Minority and Growth Equity (Private Equity)

Interview preparation summary · PE track

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INT.MG.1.a · Minority and growth equity compared with buyouts

Explain how minority and growth equity investing differs from a control buyout, covering control, leverage, the sources of return, structure as protection and founder alignment, and say when each route fits.

In a control buyout the fund owns the majority, sets strategy, appoints management and usually puts debt on the company, so returns come from earnings growth, a change in the multiple and paying down debt. A minority or growth equity investor buys a stake that does not carry control, usually in a founder-owned or family-owned business that is growing and wants capital or a partner rather than a sale. Leverage is small or zero, because growth companies reinvest their cash and a minority holder cannot dictate debt or dividends, so the return comes mainly from growth in earnings and cash. Because the investor cannot simply change the board, protection is built into the deal: preferred shares with a liquidation preference, vetoes over key decisions, information rights, pre-emption, and agreed routes to an exit. The founder stays in charge and keeps a large stake, so alignment matters and the split between primary money for the company and secondary money for the founder is closely watched. A buyout suits stable, cash-generative businesses whose owners want a full exit; minority growth suits businesses with strong growth, owners who want to stay and a use for the money. Interview point: say that without control and leverage the investor needs the business itself to grow, and that structure and partnership stand in for control.

WORKED EXAMPLE: THE SAME COMPANY, BOUGHT TWO WAYS

A company has EBITDA of 10 million and is valued at 10 times EBITDA, so enterprise value is 100 million. A buyout fund buys all of it using 50 million of debt and 50 million of equity. Five years later EBITDA is 16 million, the multiple is unchanged and debt has been cut to 20 million. A growth investor instead buys 20% of the company for 20 million with no debt. What does each earn, and what growth would the growth investor need to match the buyout fund?

Answer: The buyout fund earns 2.8x and about 22.9% a year; the unlevered minority investor earns 1.6x and about 9.9%, and would need earnings growth of about 22.9% a year to match.

> **Interview tip:** Say that the minority investor has no leverage and no control, so the return rests on growth, and the protection comes from the structure. Interviewers listen for whether you can explain the gap in numbers.

INT.MG.1.b · Minority and growth equity compared with buyouts

Source and diligence a founder-owned or family-owned business for a minority investment, testing why the owner is selling a stake, the quality of growth, the use of proceeds, key-person risk and the quality of governance.

Founder-owned and family businesses are often found through relationships, advisers, banks and proactive outreach rather than auctions, so a minority investor can be the first and sometimes only party at the table. The first question is why the owner wants a partner: capital for growth, some liquidity, help with professionalising, a family succession or a way to buy out other relatives. Each answer implies a different structure and a different risk. Diligence then tests quality of growth: how much comes from existing customers staying and spending more, from price, from new customers or from acquisitions, how concentrated customers are, and whether margins hold as the business scales. Use of proceeds matters: primary money for a costed plan is stronger than a payment to the owner. Because the investor cannot change management, key-person risk is central: how much depends on the founder, what second line exists and what keeps the founder committed. Governance quality should be examined for related-party dealings, family on the payroll, informal decisions and weak reporting. Interview point: because you cannot fix problems after investing, make them conditions of the deal or leave them out of the price.

WORKED EXAMPLE: TESTING A FOUNDER'S MINORITY RAISE

A founder-owned business with 40 million of revenue is valued at 200 million before the investment. An investor puts in 50 million: 30 million of new shares that go into the company and 20 million to buy shares from the founder. Revenue grew to 48 million last year, and existing customers spent 8% more than the year before. How should the investor read the stake, the founder's position and the quality of growth?

Answer: The investor holds about 21.7% for 50 million, the founder keeps 78.3% (worth 180 million) plus 20 million in cash, and 60% of growth came from new customers, so sales capacity and key-person terms are the main diligence areas.

> **Interview tip:** Start with why the founder is selling and what the money is for, then test growth quality and the key people. Interviewers like candidates who say what they would make a condition because they cannot fix it later.

