

Selling Without Selling Out: An Interview with Waud Capital Partners

KEY FINDINGS

- Private equity allows owners of pest control companies to diversify their wealth by selling a portion of the company
- Partnering with a private equity firm allows owners to sell their businesses to loyal management teams or children who would otherwise not have the resources to do the deal on their own
- Waud Capital Partners, one of many private equity firms eyeballing the pest control industry, has made a commitment to the industry by hiring Albert Cantu

Many of you are currently wrestling with the following questions: What do I do about my loyal management team or my children who are working in the business, they don't have enough capital to buy it from me? I'd like to diversify my wealth, which is largely locked up in my company, but I don't want to sell my business now, what can I do? What most of you probably don't realize is, there is a way for you to sell your business and still participate in future growth.... Or sell your business to your management team even if they do not have the necessary capital to do the deal on their own.

By partnering with a private equity firm, the owner can recapitalize the company and do any one of the following:

1. Sell 100% of the firm at pricing consistent with what a strategic acquirer would pay (i.e., Orkin, Rentokil, etc); or,
2. Sell a controlling interest in the business and "take some chips of the table" but still retain an equity stake in the business and continue to manage the company. This is advantageous to those who are looking for substantial growth capital for the purpose of expansion or acquisition. It allows these owners to diversify their wealth but retain ownership and realize future upside from the growth of their businesses; or,
3. Sell the business to children working in the company or a management team that doesn't have the capital required to acquire the business on their own

As the pest control industry continues to mature, the private equity industry will play a very important role in the way in which business owners grow and exit their businesses. So what is a private equity firm? In short, private equity firms are investment funds that generally invest in private companies. They do this by either acquiring

100% of the selling company, or acquiring a controlling interest (typically 51% to 99%) of a seller through a leveraged recapitalization.

Although the majority of pest control companies are acquired by strategic acquirers, the pest control industry is no stranger to the world of private equity investing, in fact, it was a pest control transaction that is largely credited with the birth of private equity. The leveraged buyout ("LBO") of Orkin Exterminating in 1964 is credited as the first significant leveraged buyout, and the deal that kicked off the growth of private equity investing that by the end of 2008 was a \$2.5 trillion global industry. Lewis Cullman, the private investor and architect of the Orkin LBO who ultimately brought Wayne Rollins in on the deal in 1964 stated, "[we] were the ones who built the model that the LBO rose from -- the ones who first applied the ancient principles of leverage to the complex world of modern finance."

In recent years, there has been some interest on the part of private equity in the pest control industry, such as Wind Point Partners investment in Wilson Pest Control in 1998, and Prometheus Partner's acquisition of Baco Exterminating in 2008. However, it wasn't until last year, when Albert Cantu, former President of Terminix, joined Waud Capital Partners, that a private equity firm has made a firm public commitment to acquiring and building a national presence in the pest control industry.

Waud Capital Partners ("WCP"), a private equity firm based in Chicago, is a firm that I've known personally since my own days as a private equity investor at American Capital, also in Chicago. I got the opportunity to discuss WCP's investment philosophy and growth plans in the pest control industry with

Partner Matt Clary and Executive Partner Albert Cantu.

Interview with Matthew Clary, Partner:

How does Waud Capital differ from other players in the pest control industry?

As a private equity firm, we look to make investments in great businesses and great management teams. We identify industries and opportunities that are attractive and we provide the capital and strategic guidance to companies that are looking to grow and build upon what they have already established.

Most private equity firms target a 3-5 year investment horizon, but if you look at our investment history, we frequently take a longer term outlook and generally hold our investments longer. Some of our investments are over 7 years old and still performing incredibly well. Our firm is only made up of 9 investment professionals, so we're pretty lean. We provide access to capital, a network of contacts and resources, as well as strategic thinking, but the executives we partner with manage the companies.

Our professionals have a total of over 75 years of experience working with companies in industries ranging from lawn care to physician staffing, so we've seen and worked through lots of different challenges along the way and we draw from this diversity of experience to benefit the companies in which we invest.

What type of experience does WCP bring to the table that is relevant to the pest control industry?

As a firm, we have extensive experience in consumer and residential services, having made successful investments in lawn care, security monitoring, residential water treatment and propane distribution over the years. We're familiar with branch based operations and the pest control industry is an area that we've found attractive for years. We've spent a lot of time talking to people

within the industry, both from an advisory standpoint and from an operating standpoint, so we've done a lot of research. We understand the importance of customer service and we like companies with strong recurring revenue and the ability to grow both by opening new branches and through acquisition. With Albert recently joining our firm, we have a wealth of industry knowledge and experience, so we're now proactively looking to build a premier player in the pest control space.

Is WCP looking to partner with owners / management in less than a 100% change of control situation? What is your philosophy on partnering with strong management teams and investing in future growth?

