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Growing a Venture With Private Equity: A Buy-and-Build Approach

Ted Clark

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EDITOR'S NOTE: In this interview with EIX, a seasoned entrepreneur and executive sheds light on a particular pathway to growing a venture – one in which acquisitions and private equity play a central role.

Theodore (Ted) Clark is an entrepreneur, executive, investor, and former executive with over 40 years of experience in both public and private specialty chemicals companies. Starting as a shipping clerk, he rose through the ranks to become President & CEO of Products Research & Chemical Corporation (PRC), a global leader in aircraft and construction sealants and coatings. Then, drawing on his industry experience, Ted co-founded another company, Royal Adhesives & Sealants. He grew that business over the next 15 years before arranging its sale to industry giant H.B. Fuller in 2017.

Here, reflecting on his experience, Ted explains what's involved in partnering with private equity firms the challenges of acquisition-based growth, and the best timing and strategy for growing a business.

Building His Business

EIX: Please tell us a little about how you launched Royal Adhesives & Sealants.

Ted: I spent over 26 years in the adhesives, sealants and coatings industry, working my way up from a shipping clerk to CEO of PRC, a global developer of adhesives, sealants, and coatings. So, I knew the industry and markets it served well and had a strong network of industry professionals to draw on, as well as significant M&A experience during my time at PRC. When the PRC shareholders decided to sell the company, I partnered with a private equity firm to put in an offer but, unfortunately, we were out-bid by PPG Industries. I decided to leave PRC, and put my experience to work in another venture.

After a short stint helping to restructure a rubber products business, I began to develop a business thesis and business plan to build from scratch an industry-leading adhesives & sealants company. I then set out to find a private equity partner to pursue a buy-and-build strategy, with the goal of building a $300-$500 million adhesives & sealants business through a very disciplined M&A approach.

I recognized that it was a stretch goal, but possible because the industry was large and very fragmented. It had lots of attractive acquisition targets that would fit into the matrix of markets and technologies that I thought would create a winning business.

With my vision in place, I began the team-building by finding an experienced M&A buy-side advisory firm that specialized in matching industry executives with private equity firms interested in executing buy-and-build strategies, and I selected a private equity firm to work with. We formed a partnership involving me, the buy-side advisory firm, and a private equity firm, and together we began the process of finding a platform company from which the new company would be built. We were able to move from developing the thesis, forming the partnership, and finding and closing on the platform company acquisition in less than nine months.

How 'Buy and Build' Works

EIX: You've described your approach to growing a venture as a "buy-and-build" strategy. How does this work?

Ted: When developing a buy-and-build strategy, you first need to determine if the industry you are looking at has certain important characteristics. You need to consider the size of the industry or markets you are targeting, and whether the industry or market is fragmented enough to assure a good universe of acquisition targets. You also need to determine the average valuations and free cash flow characteristics of typical companies in the target market, and then model

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out what a theoretical buy-and-build value creation financial model might look like for the platform company. Then you need to think through add-on deals using assumptions for synergy targets, integration costs, and underlying organic growth.

It is also important to develop a simple mission statement of what kind of company you want to build; which industry and markets to you intend to focus on; and what technologies, products, services, and geography are needed to fulfill the intended mission. Next you need to develop a list of potential platforms and add-on acquisition targets; determine if they meet two or more of the criteria listed in the mission statement; and then develop a dossier on each and a plan to develop relationships, as part of executing an intentional M&A sourcing strategy.

While it is possible to get outside consultants to do this kind of work, it is not a substitute for finding a “purist” industry executive to lead the strategy -- someone who knows the industry, markets, and technology from the bottom up and who understands the global macro trends that help define long-term strategic plans. Executing a buy-and-build strategy is not easy. It requires significant leadership experience and a track record of originating deals and integrating businesses to achieve cost and growth synergies, create high-performance leadership teams, and establish a company culture that reflects the values, expectations, beliefs, and practices that support rapid organic and inorganic growth. At the same time, you will need to efficiently manage operations, working capital, and cash flow critical to supporting the flow of add-on acquisitions.

Benefits and Drawbacks of Private Equity

EIX: When early-stage entrepreneurs think about financing, they often think about angels or venture capitalists. But they might not think about private equity as a source of financing that can help them. What can private equity firms offer entrepreneurs?

