

MONTAGE PARTNERS

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Private Equity Partnerships: Navigating Through a Crisis

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Introduction

Though “Barbarians at the Gate” was published more than 30 years ago, the negative perceptions of private equity firms as greedy dismantlers of companies remain prevalent in general society. In reality, the majority of private equity firms in the U.S. work in the middle market (outside of the headlines) and are drivers of growth and employment in both their companies and the economy overall¹. In times of crisis such as the current pandemic and resulting economic downturn, private equity firms play an even greater role helping companies navigate and recover. While we are still in the midst of this crisis and there are sure to be many studies in the future on this subject, we do know that in past crises private equity firms played a pivotal role in helping companies persevere, with researchers finding that “companies backed by private-equity firms were more resilient in the face of the financial crisis”². We wanted to take a deeper look into why this happens, at the company level.

Methodology

We surveyed the leadership teams at our 10 partner companies on a variety of topics related to COVID-19 and the resulting economic crisis, with respondents given the option to submit answers anonymously if desired. These companies are of varying sizes within the middle market and operate in many different industries. We received 22 responses across the survey. The below conclusions and direct quotes are drawn from these responses.

Background

New & Mounting Business Concerns

While businesses have weathered economic downturns in the past – who can forget the not-too-distant Great Recession? – the pandemic trigger and continuing economic consequences are singular. Many businesses find themselves facing new and unexpected concerns, while existing pressures are exacerbated or reemerge. Across our respondents, several common challenges were highlighted, some familiar from previous economic crises, others unique to this pandemic.

¹“New Research Shows Middle-Market Private Equity Is Major Source of Job and Sales Growth.” Association for Corporate Growth, 2015. Accessed at: <https://www.acg.org/news-trends/news/new-research-shows-middle-market-private-equity-major-source-job-and-sales>.

²Palvus, John. “Private Equity Helped Firms Weather the Great Recession.” Kellogg School of Management at Northwestern University, 2018. Accessed at <https://insight.kellogg.northwestern.edu/article/private-equity-helped-firms-weather-the-great-recession>.

Reductions in Cash Flow & Revenue

This business problem is one that feels familiar to management that has weathered a previous economic downturn, though the cause – and perhaps the extent – is still unparalleled. Reduction in revenue creates ripple effects, affecting more than just the top line of a company. It forces management to reevaluate future plans, including strategic changes, hiring decisions, and investment or expansion opportunities. State-by-state shutdowns affected businesses unevenly, depending heavily on their industry and location. Consumer-oriented businesses that relied on in-person sales, such as restaurants, were one of the hardest hit. For other companies, those whose services are non-discretionary and essential, cash flow is not the primary challenge.

Employee Safety & Motivation

For these companies especially, the top concern mentioned was the safety of employees. For businesses that are considered essential and where work cannot be done from home – a manufacturing company is a prime example – management had to quickly implement new safety measures, which included changing employee schedules, adjusting floor layouts, and screening each person who enters the building. Especially at the beginning of the pandemic, not enough was known about the virus and information changed or was updated often, sometimes daily, which absorbed much of management's mindshare. Many are finding that even the most stringent measures can't completely contain this virus, and so they must learn to navigate staffing and create protocols as employees are in and out of the workplace due to positive cases, suspected positive cases, and quarantines.

For businesses that were able to pivot to a work-from-home model for some or all employees, a different emotional and mental challenge arose: employee motivation and engagement. Keeping employees feeling connected socially, keeping staff informed with the most up-to-date information about the company's plans, keeping everyone in the company focused on growth while most are in-the-weeds; all are new challenges that the traditional 9-to-5, in-office workplace rarely faced.

