Minority Investing Reaches All-Time High

Danielle Fugazy | September 18, 2018

It used to be business owners sold their companies outright to a strategic acquirer or a financial buyer, or handed them down to family members. Today selling a minority stake in a business to a private equity firm is becoming increasingly prevalent and offers benefits to both owners and acquirers. In 2017, private equity investors closed on more than 1,000 deals worth about $69 billion—an all-time high, according to Pitchbook. More than $21 billion has been raised in 2018 alone for minority investing. That's in addition to the record-high $23 billion that was raised in 2017, Pitchbook reports.

Advantages for Investors

In today's crowded market, minority investments offer middle market private equity firms a chance to differentiate themselves and gain more market share. Firms like The Riverside Company, Huron Capital, and Balance Point Equity have all diversified to be more inclusive of various deal terms, allowing them to cast their deal sourcing net much wider.

In April, Huron closed on its inaugural non-control private equity fund, The Huron Flex Equity Fund, L.P., with $142 million. The new fund allows the firm to make non-control investments and be flexible with solutions for business owners. "A non-control equity strategy can help a company grow faster than it could on its own. It fills a hole in the market for businesses that would like to partner with firms that have access to operational resources and capital, but aren't quite ready to give up all the control yet," says Gretchen Perkins, a partner with Huron Capital.

In 2017, The Riverside Co. closed on its first non-control investment fund, Riverside Strategic Capital Fund (RSCF) with $418 million in capital. With a very large deal sourcing operation, The Riverside Company had noticed an increased demand for non-control capital. "Many companies have capital needs that can't be satisfied in the traditional lending markets anymore," says George Cole, a managing partner and co-fund manager of Riverside Strategic Capital Fund. "Some companies need capital for add-on acquisitions, shareholder redemptions, or liquidity, but don't necessarily warrant a change of control. We raised RSCF to meet that untapped need."

One of Riverside's first minority investments was into Bentley Laboratories, a cosmetic manufacturing company based in Edison, New Jersey. The company wanted capital to make some key add-on acquisitions to fill product gaps, add capabilities, and utilize excess production capacity. "We helped the company vet acquisitions and the company has been making add-on acquisitions and growing ever since," says Cole.

SCF had targeted $350 million and was oversubscribed, closing with $418 million. The fund is already 60 percent deployed, having invested in eight platform companies. "There was a great need for this in the market and our investors came on board. RSCF has been a great addition to the Riverside portfolio of funds and we see it continuing. It's serving an unmet demand for capital in the market," says Cole.

Benefits for Businesses

Minority investing is not only good for private equity firms and their investors, it also gives business owners more options. Selling a minority stake in a business allows the owner to take some chips off the table, buy out another minority owner, or get capital for an add-on acquisition — all while maintaining control of the business and having the opportunity to cash out at a later date.

The minority investment strategy works best for companies that are looking to continue to grow. "Owners who are interested in selling a minority stake in their company are inherently bullish. They believe their company's best days are ahead of them and are excited by what can be achieved with the right capital partner," says Charlie Gifford, a senior partner with New Heritage Capital, a private equity firm that focuses on providing minority capital for growing founder- and entrepreneur-owned businesses.

In February, the Boston-based firm made a minority investment in Flying Colours, a global aviation services company headquartered in Ontario. The business was majority-owned by the founder and his two sons, and they were looking to cash out a large minority shareholder. "They had the option of selling entirely, but they felt strongly that their company was at an inflexion point. They believe that the next five years are going to be the most exciting in the company's history, but they were capital constrained," says Gifford.

As part of the transaction, Flying Colours retained its management and operational independence, and is able to take advantage of growth opportunities. "We cashed out the inactive partner, gave the owners partial liquidity, and the company began pursuing growth opportunities. Importantly for us, the shareholders rolled an overwhelming majority of their equity into the deal. Their biggest challenge right now is handling all the growth opportunities," says Gifford.

Since the deal was inked, Flying Colours has ramped up production six-fold by opening a new St. Louis, Missouri based facility and expanded by creating 60 new jobs at its Ontario facility.

"We want to work with owners who are enthused about future and want to take that half step with a partner," says Gifford. "We aren't looking to do every deal out there. Instead, we patiently wait to find the best and the brightest operators who are bullish on their future. Yes, they are sellers – partially – but also buyers. We like to focus on leverage buy-ins, not leveraged buyouts."