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ARGOSY PARTNERS

Private Equity for Shareholder Buyout Situations

Argosy Partners is a private equity investment firm based in Toronto. The firm buys shares from selling shareholders in medium-sized, owner-operated businesses, through its well-established funding solutions: The Shotgun Fund and The Succession Fund.

AS GENERAL PARTNER of The Shotgun Fund and The Succession Fund, Argosy combines its own capital with that of a small number of experienced successful investors and entrepreneurs, to make investments in profitable private businesses with strong management teams.

The Canadian Business Journal spoke with Richard Reid, Jim Ambrose and Larry Klar, Partners of the firm. Ambrose and Reid started Argosy Partners in 1999, and Klar joined in 2006. All have extensive private equity, corporate finance, strategic planning and board of directors' experience, particularly focused on owner-operated businesses.

We also spoke with Michael Desnoyers, the President and Founder of Etratech Enterprises of Burlington, Ont., who has worked with The Shotgun Fund since 2000, when he faced a partner buyout situation that had to be financed quickly—a specialty of The Shotgun Fund.

The Shotgun Fund and the Buy-Sell Clause in Shareholder's Agreements

"It made a lot of sense to create The Shotgun Fund. The buy-sell or shotgun clause is an effective tool to have in a shareholder's agreement, because it can help to quickly resolve situations where business partners want to end their relationship. For us as investors, we have the opportunity to make a fast but informed decision as to whether or not we want to become the new part-owner in that circumstance. The shotgun clause is the mechanism that provides the entry point for us to evaluate opportunities and invest alongside committed owner-operators that want a new partner. This approach helps us to find proprietary deals, and positions The Shotgun Fund differently from other capital providers on the street," says Reid.

Once a shareholder dispute has deteriorated to the stage where one party "pulls the trigger" on a shotgun clause, time is of the essence. So The Shotgun Fund developed a proprietary process that enables them to make the fast investment decisions that these situations demand. Reid noted, "We need total cooperation in order to complete our due diligence and negotiations within the time available. It's hard work for everyone involved, but we've proven that the process works and is very efficient."

Ambrose added, "The shotgun feature in a shareholder's agreement represents an exit clause between business partners. The part-owner may trigger the clause if the business partnership has deteriorated. It avoids drawn out negotiations and minimizes the negative impact on the business. The partner/shareholder triggering the clause offers to buy the shares of the other shareholder at a specific valuation. The other shareholder must then either accept the offer and sell their shares, or buy the triggering shareholder's shares at that same price."

Klar added, "The niche created by The Shotgun Fund gives us access to profitable businesses with passionate, knowledgeable founders that have to act to resolve their shareholder issues. Doing nothing is not an option. Partner disputes stall business growth and erode value. We help get things back on track. What our firm likes about shotgun deals is that three things are known: that a transaction must happen, the price, and the closing date. We also focus on any deals that require prompt action, where we have developed a specialty in."

The Etratech Enterprises Case

As an example of a shotgun situation, Desnoyers shared his experiences having lived through a partnership dispute. Desnoyers was candid about working with The Shotgun Fund on the financing of his partner buyout, and also discussed the business guidance provided by his new shareholder and their board nominees.

"In 2000, my partner and I reached an impasse in our relationship. We had a difference of opinion about the strategic direction of the company. During the discussion with my former partner, my firm belief was that he was getting ready to trigger the shotgun clause, so I was evaluating and trying to put in place financing alternatives. However, the majority of these required several months to get approval for the financing, which was not viable in my situation. The Shotgun Fund was able to approve financing on very short notice, and conduct efficient due diligence. Speed and time was of the essence, and Argosy delivered on that," says Desnoyers.

Desnoyers added, "After completing the deal with The Shotgun Fund, a Board of Directors was formed which operates in a very different way compared to before. We have a highly functional board, and we discuss and analyze our business plans regularly, and that includes how best to build on our strengths, but also candidly discussing how we can mitigate the risks we face. Argosy's team brings a lot of business insight and strategic planning experience to the table. I believe our senior management team's productive working relationship with our investors and board members, and the dedication and hard work of our staff, had really contributed to the company's international growth."

