PRIMEIRO PARTNERS

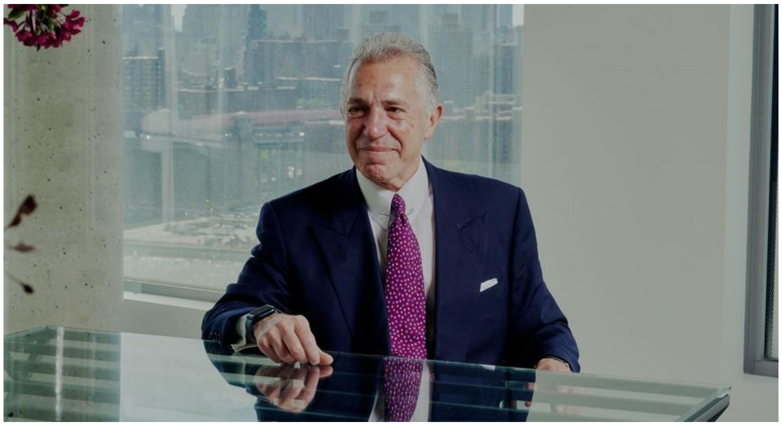
The Daily Dispatch

Weekly Special Feature

September 23, 2022

Who Will Inherit the Family Business? Often, It's Private Equity

By: Miriam Gottfried *(Published on September 17, 2022)*



Neal Rosenthal sold a stake in his wine-importing business and stayed on as CEO. Wall Street Journal.

Neal Rosenthal found a different kind of heir when he set out to craft a succession plan for his wine-importing business a few years ago.

Mr. Rosenthal wasn't ready to give up the company he started in 1977 out of a liquor store connected to his parents' pharmacy in New York City, on Manhattan's Upper East Side, and his daughter wasn't interested in taking over. So Mr. Rosenthal sold a stake in the business to a buyout firm and stayed on as CEO.

"I am confident that if I dropped dead today, my business would continue on without me," said Mr. Rosenthal, 76 years old.

Private-equity firms are joining America's family businesses. The industry that made its name taking private big corporations has shifted its focus to smaller targets, snapping up car washes, pet-food makers and specialized manufacturers, some of which have been family-owned for several generations.

Family businesses hold particular appeal for buyout firms, and they are throwing out the traditional private-equity playbook to attract them. Management is often left intact. Owners keep big stakes. Buyout firms pledge to retain employees and plow more money into the businesses.

Still, some buyout targets end up carrying heavy debt burdens that can turn a once-profitable company into a money-losing one. Families might ultimately cede control when the business is later sold so their private-equity owners can realize gains. Communities and workers, by extension, can lose their personal ties to a company's ownership.

At the same time, the deals help aging business owners ensure a future for their companies after they are gone. Many are finding that their own children aren't interested in taking over. Those whose children want to remain involved recognize that their offspring will need additional technological and financial know-how.

Even owners who want to keep working are often looking to untangle some of their wealth from their businesses. They are ready to share the risk they have shouldered alone for years, but they aren't prepared to cede their legacy to a bigger competitor.

For Mr. Rosenthal, a top concern was preserving his decadeslong relationships with winemakers in Italy, France, Switzerland and Spain.

After reviewing nine bids, including one from a bigger wine company, he and his wife and co-owner, Kerry Madigan, chose to sell a majority stake last year to Pittsburgh private-equity firm Incline Equity Partners.

Since Incline invested, the holding company that owns Rosenthal Wine Merchant has bought one of its distributors and another boutique wine business. Mr. Rosenthal identified both of the targets but said he wouldn't have approached them without Incline's backing.

"For 45 years, it's been our capital at risk," he said.

Companies in the same or adjacent businesses looking to bulk up had long been seen as the buyers of choice. They could pay more—mergers of like businesses often generate significant cost savings—and quickly grow sales. Lately, though, deal-hungry private-equity firms have been outbidding these strategic buyers, bankers say.

Private-equity firms can pay more when companies they already own do the acquiring, essentially acting as a strategic buyer. Sometimes they buy up numerous companies in the same industry and merge them together.

A family business that hasn't been touched by private equity or public shareholders can offer a path to the biggest profits because most of the financial or operational levers that could juice returns—making production more efficient, beefing up contracts, merging with competitors or funding expansion into new markets—have yet to be pulled. Many such businesses carry little debt.

Buyouts involving between $50 million and $99 million in equity—the portion of the purchase price that isn't financed with debt—have had median returns of 25.4% since 2010, compared with 19% for deals $1 billion or higher and 23.4% for all deals, according to DealEdge.

In 2014, some members of the Lang family were approaching retirement and looking to cash out of their 80-year-old pet-food business. L Catterton, a Greenwich, Conn.-based private-equity firm that invests in consumer brands, spotted an opportunity.

