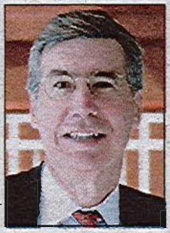
CapitalSouth, Plexus: Financing business is booming

ADAM O'DANIEL | FINANCE EDITOR
aodaniel@bizjournals.com

With banks skittish about financing small companies, investors such as Joe Alala and Bob Anders are filling the void.

The two men run separate private-equity investment companies in Charlotte that specialize in serving lower-middle-market companies. Alala's CapitalSouth Partners and Anders' Plexus Capital take debt and equity investments in small but growing companies to finance expansions, buyouts and mergers.



Anders

The business is booming. Both firms are raising money and have added employees in the past year.

CapitalSouth intends to double its assets under management to $1.5 billion from the current $700 million. Alala is on a two-week investor pitch in Europe to present his strategy to institutional investors.

Plexus, founded by ex-RBC Centura execs Anders and Kel Landis, holds similar aspirations, announcing this summer it will raise a third fund to start investing in growing companies.

The firm already has put two other pots of cash to work. A 2005 fund totaled $75 million, and a 2009 fund raised $175 million.

The target size of the third fund hasn't been disclosed publicly, but it could be as large as $275 million, according to an investor presentation obtained by the *Charlotte Business Journal*.

"The demise of traditional lending has been beneficial to us," says Anders, Plexus managing partner. "While the economy has been in malaise, good companies are still doing OK."

Alala, founder and president of CapitalSouth, shares the sentiment. "The banks aren't lending, and people are coming to us for equity solutions," he says.

The companies' missions are similar. They seek healthy, established companies with less than $100 million in annual revenue that need capital to expand or facilitate a management buyout. They avoid start-ups and turnarounds.

The investments are usually structured as subordinated debt with warrants or as a minority equity stake. Charlotte-based CapitalSouth — with offices in Raleigh; Dallas; Louisville, Ky.; and Orlando, Fla. — is investing about $50 million per quarter spread over six deals. Plexus, based here with a second office in Raleigh, has invested more than $100 million since 2010.

Of course, many of both firms' investors are the same banks said to be not lending. So in a way, the capital is being redirected.

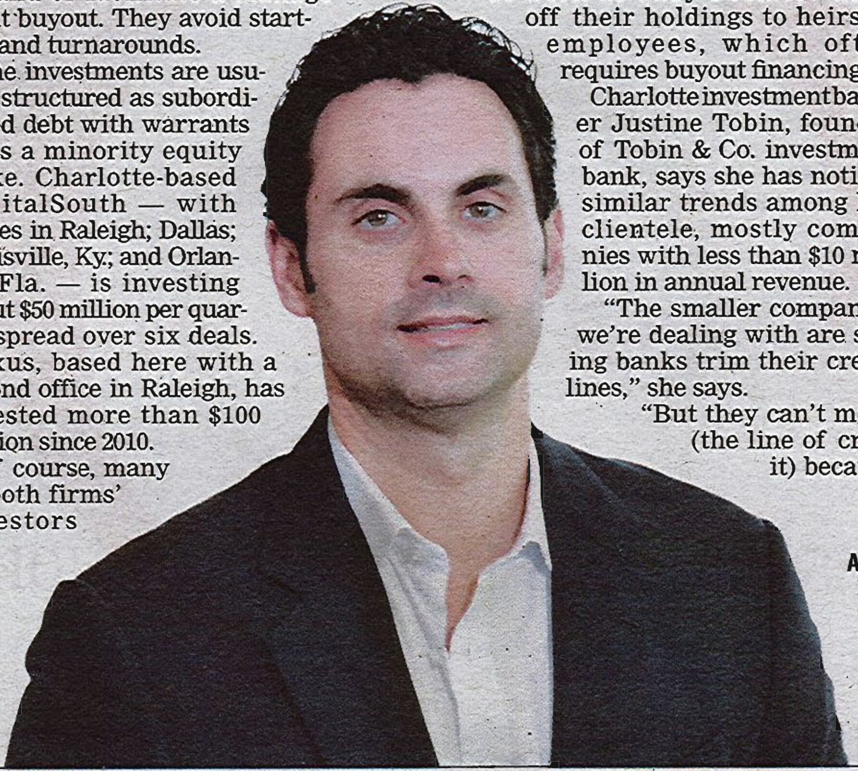
Alala says recent activity is motivated by three trends. The lack of bank financing has been the primary factor. In addition, large numbers of family-owned businesses are selling their stakes to existing management or another buyer to reap gains now, rather than delaying that move for several years, when taxes are expected to be higher.

There are also generational forces at work as baby boomers hand off their holdings to heirs or employees, which often requires buyout financing.

Charlotte investment banker Justine Tobin, founder of Tobin & Co. investment bank, says she has noticed similar trends among her clientele, mostly companies with less than $10 million in annual revenue.

"The smaller companies we're dealing with are seeing banks trim their credit lines," she says.

"But they can't move (the line of credit) because there aren't many others willing to lend."



Alala

photo NANCY PIERCE

Tobin says her clients also struggle to land deals with private investors such as Plexus or CapitalSouth. She says such funds look for any blemish over the past four years before making a deal. But she acknowledges they present a viable alternative when traditional lenders aren't interested.

"They're still being picky," she says of small private-equity firms. "But if you can prove you have a full pipeline of business and solid cash-flow growth, then you can access private capital."

Since 2005, Plexus has made 48 such investments, exiting about half of them, with investor returns of more than 10% for its first fund. During the last decade, CapitalSouth has closed 80 transactions, and it reports investor returns in the double-digit range.

Plexus' Anders says returns are bolstered by low interest rates. Both Plexus and CapitalSouth are registered Small Business Investment Companies, which allows them to leverage private funds two-to-one with loans from the Small Business Administration. They repay that cash at the 10-year Treasury rate, which is at historic lows.

CapitalSouth also is a registered SBIC. But it has hit that program's $225 million borrowing limit, so its most recent deals are 100% private-investor backed. Alala is hopeful the SBIC cap will be raised to $350 million by next year.

"We do think the economy is slowing again, so we're being selective with our investments," he says. "I think it'll be that way until we see who's in the White House."