Etratech Enterprises is a privately held corporation specializing in the design, development and manufacturing of advanced electronic controls and control systems for major multinational companies. "A significant event happened in 2005 when Etratech Asia-Pacific (Shenzhen, China) was acquired as part of the company's long-term commitment to offering a global purchasing and manufacturing solution, making our electronic controls competitive at virtually any volume and with any sourcing strategy, and to a broader list of international customers. But the key was to develop and then execute on an integration plan that would address the different cultures, and ensure that we could manage a global business with all the new and continuing challenges that it entails. So we turned to Argosy and our board of directors, and received the support and guidance to help steer us through what has turned out to be an exciting transformative event for our company. In the early years I may not have even thought about the concept of striving to build shareholder value, but I sure have come to focus on that," says Desnoyers.

The Partnership Structure

As an incoming equity partner, Argosy's private equity funds typically buy between 35 and 67 per cent of the company from selling shareholders. Although not involved in the operations of the business, Klar added, "Argosy's nominees to the boards of directors of its portfolio companies add value on matters ranging from strategic planning, review of management depth and succession, financial analysis and capital structure oversight, assessment of opportunities and risks, the evaluation of possible acquisitions, and eventually on preparing the company for sale to a strategic buyer."

Reid added, "Most owner/operators and founders we partner with may not have put in place a strategic plan, addressed the bench strength of the management team, and might have been overly reliant on only a few customers. So we bring discipline to the board around planning, addressing weaknesses and leveraging strengths. It's all about having healthy rigorous discussions about these issues, because that's what ultimately leads to growing profitable companies, and over time helps to increase shareholder value, which is the ultimate goal.

"Because shotgun transactions inevitably have tight time frames, our investment criteria are correspondingly tight. We look for profitable growing private companies that should have been running for at least three years, but likely longer, and should be able to self-finance growth. We typically invest in the manufacturing, distribution or service sectors, and only invest where the owner-operators of the business are open to having a new outside shareholder, in other words taking on a new partner, and forming a board of directors", says Reid.

Klar added, "We usually look at businesses with revenues in the $15 million to $50 million range, and many of our referrals are from legal and accounting firms that are having regular discussions with their owner managed and family controlled business clients. Frequently business owners call us directly to discuss their shareholder issues, and we always respond promptly. It's critical to us that our interests with management are aligned, and that's accomplished by all of us owning stock and working productively and candidly at the board level to best grow the companies we invest in."

The Succession Fund

The Succession Fund buys shares from selling shareholders in owner-operated businesses, and helps resolve family business ownership transition issues. When business owners want to buy out one or more of their legacy shareholders, or want to sell some of their own shares for succession planning purposes, The Succession Fund facilitates these liquidity objectives through its "Chips off the Table"™ solution. "We buy shares in a direct secondary share purchase, and we do not complete transactions using debt. The Succession Fund becomes the new partner for the continuing management teams. We also provide family business owners with the ability to achieve a partial liquidity solution and address their financial objectives without selling out prematurely or unduly leveraging their balance sheet," says Klar.

Succession planning should be a deliberate process and not a one-time event. “Business owners should realize that the best time to plan is when you can afford the time to properly evaluate alternatives and seek input from professional advisors. You ideally never want to be forced to accelerate your family business succession because of illness, divorce or death, so it’s always best to be prudent and plan ahead,” says Klar.

Business succession planning is an investment in the future of your company for the owners, employees and customers. Planning is the key to future success for everyone whose efforts have helped the business to grow. The existence of a succession plan emphasizes your commitment to your company’s long-term growth, and creates confidence among shareholders, lenders, employees and suppliers. “There is no time like the present to explore your options. This process will involve asking some tough questions and exploring scenarios that may not please all family members, shareholders, or senior managers, but it is necessary and prudent,” says Reid.

Argosy Partners

Between The Shotgun Fund and The Succession Fund, Argosy Partners has raised close to $100 million. The firm has proved that there is a market in providing liquidity to private company owners. Argosy likes the partnership approach where the firm serves as a financial partner to the business. “We think this is a good combination for us and for the business. Going forward, we will continue to raise financing for these situations, perhaps trying to work with slightly larger businesses, but we’ll maintain our focus on those transactions where we can add value at the board level and partner with successful owner-operators to accelerate business growth,” concluded Reid. **CBJ**

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