Americans' growing obsession with their pets had recently spurred Ainsworth Pet Nutrition LLC to shift its focus to growing its premium offerings under the Nutrish brand, a partnership with celebrity chef Rachael Ray. L Catterton wanted to bring the brand to the mass market.

But first the firm had to win over the Langs. L Catterton Co-CEO Scott Dahnke trekked to the company's headquarters in Meadville, Pa., which sits about two hours from a major airport, and was grilled for three hours by four family members and the company's CFO.

"It was like a political town hall for them where half of the people are progressives and half the people are conservatives," Mr. Dahnke said. "Somehow I survived that initial meeting."

The family opted to sell a 42% stake at a $200 million valuation but gave L Catterton free rein to run the company.

Ainsworth paid down debt, expanded its marketing budget and cleaned up its contracts. It broadened its product offerings and moved into new distribution channels. The company acquired Triple T Foods Inc., which had manufactured some of its products. By 2018, annual sales of the Nutrish brand had grown sixfold to $700 million.

When J.M. Smucker Co. bought Ainsworth in 2018 for $1.9 billion, L Catterton and the Lang family earned a whopping eight times their money based on the value of their stakes when the private-equity firm invested.

"It really is the American dream," said Sean Lang, Ainsworth's CEO when L Catterton invested.

L Catterton Managing Partner Andrew Taub, far left, and co-CEO Scott Dahnke, far right, with members of the Lang family at a dinner in 2018.
PHOTO: AINSWORTH PET NUTRITION

Buyouts can come at different points in a company's life cycle. Some involve taking a public company private; others are meant to prepare a private company to go public someday. Private-equity firms often buy companies from each other, each one nipping and tucking and tweaking the business model to extract more profits along the way. Sellers who retain a stake can also reap huge rewards when the business is sold again.

Bill Clendenen sold his Eugene, Ore., workplace safety company to private-equity firm Riverside Co. in 2006. In 2012, Riverside sold Health & Safety Institute Inc. to another firm, DW Healthcare Partners of Toronto, which then sold it back to Riverside in 2015.

In 2019, Riverside sold HSI to Chicago-based Waud Capital LLC. With each subsequent sale, Mr. Clendenen has retained a stake in the company, and each time he has earned more than three times his money.

The company has grown so much that the check Mr. Clendenen received from his less-than-5% stake in the most recent sale to Waud was bigger than what he and his original partner received when they first sold in 2006.

While he no longer works for HSI, Mr. Clendenen still owns a small portion of the company and expects to collect another check when Waud sells it.

"It has transformed my life and my family's life," he said. "A lot of people think private equity is there just to slash and burn, but this has been all about growth."

Buyouts typically increase risk because a significant portion of the purchase price is financed with debt. Scores of private-equity-backed companies have gone bankrupt under the weight of debt loads they couldn't afford, resulting in the loss of thousands of jobs.

Those risks extend to more workers and communities as private-equity firms buy up more companies, a concern that has led to attempts by lawmakers, including Sen. Elizabeth Warren (D., Mass.), to further regulate the industry.

Private-equity firms and private-equity-backed companies employed 11.7 million workers who earned a total of around $900 billion in annual wages and benefits in 2020, according to a report by consulting firm EY that was commissioned by private-equity industry lobbyist the American Investment Council.

Gary DeAngelo kept a stake when he sold his sunscreen company, Sun & Skin Care Research Inc., to private equity in 2012, but the buyers brought in new management.

The new CEO, who came from a large consumer-packaged goods company, ramped up production with the goal of boosting sales of its No-Ad, Ocean Potion and Bullfrog sunscreens.

The strategy was a flop. Retailers typically buy sunscreen on consignment during the busy summer months and return whatever they don't sell at the end of the season. The company ended up with a glut of inventory. Profits evaporated and losses mounted, said Warren Feder, the company's banker at Carl Marks Advisors, which specializes in advising family businesses.

The company got a new CEO who repaired some of the damage, but by 2015 the weight of its roughly $30 million in debt proved too heavy. It was forced to pursue a foreclosure sale that allowed it to avoid bankruptcy and prevented it from missing the all-important summer season. Mr. DeAngelo submitted a bid to buy it back but was unsuccessful. He didn't respond to requests for comment.

The new owner, private-equity backed Kik Custom Products Inc., closed Sun & Skin Care Research's Florida factory, putting 130 people out of work.

When John McGaffey decided it was time to sell his company, which makes pedestrian signals to help blind people safely traverse crosswalks, he had a demand: No layoffs.

Mr. McGaffey's father had founded the business in 1969. With 80 employees, it is among the larger employers in its hometown of Greenville, Texas.

After a process involving 10 bidders, including six private-equity firms, Mr. McGaffey sold a majority stake in Polara Enterprises LLC to Los Angeles-based Vance Street Capital last year. The Vance partners showed up in jeans and polo shirts instead of suits and loafers. They flew commercial. And they agreed not to cut any jobs.

