PRIVATE EQUITY: WHEN BIGGER INVESTORS GET INVOLVED

How private equity firms invest in businesses that already work, what they look for, and what changes when they come in.

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AT A GLANCE

- **Private equity (PE)** firms invest in **established, profitable businesses**, often buying a large or controlling share.
- Unlike venture capital, PE looks for **steady profits and cash flow**, not just fast growth. That makes PE relevant for strong main-street businesses too.
- PE can bring capital, expertise and a path to growth or sale, but you usually give up significant control.

Why it matters

When a business has proven itself, with steady revenue, real profits and clean books, PE becomes one of the main sources of larger checks. Project Underdogs' graduation standard is built around what these investors need to see. See **UD-05 The Graduation Standard, Explained**.

How PE differs from VC

	Venture capital	Private equity
Invests in	Young, fast-growing startups	Established, profitable businesses
Looks at	Growth and market size	Profits, cash flow, steady performance
Ownership	Usually a minority stake per round	Often a majority or controlling stake; sometimes a minority "growth" investment
Uses debt?	Rarely	Often, to help pay for the purchase
Hold period	Until a sale or IPO	Often around 3 to 7 years, then sells

Types of PE deals

- **Buyout:** the firm buys most or all of the business, often using some borrowed money.
- **Growth equity:** the firm buys a minority stake to fund expansion.
- **Recapitalization:** the owner sells part of the business, taking some money off the table while staying involved. See **X-08 Selling to Private Equity**.
- **Platform and add-on:** the firm buys a strong business (the platform), then buys smaller similar businesses and combines them.

What PE looks for

1. **Consistent revenue and profit**, often measured by **EBITDA** (your profit before taxes, interest, and accounting adjustments)
2. **Clean, reliable financial records**, often reviewed or audited
3. **A business that doesn't depend on one person**
4. **Room to grow**: new locations, products, markets or acquisitions
5. **A strong management team**, or a plan to build one
6. **Diverse customers**, not reliant on one big client

> EXAMPLE
>
> **Rosa's Cleaning Co.** grew to 45 cleaners, $2.4 million in sales and about $400,000 in EBITDA, with 70% of revenue from recurring contracts. A PE firm building a regional cleaning company offered to buy 60%. Rosa would stay as president, keep 40%, and share in the value when the larger company was sold later. She hired advisors to negotiate the deal.

What changes after PE invests

- **Reporting:** monthly financial reports and board meetings
- **Goals:** clear targets for growth and profit
- **Decisions:** big decisions often need investor approval
- **Exit timeline:** the firm plans to sell its stake within several years

Common mistakes

- **Approaching PE before the numbers are clean.**
- **Focusing only on price**, not on control, your role and future payouts.
- **Not hiring experienced advisors** for the deal.
- **Not understanding earn-outs and rollover equity.** See **X-08 Selling to Private Equity**.

Your checklist

☐ Get 2 to 3 years of clean financial statements

- ☐ Calculate your EBITDA
- ☐ Reduce dependence on yourself and on any single customer
- ☐ Learn the deal types that might fit your goals
- ☐ Find advisors with PE deal experience

Key words, explained

Word	What it means
Private equity	Investment in established private businesses.
EBITDA	Profit before taxes, interest, and accounting adjustments.
Buyout	Buying most or all of a business.
Recapitalization	Changing the mix of ownership and debt, often so the owner can sell part.
Rollover equity	Part of the sale price the owner keeps as ownership in the new structure.

Where to go next

- **X-08 Selling to Private Equity**
- **UD-05 The Graduation Standard, Explained**
- **X-03 How Businesses Are Valued When They're Sold**

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