HIGH RISK PRIVATE EQUITY FUND COMPANIES *By Tom Hoyum, Hoyum Services January 2010*

Use your credit principles and process consistently. If you have a new customer with little or no credit information about the company and/or the owners, how much credit would you give them? Not much.

For an average new customer, you can easily do this. For a high risk private equity fund company, the company is usually large enough to be one of your big customers in sales. You may know the company through a customer relationship from a previous owner. Sales will want to hang onto these customers.

The many good private equity fund companies are much different. They have transparency and provide information about their companies. They look and act like a good customer, because they are. You don't see them as being much different from a parent company and a subsidiary.

Explaining what these high risk private equity fund companies do is difficult. Their profit targets and methods are different. Would your company borrow to pay dividends or consider selling the company at a loss if a short term profit target was missed? I have had people ask how anyone could treat a company this way. For some background, you may want to read Business Week's 10/30/2006 article, "Gluttons At The Gate - Private equity are using slick new tricks to gorge on corporate assets--A story of excess." Here is the link: http://www.businessweek.com/magazine/content/06_44/b4007001.htm

When you meet a high risk private equity fund with little or no credit information, you may see a company that appears better than the real situation.

The high risk private equity fund has credit references from the company they bought and rarely about themselves or their other investments.

What they are doing is legal. Seller beware. Set limits. Remember, how you grant credit for a new company. Analyze their credit thoroughly. In many cases, you don't know the owners or can't verify how they do business. I have tried to track down prior private equity fund investments and usually there is no public record or they vanish into another company with no record. Experian and Euler Hermes appear to pay special attention to companies with limited information and rate them accordingly.

A high risk private equity fund buys an established company that is successful or bankrupt with room for more profit and more efficiency. The private equity fund management sells its consulting services to their companies and rarely direct management in the company. They move toward looking like a distressed company as time goes on.

Here are examples of these high risk customers prior to the financial crisis that began in 2009. These two first customers were previously good paying customers.

A Fortune 500 company sold an appliance component company to a private equity fund, which also owned restaurants, daycare centers, and healthcare businesses. Payments became slower and slower. The company tried to get supplier and vendor support during their financial problems, which turned into a Chapter 7 bankruptcy.

A private company that made heavy equipment parts was sold to one private equity fund, which, according to the CFO sold "this cash cow" to raise money before they went bankrupt. The buyer was a private equity fund, owned by major bank, which was big enough to get bailout money, owns the private equity fund that owns our customer and also owns their loan. According to Accounting management, the bank has seized the company's funds high interest rates of 14% on the loan, fees, and other charges, telling them to collect their receivables to pay payables. They have fallen significantly past due for the first time ever.

The third company was an old, established company, making parts for the automotive industry, went bankrupt, primarily because of a financing problem relation to the previous owner. The private equity fund that bought them, promised to infuse lots of cash and make it more efficient. The payments have slowed as they appear to have missed profit targets.

They are acting like a severely distressed company. Most have severe cash flow problems.

When things go bad for these companies, you often will go over your credit information and find black holes. The customer that you thought you had does not exist. What can you do?

- Follow your approval process. Know your good customers and know the high risk companies for your company. Set limits.
- Monitor news alerts and update credit reports and references periodically. Has ownership changed? Have payment patterns changed?
- Pay attention to things you do not understand or know. You may find the ownership and customer's credit status confusing at times. Get more information from reputable sources.
- You can reduce your risk.