the price regardless of the initial valuation. As such, an investment banker would be wise to highlight their historic ability to close deals in excess of their original valuations. This aspect of their history might be considered an investment bank's "value add."

One of my favorite quotes about valuation comes from a well respected industry veteran: "This is about process. We don't tell people what it is worth; we tell them why it's a great company."

Selecting a winner of the bake-off is influenced by a myriad of factors, the aforementioned qualities included. One thing is for certain: an equity group gets a handful of opportunities to put wins on the board and the selection of an investment banker is an integral piece of the process. A key determinant of PE lifespan (i.e., returns to their LPs) is being entrusted to a third party and will ultimately land with a firm who presents themselves as experienced, hungry for the business, excited about the opportunity and confident that they can achieve superior results. Finally, a statement of the obvious is in order here. The sale of a portfolio company is first and foremost a sale. If after a pitch, a PE group feels that the investment bankers were great salespeople, trust me, that is not a pejorative. Quite the contrary. It is fair to say that one hallmark of being a great salesperson is the ability to sell oneself. Oftentimes, the efficacy of a pitch is measured by this yardstick.

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