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Capital Call:

Sri Lanka private equity courts fast growing firms

Jan 27, 2014 (LBO) - Small and medium companies with a winning business model that have growth plan can fuel their expansion with private equity, industry officials said.

Indika Hettiarachchi, managing director, Jupiter Capital Partners, a Colombo based private equity firm said a firm with a 10 to 15 percent a year growth plan was not a candidate for PE funds.

"Unless we make a return of 25 percent IRR we cannot do the deal, because the investors demand high returns," he told a forum on private equity investment in Colombo.

Private equity firms were not looking to provide seed capital to start ups like 'angel investors' and 'venture capital' but wanted to invest in businesses with an ongoing operation which had ambitious growth plans.

A PE fund manager would typically be an independent firm owned by those who run it from investors and investment funds or limited partners into a private equity fund and then put the money into firms help them grow and then exit.

An exit may be an initial public offer or sale to another firm or strategic partner.

But PE firms was careful to make sure that investee firms did as the track record of investee companies is what brought more funds into their hands in the future, Hettiarachchi said.

Though there were PE funds for specific areas, smaller emerging markets like Sri Lanka a generalist fund which could invest in a broad range of sectors made more sense, Hettiarachchi said.

Regional and country specific funds would invest here.

A fast growing company had the option of raising debt or even taking on a strategic partner rather than taking private equity.

"Private equity is not cheap," Hettiarachchi said. PE involved dilution of ownership.

But other than bank debt which drained cashflows out as debt had to be repaid, equity investment allowed cash to remain in the business for growth.

A strategic investor may also constrain growth opportunities that conflicted with their own business.

Most Sri Lankan entrepreneurs were focused on making money only with operational profits of a company.

But by going with private equity investor and creating company that can be sold to others created wealth, Hettiarachchi said.

The wealth of people like Bill Gates came from the value of the business they created he said.

To create value in a company, it had to have good governance and be run according to health and safety standards and the law of the land, he said.

Many small companies sometimes had two sets of accounts, tended to under-report revenues and profits.

Hettiarachchi said in order to realize the true value of the company, as well as draw PE capital these practices had to end.

Chanaka Wickramasuriya, financial consultant who had worked in regional and Sri Lanka based private equity firms said family companies had to make themselves ready for private equity.

They had to 'clean up' scattered ownership perhaps by putting them in a single holding entry and had to come into a agreement about bringing in a PE firm.

If family members do not see eye-to-eye the issues had to be resolved. Asset and intellectual property ownership had to be cleaned up. Some of these processes may take time, Wickramasuriya said.

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