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Capturing Value for Future Growth



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Middle market investors occupy a distinct and important niche in the U.S. economy, and more so than with any other investment stage, it is critical for these investors to articulate concrete growth strategies to capture the value of future growth in the companies they helped to build. Middle market investors generally are not asked to take start-up or technology risk of venture capitalists, nor are they asked to assume many of the competitive and mature market risks characteristic of larger capitalization investments. Instead, middle market funds face more of what we call inflection point risk – the risk that arises from a combination of participating in (and sometimes creating) growing niche markets, building company infrastructure and formulating long-term strategic growth plans.

At exit, growth investors generally are not touting the multi-billion dollar next big market, nor can they rely on volumes of Wall Street research to validate growth opportunities to their buyers. What is required in most cases is significant legwork to define, understand and present an emerging or niche market that may be too small to be followed by analysts and too developed to be presented in a nebulous manner. Further-

more, because of investment horizons and the continued growth prospects of their most successful investments, funds often exit companies that present new owners with continued above-average growth prospects.

In a crowded market that sees all too many hockey stick projections and few less than rosy projections, how can sellers that they are rewarded for making the right decisions to prepare a company for future growth? We find the most important things to remember when selling high growth companies are: 1) looking at the company with a new set of eyes; 2) doing your buyers' due diligence for them; 3) becoming your own research analyst and 4) making your growth story iron-clad.

Taking a Fresh Look

After being involved in a business for three to five or more years, it is beneficial to have new perspectives on your companies, whether from experienced outside board members, industry thought leaders or your advisors. In the case of Chemical Information Services, we engaged in a number of brainstorming sessions with management in order to make sure we were presenting the most attractive story to potential buyers, and we were able to facilitate very productive discussions with the ultimate buyer that uncovered additional growth opportunities. While not all ideas were good ideas, the supportable ones helped achieve an attractive sale.

Do the Work for Your Buyer

One thing we stress with all of our clients is that there is no such thing anymore (if there ever was) as an unsophisticated buyer. Legal, accounting and buyers' internal due diligence teams are almost sure to uncover every piece of information relevant to their purchase, so we stress putting all issues on the table prior to launching a process. The easiest way for a good company to distract a buyer is to have issues uncovered as closing approaches.

Become Your Own Analyst

We often find that referencing Wall Street or other third-party research, if it is even available, is inadequate for the sale of a high growth business. In most of our client situations, we engage in our own market sizing analysis and conduct primary research when necessary. In our sale processes, we have found these bottoms-up analyses more valuable than any up-and-to-the-right bar chart. With instruction, we examined educational technology buying cycles and potential market sizes to illustrate the Company's potential growth and came up with a compelling growth story based on company dynamics and the overall market potential.

Sweating the Details

It also is imperative to examine the dynamics within the company's current customer base or other historically supportable future growth drivers. In a current sale process, we were very excited about the company's performance, but needed a way to quantify the company's growth prospects. After analyzing all order data from the company's 30,000 individual users over the past five years, we were able to construct a very defensible customer profile over time. What astounded us, and our client, was that the company could almost meet its 50% revenue growth target simply by properly developing its existing customer base at the same rate as it had in the past. New customers were almost all upside, which gave us a great story to tell to potential buyers and a way to differentiate our clients' story from others in the market.

The recurring need to exit rapidly-growing businesses makes it critical for middle market funds to capture value for the future growth of their investments. While there is no sure prescription for success, we find the return on the work above more than justifies the effort.

ABOUT THE AUTHORS

Mike McGill is a Managing Director, and Eric Wenick is a Principal, at MHT Partners, a middle market investment bank that focuses on emerging growth companies. Prior to founding MHT Partners, Mr. McGill was an investment banker with Lehman Brothers, Donaldson, Lufkin & Jenrette and CS First Boston. He earned an MBA with distinction from The Kellogg Graduate School of Business and a BBA from Southern Methodist University. Prior to joining MHT Partners, Mr. Wenick was an investment banker with Donaldson, Lufkin & Jenrette. He has an MBA from Stanford Business School and a BA from Yale University.