BUYOUTS

Talking Deal Prices: Offering owners a second bite at the apple for lower PPMs

April 3, 2017 By Steve Gelsi

- Entrepreneurs, owners keep stakes after buyout
- Founders offered greater returns down the road
- CD&R and HGGC tout this approach

Say you founded a viable industrial or software business and are thinking about selling it for a good price. You find an investment bank, hold an auction and cash out to a strategic or a buyout firm for 10x EBITDA or much more in the hot tech or healthcare sectors.

It's probably a great deal for you but maybe not so much for the buyout firm that plunked down enough money to beat out the crowd.

Another path price-wary GPs are pursuing may appeal to founders as well as LPs worried about lofty purchase prices eating into their returns.

It's called a second bite at the apple. Instead of selling an entire company, owners accept a lower purchase-price multiple and roll a chunk of their equity into the new platform company. If the company grows as planned, the founders pocket more of a gain down the road than if they'd sold all of it.

Clayton Dubilier & Rice champions a similar method. Under its so-called partnership transactions or solution-capital deals, CD&R finds sellers and other stakeholders willing to reinvest in businesses, often outside the competitive auction process. The firm touts the approach as a unique sourcing angle.

Among such deals, **Ingersoll Rand** retained a stake in **Hussmann** when it sold the refrigerator company to CD&R in 2011. When **Panasonic** bought Hussmann from **CD&R** for $1.55 billion last year, the deal generated additional return for IR.

In the middle market, **HGGC** works to avoid overpaying for deals through its partnership-investing approach, which involves a seller rollover.

Among the Palo Alto, California, firm's deals of this type, it teamed with founder **Doug Troxel** in its 2014 buyout of **Serena Software**, an IT firm, from **Silver Lake** for $454 million. Troxel rolled his 30 percent equity stake into the company and added more cash to own 49.9 percent of Serena at the close, while HGGC held 50.1 percent.

Teaming with management, HGGC stabilized revenue by revamping its products, increasing customer-retention rates and energizing its sales team.

In 2016, HGGC sold Serena Software to **Micro Focus International** for $540 million, about $100 million more than it paid. During its hold period, Serena Software's EBITDA margin widened to 53 percent from 45 percent and operating expenses dropped to $55 million from $74 million. Because of these and other factors, HGGC realized a gross money-on-money gain of 2.1x in about two years on the deal.

Of course, HGGC used plenty of its secret sauce and some personal connections in the process.

HGGC CEO **Rich Lawson** told *Buyouts* he'd known **Credit Suisse** banker **Chris Gaertner** for 25 years, from when they worked together on Wall Street. CS introduced Troxel to HGGC outside a traditional sales process.

The firm also had to use its proprietary skillset to assess whether Serena Software, which had been in decline, was in a death spiral or ready to bounce back.

HGGC tapped the star power of its co-founder, former San Francisco 49ers quarterback **Steve Young**, by bringing Serena Software executives to mingle with prospective customers at **Monday Night Football** gatherings held at live events.

In a testimonial provided by HGGC, Troxel said investing in Serena a second time marked a big decision for him, but he and HGGC shared a vision for the business. He also said he was thrilled to play a larger role in the company's turnaround strategy.

As HGGC marks its 10th anniversary in 2017, Lawson said the firm has averaged a purchase-price multiple of 8x EBITDA on deals, even as prices remain frothy.

To be sure, HGGC's account of the Serena Software deal most likely includes plenty of positive spin. But it does appear to show the benefits of spotting downtrodden tech names.

Investors in the sector tend to inflate their pet companies while crushing players that miss a beat or two. Finding a relatively inexpensive company isn't that hard, but successfully tapping that company's potential takes skill and hard work. Partnering with company owners and their egos may not always be a piece of cake, either.

Nowadays, some buyout pros may claim that 14x EBITDA is the new 11x for purchase-price multiples. But others may prefer a potentially less expensive path of letting an owner or entrepreneur into a deal to help their baby shine.

Action Item: Reach HGGC's Rich Lawson: +1 650-321-4910

HGGC's Rich Lawson (left) and Steve Young flank Serena Software CEO Greg Hughes. Photo courtesy HGGC.

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