Ted: It depends on what the entrepreneur is trying to accomplish. For those with a great idea that needs funding to get off the ground, it makes sense to try to find an early-stage investor to back them with private capital – like family or friends, an angel investor, or a VC fund with expertise to help grow their business plan. Private equity firms, on the other hand, look to invest in companies with established cash flow and a clear growth strategy.

Private equity is a good option for entrepreneurs who have a good value creation idea to change the current paradigm of an industry and execute the plan by acquiring an existing business. These entrepreneurs might start by acquiring a business and offering a new value proposition to customers to increase organic growth, and then expanding that model with additional acquisitions to rapidly grow the business, using the cash flow of the current businesses to help finance the add-on acquisitions.

It is also important to understand that private equity firms come in all shapes and sizes. Some specialize in investing in companies in the lower middle market of $5 million to $50 million in annual sales; others invest in middle market companies with $50 million to $500 million in annual sales. Larger private equity firms invest in upper middle market companies with $500 million to $1 billion in annual sales, and the very largest private equity firms invest in large companies with more than $1 billion in sales. In addition, private equity firms now more than ever are specializing in different industry and market segment verticals, including technology, aerospace, industrial, retail and so on. The upshot: finding a private equity firm that is right for your business plan is an important part of leveraging private equity capital to build a business of your own entrepreneurial design.

EIX: When is private equity *not* appropriate for a growing firm?

Ted: Private equity investors are control investors. If your goal is to remain in control of your business for a long time, private equity may not be the right investor for you. Many great companies are built by entrepreneurs who are also controlling owners, but at some point those entrepreneurs may want to diversify their wealth and be more inclined to recapitalize with a private equity firm. This helps owners retain a significant minority stake and get a second bite of the apple when the private equity firm eventually exits its investment, five to seven years in the future.

Growing the Right Way

EIX: Scaling a business can be tricky. How do you know the right time to grow? And how do you get

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the sequence of steps right?

Ted: The sequencing of steps is a critical factor in buy-and-build growth strategies. The first phase involves finding a solid platform acquisition as the base for future growth; the next phase involves finding, acquiring, and integrating strategically important add-on deals. As for the timing question, it is important to evaluate private equity-backed deals based on how the target companies have performed in the past. Research how they performed through recessionary, inflationary, or black swan events like the global pandemic, to determine the company's pricing power, ability to reduce working capital, and variable costs in a recession and so forth. This helps you pressure test the investment models to help determine what you might offer for the company. It also helps you develop contingency plans that will still allow you to achieve your goals, even if on a slightly different timeline than originally planned, if necessary.

Advice for Entrepreneurs

EIX: After 14 years of growth, you sold Royal Adhesives & Sealants to HB Fuller. Based on that experience, what advice would you offer to other entrepreneurs contemplating a sale?

Ted: Well, first it is important to remember that private equity firms are investing in deals that they hope will pay off in five to seven years. Also, they are control investors and, therefore, they ultimately make the decision to sell. Most private equity firms I have worked with do work closely with the CEO and management team to agree to the optimal time to sell within the five-to-seven-year investment time frame.

And keep this in mind: When you are working with private equity you are essentially an operator/investor and all your incentives are aligned with those of the private equity firm. I have found that the private equity firms I have worked with have given me a say in choosing the ultimate buyer, especially when the offers are close. I've worked with three different private equity firms, starting with my first private equity partner, with which I acquired my platform company; then seven years later recapitalizing with a second private equity firm; and then five years after that recapitalizing again with a third private equity firm, before selling to a public company for the final time, 2 1/2 years later. In the 14 years since closing on the first platform company, we closed 18 additional acquisitions. We started as a regional adhesives & sealants company with $35 million in sales and built a global adhesives & sealants company with close to $700 million in sales and an enterprise value of $1.6 billion. With the support of these private equity firms, I was able to actualize my entrepreneurial vision to create a business worth significantly more than the sum of its parts.

You can learn more about Ted's experiences at the website, ShippingClerkToCeo.com (https://shippingclerktoceo.com/) *. And in his book,* ***Buy and Build CEO: Leveraging Private Equity to Build a Winning Global Business*** (https://www.amazon.com/Buy-Build-CEO-Leveraging-Business/dp/1945401192/) *, which was released last month from Dudley Court Press.*

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