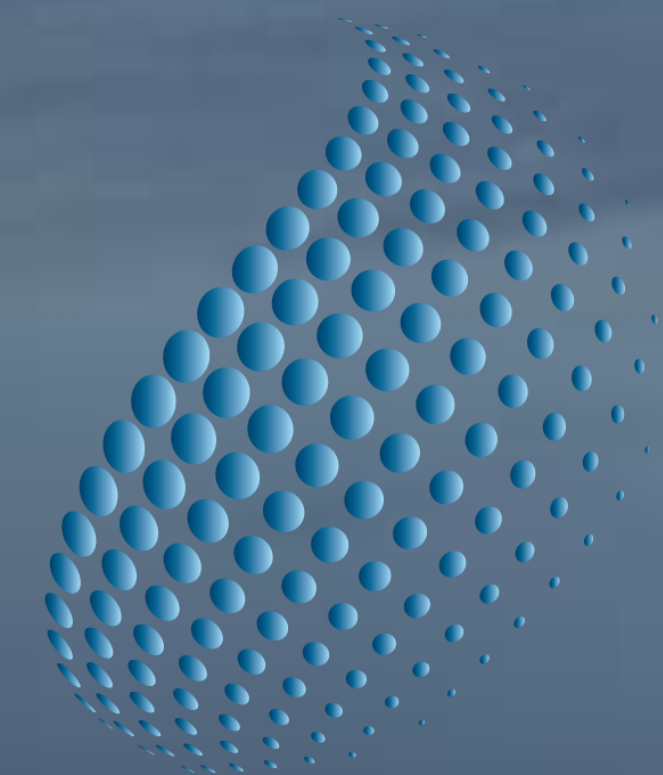


# A private strategy for public markets

By Oddbjørn Dybvad



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REQ Global Compounders invests primarily in listed serial acquirers across the globe. The companies we own acquire several small private companies. Over the years we have spoken with many founders of private businesses who decided to sell to the companies in our portfolio to understand their reasoning. We have detailed our key takeaways from these discussions below.

Capitalism does not always work according to the textbook. The highest bidder for an asset does not always succeed. Our discussions with founders reveal some interesting and important considerations when weighing up whether to sell their business, often a life's work. Price is of course important with many founders deciding to sell to the highest bidder. The listed serial acquirers in our portfolio offer founders much more than a price, something that can be very important to some private sellers.

There are many reasons why the founder of a private company chooses to sell. For example, the next generation of the family may not be interested in running the business; there may be no natural successor; the founder might be in poor health; or perhaps the founder realizes that they have taken the business as far as they can and recognizes that a new and professional owner who is able to inject additional capital would be beneficial.

### Permanent homes & autonomy

Our serial acquirers offer a 'permanent home', to borrow a phrase from the legendary investor Warren Buffett. Our acquirers have spent decades building relationships and trust with the owners of private businesses. The companies in our portfolio do not buy, "fix" and sell – in fact our serial acquirers very seldom sell companies. They buy, help build and hold. They pay in cash after a thoughtful, but rapid, due diligence process.

The founders of acquired private companies typically remain with the business, and also often retain a minority stake of 10-20%. This means the original owners are able to operate as before, but with the benefit of valuable insights and experience of the new listed majority shareholder on how to improve capital efficiency and growth. Long term capital is provided when needed.

With autonomy comes responsibility. Our listed serial acquirers tend to have clear goals when it comes to improving results and cash flow through inventory levels and accounts receivables. Key Performance Indicators are often closely monitored on a monthly basis. For the new majority shareholder it is a delicate balance, refined over many years, of using both the carrot and the stick in order to increase performance.

## Capital

Many privately owned businesses reach a point where significant capital is needed in order to increase capacity, enter new markets or acquire competitors. We often see that the original founder, who has invested all their energy and capital into the business for many years, does not have enough capital and generally have a very conservative approach to taking on debt.