Whether owners are looking to exit the business entirely or remain with the company, we can be flexible with how we structure deals so that we address the objectives of the specific situation. Unlike other firms, we have a great deal of industry knowledge in Albert, so if an owner is looking to exit the business entirely, we can accommodate them without compromising performance at the company. On the flip side, we also know that many owners want to continue running their companies, but they also might be interested in taking some chips off the table and capitalizing on what they've built so far. In those situations, we're happy to discuss rolling over some of their ownership into an ongoing entity that has access to a substantial amount of capital for growth. This allows a business owner to take some money off the table now, but also realize what we believe will be an attractive return on their rollover investment as well.

Can a private equity firm really be price-competitive with strategic buyers when acquiring a pest control company?

Without a doubt, we can be competitive with strategic buyers. We understand the business from an operational perspective, so we can quickly evaluate each opportunity and determine where there are areas for growth and improvement

and where there are risks. While every acquisition opportunity is unique, our knowledge of the space allows us to be competitive. We also believe the flexibility of our capital and our ability to structure deals differently, according to the objectives of an owner, make us an attractive partner.

Interview with Albert Cantu, Executive Partner:

How did this new opportunity come about? Who approached who?

Waud Capital is a very well-respected private equity firm that's been around quite a while. They have an excellent track record in building businesses and being long term partners in the industries they participate in. The evolution of the strategy we have was really a collaborative effort. We both believe that there are great opportunities in pest control, lawn care, plumbing, heating and cooling, home warranties, maid service and other home service industries.

What will be your primary growth strategy? Acquiring new companies or setting up new branch offices?

The growth strategy is to acquire companies on a regional basis and to continue to build on the strength on their brands. Many companies have been in business for years and consequently have built a lot of customer good will and brand equity. It is our intent to build on all of the attributes that have made those companies great. So we'll continue to grow the companies both organically, as well as through acquisition.

In terms of acquisitions, what will your company look for in potential partners?

The thought is to approach this from a regional perspective and build out each region of the country using the strength of the brands that we acquire in each of those regions.

How important is pest control to this new sector?

I think that clearly pest control is a very solid, strong industry. The business

model is time-tested. It is an industry that provides a great service to this country. It just has a tremendous amount of good, solid business people in it. I've had the pleasure of being involved in this industry the last 20 years and have met many great people in it. We anticipate being able to help these firms generate additional value for their respective stakeholders. We intend to be a long-term and a responsible participant in all the industries we enter into. It's a track record we have and quite frankly one of the things I think will contribute to a great partnership between us.

What is the strategy for growing nationally in terms of geographic expansion?

There's not one area of the country we are targeting. It's going to be on a case-by-case basis. As each of these industries presents opportunities to us, we will work hard to capitalize on that opportunity. We intend to be a strong member and participant in the pest control community. Like I said before it is a great industry and something I have been around all my life. I know of no better industry to try to be a part of.

Do you feel there is room for another major player?

Absolutely. In this marketplace there are a tremendous number of successful companies out there. Even with that there is just so much opportunity out for everyone. Looking back at my days with Terminix with all the independent market studies and analyses that we did one theme rang true over and over, the market is ripe for opportunity for everyone. The more pest control companies there are providing quality services and great career opportunities will only serve to expand the market.

What can you tell us about Waud Capital Partners?

If you look at their history, what impresses me is their ability to be responsible owners, if you will. By that, I mean they enter into a business or an industry with the intent of creating value,

not only for their investors, but for the firm they acquire and its employees. It clearly is more of a partnership with the companies that they invest in. The goal is to create value for everyone involved as opposed to approaching it as if it were strictly a financial play. That type of approach is very important particularly in a service business because it is a people business. The service is only as good as the people providing it. If your associates don't perceive their company as a great place to work or that management doesn't care about them as individuals, the job they are doing and about customers in general, then that is going to manifest itself in the type of service they are delivering. Waud Capital has a great track record of creating partnerships and enhancing the value for everyone involved in the business. We also help these companies reach their potential and achieve their vision. We do this by giving the company opportunity and resources to execute the strategy.

From operation standpoint under one brand name like Orkin and Terminix?

No. While tucking in acquisitions has been successful for Orkin and Terminix, this strategy is different. We envision partnering with strong regional companies and continue to build on the brand equity and the customer good will that has been created over the years. The continued existence of the regional brand is key to successful execution. We want to enhance those respective brands individually and grow those businesses both organically and through smaller tuck-in acquisitions.

What type of a timeline are you looking at? For example, with the pest control division, where do you see it in 1 year, 5 years or 10 years.

That's a very difficult question. Clearly we will be ready to examine any and all opportunities that present themselves within the pest control industry. It's an industry we feel very strongly about. We believe there is a lot of opportunity to create value for the companies in the

industry and the industry as a whole. We are going to be patient participants in the industry and we'll make decisions and acquisitions based on sound financial and strategic information.

How do you feel your personal successes at ServiceMaster and Terminix will benefit you in this new position?

Suffice it to say my 20 years in the pest control industry with Terminix and running multi units of ServiceMaster will be beneficial. Knowing what is important to potential partners is very important in my view.

About The Potomac Company

The Potomac Company is a Philadelphia-based mergers & acquisitions and valuation advisory firm with a transaction group dedicated exclusively to the pest control industry. The Potomac Company advises pest control companies in North America, South America, Europe, Africa, Asia and the Middle East.

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