Mr. McGaffey, 64, retired but he kept a seat on Polara's board. His son and son-in-law, both in their mid 30s, remained executives.

“I would have loved to have just left it with my boys, but we felt that we could get a lot further in terms of our technology if we could get an outside investor,” said Mr. McGaffey, whose voice can be heard at intersections around the country instructing pedestrians when to cross. “I didn’t want to risk all of my own capital.”

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TODAY'S TOP NEWS

Co gains ₱1.5B from sale of stake in brandy maker

Businessman Lucio Co made a P1.5-billion windfall from the sale of his own stake in Alfonso brandy maker, Williams and Humbert SA. Co, known for his popular grocery chain Puregold, has sold his stake in the Spanish brandy maker to his publicly-listed liquor distribution company, The Keepers Holdings Inc.

$150M PH cable network lands on shores of Siargao

Globe Telecom Inc. and Eastern Communications expanded their footprint in the Visayas and Mindanao through the Philippine Domestic Submarine Cable Network, a joint undertaking with partner InfiniVAN Inc. PDSCN covers a total cable distance of roughly 2,500 kilometers or about the same distance between Manila and Singapore.

URC launches 2 new plastic collection sites

Food manufacturing giant Universal Robina Corp. (URC) recently opened two new plastic collection sites as part of the firm's sustainability program. URC's new sites are located in Barangay Sambat in Balayan, Batangas, and Barangay Nagasi in La Carlota, Negros Occidental.

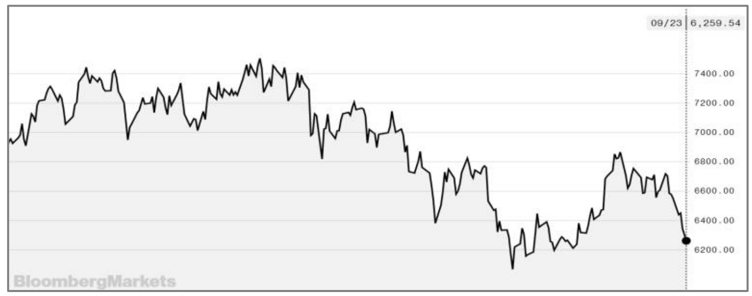
ABS-CBN's TFC beats rivals in US

TFC, the flagship channel of ABS-CBN International said it is the most watched multi-cultural network in the US in the first half of the year, beating rival networks. According to Comscore's US viewership, 249,000 households watched TFC for a combined total of 18 million hours during the first half of 2022.

SGP declares quarterly dividend

Synergy Grid and Development Philippines Inc. (SGP) has declared a cash dividend of P0.26 per share for the third quarter. The cash dividend amounting to P1,369,125,160 for the third quarter is the same amount declared in the previous quarter that was distributed and paid out last July 26.

Philippine Stock Market Update



Previous Close:
6,301.71

1 Yr Return:
-7.73%

Open:
6,291.37

YTD Return:
-12.12%

52-Week Range:
6,054.79 - 7,552.20

Source:
Bloomberg

Foreign Exchange

As of September 22, 2022

US Dollar	Philippine Peso
1	58.41

BVAL Reference Rates

As of September 22, 2022

Tenor	Rate
1Y	3.925
3Y	5.515
5Y	6.211
7Y	6.624
10Y	6.891
20Y	7.153

Daily Quote

"There is no risk-free path for monetary policy."
– Jerome Powell

MORE LOCAL NEWS

ACEN lists P10-B ASEAN green bonds

ACEN Corp. announced that it had successfully issued and listed its maiden peso-denominated ASEAN green bonds with a principal amount of P10 billion. “We are grateful for the strong support of PH institutional and retail investors for the company’s maiden peso green bond issuance,” ACEN President and CEO Eric T. Francia said.

BSP, BAP push for banks’ digital transformation

The BSP and the Bankers Association of the Philippines (BAP) will continue to foster digital transformation in the sector to meet demand for online financial services. “Our policy agenda on digitalization will not only make the financial system more inclusive but also more efficient,” BSP Governor Felipe M. Medalla said.

CREIT BOD clears P4.5B unsecured fixed rate bonds

Citicore Energy REIT Corp. (CREIT) said on Thursday that its board of directors had approved the issuance of P4.5 billion worth of unsecured fixed rate ASEAN green bonds. CREIT said its green bonds comprised of a based offer of up to P3 billion with an oversubscription option of up to P1.5 billion.

BSP raises key rates to tame inflation

The Philippine central bank raised benchmark interest rates on Thursday for a fifth time this year to rein in persistently high inflation amid a struggling peso and hawkish US Federal Reserve. The BSP increased its overnight borrowing rate by 50 bps to 4.25% effective Friday, and its corresponding lending rate to 4.75%.