## Head office & local community

Deciding to sell a business which has been built over decades is emotional. Most founders are very attached to the business, its employees, the headquarters location and the local community. The name and reputation of the company is often deeply attached to the founder, who consequently, cares about the perception of the company in the local community. We tend to see that the company name, head office, logo and brands are all retained after a transaction.

## Employees

The founders who choose to sell their companies to our listed serial acquirers have often built their companies over many decades. They have been a good employer and are motivated to continue to take care of their employees. They are keen to retain the entrepreneurial spirit and “family-feeling” of the business.

*“Companies die prematurely because managers focus exclusively on economic activity, forgetting that an organization is a community of humans”*

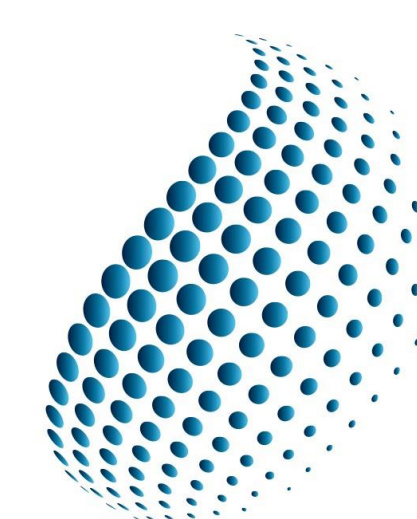
(Lessons from Century Club Companies)

What do the listed serial acquirers in our portfolio typically offer? In addition to autonomy and capital, our portfolio companies have deep experience in dealing with small private companies. Generally, they do not buy a private company in order to cut costs, but use their accumulated knowledge from many private company acquisitions to offer guidance on how to improve cash flow and to challenge the original founder on existing practices. Many of our serial acquirers offer conferences where CEOs from all underlying companies meet to exchange best practices which can be highly valuable.

## Our strategy

Some investors say our strategy resembles a private equity strategy with daily liquidity but without the typical “2&20” fee structure.

Others view our strategy as a “private/public arbitrage” since our listed holdings buy private companies at much lower multiples than the multiple our listed holdings trade at themselves.



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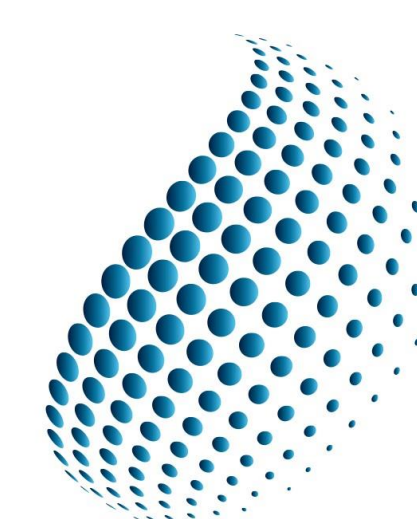
We think our strategy offers the best of both worlds when it comes to risk and return. Since we end up with a significant number of private holdings in our fund across sectors and geographies, we believe the underlying risk/reward of the strategy is attractive. From a return perspective our companies offer two engines of earnings growth; the traditional organic engine and an important growth engine from many bolt-on acquisitions. From a risk perspective, if one of the small private companies fails, it does not rock the boat for the holding company. Strong serial acquirers with the opportunity to deploy the majority of free cash flow into small bolt on acquisitions have enormous future optionality which tends not to be captured in analyst forecasts. In our experience, investors often underestimate this source of future value creation.

*“When it comes to great small businesses: Why not own a bunch of them through a holding company?”*

(Mark Leonard, Constellation Software)

To sum up

Our goal is to own a portfolio of around 30 stocks that are heavily skewed toward serial acquirers which will outgrow the market for decades to come. These companies are led by individuals who have exceptional capital allocation skills, who believe in decentralization and entrepreneurship, and have a management team with significant skin in the game.



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