INT.MG.2.a · Instruments, structure and governance

Explain the instruments and structuring tools of a minority or growth deal: primary and secondary, ordinary and preferred equity, convertible preferred, liquidation preferences with and without participation, redemption and put rights, and ratchets.

A growth investor can buy new shares issued by the company (primary, so the cash goes into the business and existing holders are diluted) or existing shares from the founder or other holders (secondary, so the cash goes to the sellers). Many deals mix the two. The shares are often convertible preferred shares rather than ordinary shares, which lets the investor choose between taking its preference and converting. A liquidation preference sets what the holder is paid first on a sale or winding-up, commonly one times the amount invested. A non-participating preference pays the greater of the preference and the as-converted share, so it protects the downside and the investor gives up the preference when converting is better. A participating preference pays the preference and then also a pro rata share of what remains, sometimes capped, which transfers value from the founders and is more heavily negotiated. A redemption or put right gives the investor a route to be repaid after a set date, usually at a formula price, but it depends on the company's cash and legal capacity. A ratchet adjusts the investor's stake or price if targets are missed or a later round is cheaper. Counsel handles the drafting. Interview point: show that you can trade headline valuation against structure.

WORKED EXAMPLE: ORDINARY, NON-PARTICIPATING AND PARTICIPATING SHARES

An investor puts 50 million into a company for 20% at a post-money value of 250 million. The company is later sold, with no debt, for 100, 250 or 600 million. Compare what the investor receives with ordinary shares, with a 1x non-participating preference and with a 1x fully participating preference.

Answer: At exits of 100, 250 and 600 million the investor receives 50, 50 and 120 million with a non-participating preference, against 60, 90 and 160 million if it participates, and 20, 50 and 120 million with ordinary shares.

> **Interview tip:** State the preference type and the multiple first, then work out the payout as the greater of the preference and the converted share, or the preference plus the share. Interviewers listen for whether you separate the two.

INT.MG.2.b · Instruments, structure and governance

Describe the protective provisions and governance a minority investor negotiates in place of control, including board seat or observer, reserved matters, information rights, pre-emption, anti-dilution, tag-along and drag-along, and how to influence a business you do not control.

Without a majority, the investor gets protection through the shareholders' agreement and the company's articles. Board rights come as a seat, which carries a vote and a director's duties, or an observer role, which gives the papers and a voice but no vote. Reserved matters, also called protective provisions or vetoes, list the decisions that need the investor's consent, such as issuing senior shares, changing the business, large debt, related-party deals, big acquisitions or disposals, changing the budget materially, and selling the company. They should be drawn tightly enough to protect the investment without making the founder feel the investor runs the business. Information rights give monthly accounts, budgets and access. Pre-emption lets the investor take its share of new issues to avoid dilution, while anti-dilution adjusts the conversion price if shares are later issued at a lower price, either by a full ratchet or by a weighted average. Tag-along lets the investor sell alongside a majority sale on equal terms; drag-along lets a majority force a sale, usually subject to price and timing conditions. Influence in practice comes from being a useful partner on hiring, strategy and later fundraising. Counsel handles drafting. Interview point: protection is for the downside, while influence comes from adding value.

WORKED EXAMPLE: ANTI-DILUTION AFTER A LOWER-PRICED ROUND

An investor holds 2 million preferred shares bought at 10 pounds a share, convertible one for one, in a company with 10 million shares fully diluted (so 8 million other shares). The company issues 2 million new shares at 5 pounds. Compare the investor's stake with no anti-dilution, with broad-based weighted-average protection, and with a full ratchet.

Answer: The stake is 16.7% with no protection, about 17.9% with a broad-based weighted average (conversion price 9.17 pounds) and 28.6% with a full ratchet.

> **Interview tip:** Say that weighted average adjusts for the size of the new issue, while a full ratchet only looks at its price. Interviewers want to hear that you know the cost to the founder as well as the protection to the investor.

