DEBT

What is the big deal about debt in private equity transactions?

The media typically describes acquisitions by private equity firms as 'leveraged buyouts', a reference to the use of financial leverage, or debt, to acquire a company. Similar to a mortgage on a house, a private equity firm will borrow debt from a lending institution in order to 'lever' its equity investment. While some private equity firms will utilize as much debt as banks are willing to lend, DW Healthcare Partners is considerably more conservative in the use of debt. DWHP seeks to partner with companies that exhibit significant historical growth, and if debt is not used wisely, it could significantly stifle the company's operations.

One of the differences between DWHP and its private equity firm peers lies in the respective investment objectives. DWHP specifically seeks out high-growth companies and focuses on supporting the growth trajectory in order to achieve its investment goals. As such, DWHP utilizes a relatively conservative amount of debt in its portfolio companies so that the growth initiatives are the primary focus, rather than managing debt obligations. In contrast, many private equity firms utilize financial leverage as a means to achieve their own return objectives, especially with lower-growth companies. By layering on too much debt, the company could be forced to divert all of its cash flow to the repayment of the debt obligations rather than re-investing available cash flow into the business to support growth. Meanwhile, the debt repayment enhances the private equity firm's investment without enhancing overall value through successful growth initiatives. This significant leverage introduces undue volatility into the value of the business and could impact the business growth plans if debt covenants are breached. DWHP prefers its portfolio companies to reinvest in the business in order to continue to grow and increase market share.

You may have read about recent trends in the credit markets that are impacting the availability of debt to finance private equity transactions. As a result, many of the private equity firms that rely on significant debt to complete their transactions have been forced to cancel or renegotiate letters of intent due to the limited availability of debt. Given DWHP's relatively conservative use of debt, we have not seen a material impact from the changing credit markets on our business and in fact, our lending relationships are stronger than ever. Other private equity firms will typically use debt leverage in excess of 4.5 times cash-flow, as compared with DWHP's historical average of 2.0 times cash-flow. By using minimal debt, DWHP's portfolio companies have been able to build excess cash balances to be reinvested into capital expenditures, additional personnel, and acquisitions to support the company's growth trajectory.

Learn More

Whether you are interested in learning more about how to create an appropriate exit strategy or how debt might be a useful tool for your business, we invite you to call or visit us online:

www.dwhp.com

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