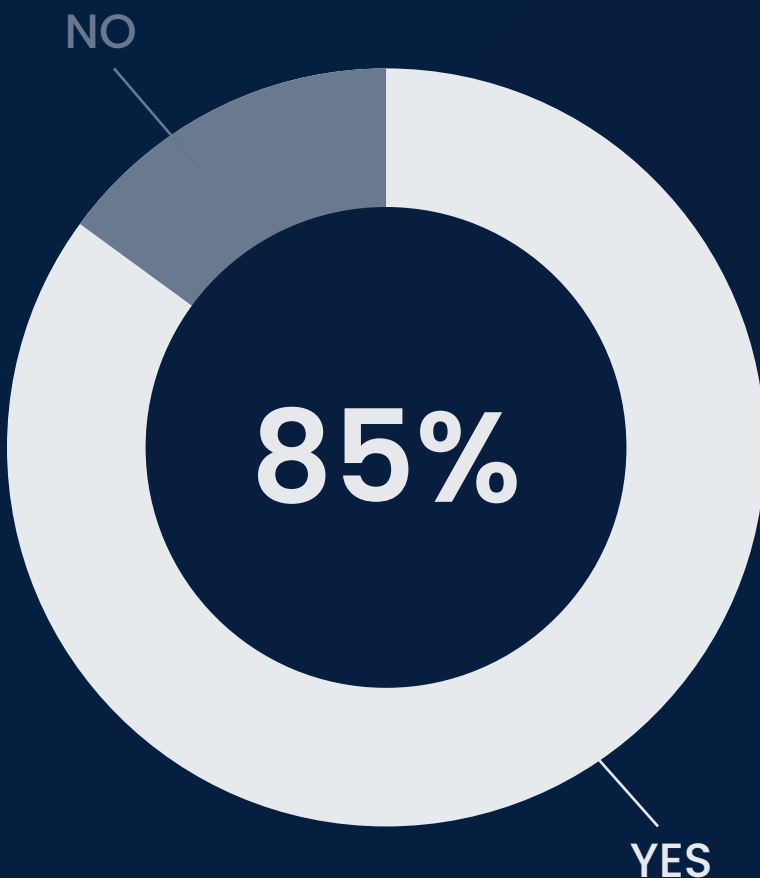
Future Growth Questions

While even in the best of times, planning and predicting future growth of a company is never perfectly clear, many management teams are now finding this evermore challenging. With the general economy contracting, visibility into existing or new customer spending is uncertain, and even the expense side is not guaranteed to be stable, with potential supply chain disruptions or increased spending on safety measures becoming reality for many. While the virus is still widespread, the fear of a new or partial shutdown lingers.

The above business challenges are felt across many companies, regardless of affiliation or ownership status. Being partnered with a private equity firm does not make a company immune to the general effects of this crisis. However, based on our respondents' comments, this partnership does help management feel better prepared and supported when facing these common challenges.

Results

Being partnered with private equity helped management feel more secure



The majority of respondents confirmed that their partnership with a private equity firm has increased their security and confidence in the face of this crisis. "Security" was left open to interpretation by the respondents, and could refer to monetary security, emotional security, strategic security, etc., or a combination of any of these.

Below we take a deeper dive into some of the specific benefits the partnership brought that were repeated across many of the responses.

"Has being partnered with a private equity firm helped you feel more secure during the pandemic and resulting economic downturn?"

Private equity partners have access to **important banking relationships**

In times of economic uncertainty, access to additional capital is crucial. Private equity firms work with banks and lenders frequently in their normal course of business, and over time these relationships strengthen and build a solid foundation of trust and mutual respect. For companies partnered with the right private equity firm, this relationship can be extended to the company and make it easier to secure credit quickly. There is a baseline of trust and willingness on the bank's part to work with the company due to their relationship with the private equity firm. The fact that the company has support from an equity partner reduces risk from the bank's perspective.

Liquidity During Crisis

Contrary to the perception that private equity firms strip companies of cash, many firms (including Montage Partners) encourage the companies in which they invest to operate with a liquidity buffer to ensure that the company has cash to react quickly to opportunities and to protect against challenges. When liquidity becomes a primary concern, it tends to concentrate all attention in the moment and steals energy away from focusing on the forward-looking priorities that will position the company for success coming out of the crisis. Across our respondents it was clear that frequent dialogues early on assessing liquidity positions allowed the companies to focus their energy on the health and safety of employees and anticipating and addressing any supply chain disruptions or potential demand shocks.

Companies rely on their private equity partners to be a **sounding board during crisis**

Given the uncertainty about the virus, the economy, and the length of this crisis, it is no surprise that more than 60% of respondents called out the ability to use their private equity partners as a much-needed sounding board as a key benefit of the partnership.