INT.MG.3.a · Valuation, returns and exits

Value a minority stake and work out its returns, using growth-adjusted multiples, minority and illiquidity discounts, the trade-off between entry price and structure, MOIC and IRR with a preference and with dilution, and a comparison with a levered buyout.

Valuing a growth company often starts with multiples of revenue, or of earnings measured against growth, because current profit is held down by reinvestment. A buyout multiple is set against steady cash flow and debt capacity, while a growth multiple pays for expected expansion and so carries more risk if growth slows. A minority stake is worth less than its pro rata share of the whole, because the holder cannot control strategy, dividends or the timing of a sale and the shares are hard to sell. The discount is a matter of judgement, and in practice the price is negotiated, with structure often moving the real terms: a higher headline valuation with a preference may be better for the investor in a poor outcome and worse in a good one than a lower price for ordinary shares. Returns are measured as MOIC and IRR on the investor's own cheque, taking account of any preference, of dilution from later rounds if the investor does not follow its money, and of the time held. Compared with a levered buyout of the same company, the minority investor lacks the boost from debt paydown and so needs more growth. Interview point: always state the instrument, the entry price and what happens at low, middle and high exit values.

WORKED EXAMPLE: A HIGHER PRICE WITH A PREFERENCE, OR A LOWER PRICE WITHOUT

A company with 20 million of EBITDA is valued by peers at 12 times, so 240 million of equity with no debt. An investor can buy 25% either for 48 million as ordinary shares (a 20% discount to the pro rata value), or for 60 million with a 1x non-participating preference. Compare the money multiples and five-year IRRs at an exit equity value of 150 million and of 400 million.

Answer: At 150 million the preferred option returns 1.0x (0% IRR) against 0.78x for ordinary shares, and at 400 million it returns 1.67x (about 10.8%) against 2.08x (about 15.8%); they cross at an exit value of 192 million.

> **Interview tip:** Show both sides of the trade, the downside protected and the upside given away, and name the break-even exit value. Interviewers prefer a view on which option you would take and why.

INT.MG.3.b · Valuation, returns and exits

Describe the exit routes for a minority holder, including an IPO, a sale alongside the majority, a secondary sale to a buyout fund and a put or redemption, and judge the cost of delay and the risk of being stuck.

A minority investor does not control the timing of an exit, so the routes are agreed at entry. The main routes are a sale of the whole company, in which the investor sells alongside the majority, helped by tag-along and drag-along rights; a stock market listing, where the investor sells over time and may be subject to lock-ups; a sale of the investor's stake to another investor, such as a buyout fund, a larger growth fund or a strategic buyer, often at a price shaped by the same minority discount; and a put or redemption right against the company or the founder, which depends on the company's ability to pay. Often the agreement gives the investor the right to require a sale process after a set date, a long-stop for a drag-along, or a step-up in the investor's stake if it is not repaid. The risk of being stuck is real: a successful business with a founder who does not want to sell can leave the investor holding an illiquid stake. Delay cuts the IRR even if the multiple holds, so the cost of waiting should be measured. Interview point: say how you would build the route out at entry and what you would do if it fails.

WORKED EXAMPLE: THE COST OF A DELAYED EXIT

A minority investor puts 50 million into a company. It expects its stake to be worth 125 million in year five, but the founder does not want to sell and the exit slips to year eight with the stake still worth 125 million. The agreement also gives a redemption right at cost plus 8% a year compounded. Show the IRR in each case, the stake value needed to hold the original IRR, and what the redemption right is worth.

Answer: The IRR falls from about 20.1% to about 12.1% when the exit slips from year five to year eight at the same 125 million; holding 20.1% would need about 217 million, and the redemption right sets a floor of about 92.5 million.

Interview tip: Quote the IRR for each date rather than only the multiple, and name the contractual routes to liquidity. Interviewers listen for whether you see that a minority investor's main risk is time.

Summary of the Charta interview-preparation topic. Companies and figures in the examples are invented. Draft content, not yet expert reviewed.