Private Equity, Up Close and Personal

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NEW DIRECTION PARTNERS

As financially motivated buyers with a timeline for what they want to accomplish, PE investors follow an M&A playbook of their own. But, following along with it can be rewarding for owners of packaging companies as well.

Wherever business and industrial activity takes place in the U.S., private equity (PE) funding drives more of it than many people realize. According to a report prepared for the American Investment Council, private equity-backed firms generated $1.4 trillion of GDP in 2020 – 6.5% of total U.S. GDP for that year. These firms also employed 11.7 million workers who earned $900 million in wages and benefits.

A sizeable share of the bounty has found its way into the label and packaging printing industry, where PE investors acquired these businesses at a record-setting pace in 2021 and 2022. So far this year, nothing leads us to believe that the pace is slowing down. The PE investment model – buying and building groups of related businesses to be resold for profit at a later date – continues to be a winning formula for the people who have perfected it.

Understanding who these people are and how they think is essential for owners of packaging businesses, especially those in labels, flexible packaging, and other market segments that are catnip to PE investors right now. As financially motivated buyers with a timeline for cashing out, PE investors follow a different playbook than do strategic buyers – packaging companies that acquire other packaging companies to achieve long-term growth.

Countdown to Completion

Probably the most fundamental thing to know about PE investors is that they always have one eye on the clock that counts down the time until they can reap a full return on their investment by walking profitably away from it. For a PE investor targeting an industry like packaging, a first acquisition is exactly that: a springboard to other acquisitions that together make up the enterprise "platform" another investor will acquire for more than it cost the founding investor to build.

This teaches PE investors to think and act swiftly, always keeping the next acquisition in mind and the exit from the investment as the ultimate goal. As newcomers, in most cases, to the industries they have set their sights on, PE investors know they cannot make these things happen by themselves. This is why they depend on the continued participation of the people they have acquired companies from – a key consideration for packaging company owners as they weigh offers from PE investors.

A selling owner whose business represents the first piece of the platform can expect to take on a lead role in building up the rest of it. As a management assignment, this is likely to be fast-paced, given PE investors' relentless emphasis on increasing EBITDA in anticipation of the platform's eventual sale.

The good news is that the new owners will be prepared to do whatever it takes to get there, including making capital expenditures for new equipment to boost productivity and earnings. PE investors are focused on improving earnings and, as such, are often more willing to carry CAPEX debt than strategic buyers typically are. PE investors can help the acquired company develop capabilities it wouldn't have been able to finance on its own.

The Cultural Fit Factor

Some owners – particularly those who have never been employed by anyone other than themselves – may wonder what being on the same team as these high-energy businesspeople will be like. In our opinion, the PE investors we have worked with on behalf of our clients are the kinds of individuals whom anyone would want to do business with: deeply intelligent and intensely focused, but also thoroughly personable and wholly committed to integrity. They respect the cultural fit that is so important to the success of a partnership by acquisition, in this industry or any other.

In practice, this means that the new owners will not be closely involved, if they are involved at all, in the day-to-day operation of the acquired company. Unlike strategic buyers who acquire businesses in areas they already are familiar with, PE investors usually have little practical knowledge of the industries they have put their money into. They're happy to leave that aspect of management to those who know the details best.

They will, however, take seats on the board of directors and conduct regular financial reviews to ensure that their revenue and EBITDA targets are being met. Requests for CAPEX spending will be closely scrutinized, but with a view to approving them if the return on investment can be justified. This will require extra discipline on everyone's part, but discipline is a good thing for any company that wants to thrive and grow.

As owners, PE investors want strong teams of managers who share their motivations and their focus on the platform-building objective. We think that a big reason for private equity's continuing interest in the packaging industry is the fact that it contains so many of the kinds of professionals that PE investors are most eager to work with. We're happy to have helped them connect with increasing numbers of our clients over the last few years, and we fully expect to go on doing so.

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