From sharing research-backed insights into the company's markets and industry trends, to providing guidance on processes the company should consider implementing, to simply being another similarly-motivated person to bounce ideas off of, respondents saw their private equity partnership as a trusted additional source of information. This support could be as abstract as providing a sanity check to a management team's idea, or as hands-on as helping management craft a COVID action and personnel plan to roll out company wide. Because private equity firms often have years of experience across their associates, working with a wide array of industries, chances are they've helped a firm navigate a similar problem and can share this experience to jump start a company's crisis response.

60% of respondents see their private equity partner as a trusted additional source of information

“They provided emotional support. For a business owner, all employees are looking to the leader for guidance, and the future of the business is on the line which is stressful and scary. Having [our private equity firm] behind me gave me the confidence to navigate the stressful time.”

– Pejman, CEO of Boundary Devices

In normal times, many private equity firms support a company's management team in forming and articulating a growth strategy. When a crisis hits and management finds itself overwhelmed and mired in the proverbial operational weeds, a private equity firm can help provide long-term perspective and assist in adapting the company's strategy to not only pull through the current crisis, but to continue on the growth path beyond.

In addition to serving as a sounding board for the management teams with whom they've partnered, many private equity firms

have also cultivated a vast network of other advisors and experts across functions like accounting, legal, and recruitment firms. As a partner to the firm, a company has access to this network which provides additional guidance and expertise, access to information, speeds up execution and allows more initiatives to be tackled simultaneously as compared to companies limited to their own networks and forced to start from scratch when help is needed.

Private equity partners can share **best practices and solutions** across their portfolio

Perhaps the greatest inherent value involves the private equity firm's network of portfolio companies. They are in the unique position of insider to many management teams simultaneously, able to observe what does and does not work for each of their partner companies in real time. This often translates to real value in accessing best practices from peer CEO's. The best firms will share these lessons learned across their partners, sharing with other leaders when a company enacts a visitor ban in a factory, circulates a plan to employees regarding how a remote work environment would function, or drafts important communications to employees, customers, and suppliers. Some firms may encourage cross-portfolio collaboration, facilitating discussions between their partner companies. For many respondents, the ability to hear real-time tactics from similarly sized or focused companies was more helpful than combing the myriad of general articles or tips found online, particularly at the beginning of the pandemic as COVID became a growing threat.

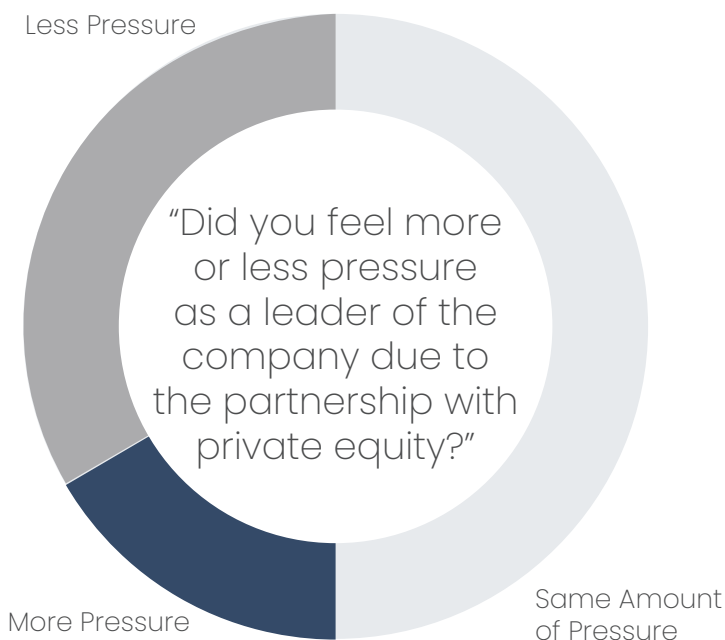
“In times of crisis, being part of a larger group is beneficial; there's a sort of collaboration without actually collaborating.”

– Bert, Accounting Manager at METALfx

Companies did not experience any drawbacks in being partnered with a private equity firm during this crisis

Along with providing examples of ways in which they benefited from the private equity partnership, respondents were asked if they experienced any drawbacks of being aligned with a private equity partner during this crisis and given a chance to elaborate. All respondents answered “no,” which confirmed that the private equity relationship was neutral or positive for 100% of respondents.