MPTC’s innovations arm to expand services port

MPT Mobility, the innovations arm of Metro Pacific Tollways Corp. (MPTC), said it is expanding its portfolio of services with new mobility solutions. The company now has 8 active business units: Dibz, On-Us Solutions, Inc. (Byahe), Spot On, Easytrip Services Corp., MPT DriveHub, Savvice Corp., NLEX Drive and Dine, and Onehub.

Peso drops to P58.49:$1, hits all-time low

The Philippine peso continued to depreciate against the US dollar on Thursday to hit another record low for the third straight trading day, dragged by the policy tightening in the United States. The peso has now depreciated by P7.491 or 14.7% from the P50.999:$1 finish at the last trading day of 2021.

BSP to have room taming inflation amid weak peso

The Bangko Sentral ng Pilipinas has room to cool down inflation despite the continued peso depreciation against the dollar, an analyst said on Thursday. The overperforming US dollar is affecting most of the global currencies, RCBC Trust and Investment Group Head Robert Ramos told ANC.

Ministop chain of stores is now Uncle John’s

Robinsons Convenience Stores, Inc. (RCSI) on Thursday announced that it would rename its Ministop convenience stores to Uncle John’s, banking on the popularity of store chain Uncle John's Fried Chicken. In February 2022, Robinsons Retail acquired 40% of Ministop Japan in RCSI. With this, RCSI is now 100% Filipino-owned.

RCBC taking in more foreign investors

Rizal Commercial Banking Corp. (RCBC) has received the green light from the Bangko Sentral ng Pilipinas (BSP) to amend its articles of incorporation (AOI) and take in additional strategic foreign investors. The Yuchengco-led bank said the proposed amendment would allow foreign ownership of the bank to exceed 40 percent.

DITO says it passed NTC's 3rd-yr technical audit

DITO Telecommunity passed its 3rd year technical audit by the National Telecommunications Commission. A copy of the NTC findings shared by DITO said it covered 72.39% of the population and delivered 71.8 Mbps for 4G and 801.1 Mbps for 5G, above its 70% coverage and 55 Mbps broadband speed commitment.

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TODAY'S TOP ASIAN NEWS

HK's share of Asian IPOs slumps, over 2-decade low

HONG KONG'S share of regional initial public offerings (IPO) has shrunk to the lowest in more than 2 decades despite a recent pickup in deals, costing the financial hub its position as one of Asia's biggest listing venues.

HappyFresh wins funding, revamps board

HAPPYFRESH has secured funding from investors to resume online grocery operations in Indonesia, staving off a potential cash crunch fomented by the regional economic slowdown.

GIC buys majority stake in luxury resorts group

Singapore sovereign wealth fund GIC, one of the world's biggest investors, has bought a majority stake in Sani/Ikos Group (SIG) in a deal that values the Mediterranean luxury resorts operator at 2.3 billion euros (S$3.2 billion), both companies said in a joint statement on Thursday (Sept 22).

JP intervenes to prop up yen, first time in 24 yrs

Japan announced on Thursday that it had intervened to prop up the value of the yen for the first time in 24 years, seeking to stanch the currency's continuing slide against the US dollar. The yen has lost more than 20 per cent of its value against the dollar over the past year, pressuring Japan's economy.

Asia stocks slump on global slowdown fears

Asian stock markets slumped on Thursday amid heightened global slowdown fears after the US Federal Reserve signalled even more aggressive rate hikes ahead than investors had expected as it raised its key interest rate by a hefty 75 basis points for a third straight time.

TODAY'S TOP GLOBAL NEWS

Polaroid ventures into music w/ speakers, streaming

POLAROID Holding, the brand that has been a staple of still photography industry since 1937, sees music in its future.

EU to pave way for €565b electricity grid overhaul

THE European Union's (EU) executive branch will lay out a plan to digitalise its energy grid as it seeks to spur the rollout of renewables to reduce its dependence on Russian sources.

Meta to pay US$174.5m for violating patents

A US jury on Wednesday ordered Meta to pay US$174.5 million for violating live-streaming patents developed by a US Army veteran seeking to fix shortcomings in battlefield communications.

Bank of England raises rates by a half-point

The Bank of England (BOE) delivered a second consecutive half-point interest-rate hike in its battle to bring down inflation, as three officials pushed for the institution to join its global peers in moving at an even quicker pace. The move to 2.25 per cent was backed by five of the nine-member Monetary Policy Committee (MPC).

C'Suisse planning to split investment bank in 3

Credit Suisse Group has drawn up plans to split its investment bank in three, the Financial Times reported on Thursday, as the Swiss lender attempts to emerge from three years of relentless scandals. Under proposals to the board, the bank is looking to sell profitable units.