Most companies did not feel more pressure as a result of the private equity partnership



33% *“I felt less pressure as a result of the relationship.”*

For these respondents, having a private equity partner meant they felt less pressure and fear as a leader of their company when faced with the crisis. They felt they had a better understanding of the wider situation, and the ability to use their private equity firm as a sounding board gave confidence that they were truly asking the right questions and thinking through all options and potential scenarios.

“If you’re a small company, it is wonderful to have another set of eyes watching your back. A private equity firm is looking out for you as well and may provide insight that might otherwise be overlooked.”

– Dennis, President of Puroflux Corporation

50% *“I would have felt the same amount of pressure with or without the relationship.”*

Half of the respondents felt that being partnered with a private equity firm did not add or alleviate pressure in this crisis. For these respondents, a common theme was that they felt their responsibilities to the company, their employees, and their customers remained the same, regardless of the partnership. Many pointed to their innate sense of motivation to succeed and lead as the source of any pressure they may have felt, confirming that this would be the same with or without an investment partner. Others explained that being partnered with a private equity firm simply added a different element to their responsibilities, while the alternative would have brought yet another element of pressure and uncertainty.

17% *“I felt more pressure as a result of the relationship.”*

Because private equity firms will still tend to maintain long-term outlooks even in the thick of a crisis, this can feel like a lot for some leaders who are in the weeds of operations. The simple fact of having commitments to someone other than yourself (as President or CEO) added a layer of pressure for some respondents, knowing they are a part of something larger, and that their actions affect more than their own company (which is already a momentous responsibility on its own). Others explained that their respect for the partnership and their desire to validate that the firm made a good investment was an additional motivating factor for success.

“I highly recommend being partnered with the right private equity firm. [Unlike ours], I can see a scenario where the private equity company puts more pressure to get things right, which would not be helpful. Having the right private equity firm provides immense advantages, especially in situations of uncertainty and crisis, with their years of experience as well as an outsider’s view of your business.”

– Pejman, CEO of Boundary Devices

The Right Private Equity Firm

Even in the best of times, ensuring a good fit and alignment between a company and any potential private equity firm is essential prior to entering into a partnership. The need for this fit has only been highlighted by the pandemic. Elements such as communication expectations (in good times and bad), the goals behind each party’s interest, and the private equity firm’s track record should be carefully considered. Talking to current and past companies that the firm has invested in can be invaluable here.

The best firms will make accountability a two-way street between themselves and the company, and will let management remain in the driver’s seat while providing the support being sought. As many respondents pointed out, in times of crisis, firms should continue to let management make decisions in the interest of the company, and be there when needed rather than increasing pressure through daily required updates or otherwise adding to a management team’s workload.

“If the firm has a proven track record like [ours], it does add a level of confidence for the future and while navigating trying times.”

– Chris, President of United Right-of-Way



Montage Partners and the Crisis

The pandemic and resulting economic crisis has touched Montage Partners and our partner companies just as it has nearly every other business out there, proving that no one is immune. Our team has been as hands-on as requested by our partner companies as this crisis has unfolded, and all are weathering the storm. As a result of the partnership and the long-term planning associated, we supported our partner companies that wanted to proceed with significant capital expenditure outlays to upgrade technology and equipment, even amidst the uncertainty in April and May, positioning those companies to benefit as the economy eventually recovers. We are proud that none of our respondents felt that as a firm we did not meet their expectations for support during this crisis.

Reach out to us to learn more about how we have helped our partner companies navigate this crisis, and how we can be a resource to your company.

“The depth of Montage’s experience has been a great resource for our crisis management team. Their guidance has helped our continued growth without pause, during a time when most are struggling.”

– Martin, President of Southwest Data Products

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About Montage Partners

Founded in 2004 and headquartered in Scottsdale, Arizona, Montage Partners is a people-first private equity firm dedicated to helping established businesses reach transformative growth. Montage Partners invests in companies in diverse industries, including business services, consumer, healthcare, industrial, and technology. Above all other investment criteria, Montage Partners invests in exceptional people. Montage Partners is actively seeking new investments in companies in the U.S. with EBITDA between \$1 million and \$5 million. For more information, please visit www.montagepartners.com.

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