PRISM CAPITAL PARTNERS: INVESTMENT DECISION

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1. Introduction

Prism Capital Partners was a private equity firm that raised funds from accredited investors to acquire and improve companies before selling them at a profit. Prism had recently been approached by investment bankers with two potential acquisition targets and needed to determine whether to pursue one of them, or neither. Because Prism did not have sufficient capital allocated to make both acquisitions, the firm needed to compare the opportunities and select the option that best aligned with its investment strategy and fund thesis.

One of the prospects was a camper rental business, and the other was a chain of dog daycare centers (Kaplan & Strömberg 2009). The case provides high-level operational and financial information for each business. Participants must identify the due diligence questions they would need to ask to complete a deeper evaluation, recognizing the limits of the information provided.

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2. Hedge Funds and Private Equity Characteristics

Private equity firms were similar to hedge funds in that both accepted capital only from accredited or otherwise qualified investors. Requirements differed for individuals and for entities such as funds or trusts. Individuals needed to demonstrate that they earned income of at least $200,000 if filing singly or $300,000 if filing jointly with a spouse for the previous two years, with a reasonable expectation that income would remain at that level for the current year. They also needed to have a net worth of at least $1 million, excluding their primary residence. Entities, including private equity partnerships or trusts, qualified under separate standards, generally by holding more than $5 million in assets (Metrick & Yasuda 2011). These criteria were intended to ensure that only those with sufficient financial capacity and sophistication participated in high-risk private market investments.

Exhibit 1. Requirement to become accepted as an Accredited (Qualified) Investor
Source: Authors' notes

- Earned income is greater than $200,000 if filing as a single person or $300,000 when filing jointly with spouse for two consecutive years.
- Reasonable expectation that income will be at least the same for the current year.
- Net worth greater than $1 million excluding primary residence.

or

- Be a hedge fund partner.

or

- Be a trust fund holding more than $5million in assets.

Another similarity between hedge funds and private equity firms was their fee structure. The most common arrangement was the *"two and twenty,"* under which the fund charged a 2% annual management fee based on committed or invested capital and retained 20% of any profits as a performance fee. For example, if an individual invested $1 million, the fund charged a $20,000 management fee ($1 million × 0.02). If that investment earned $200,000 in profit, the firm kept $40,000 as carry ($200,000 × 0.20). After both fees were deducted, $140,000 was returned to the investor.

There were major differences between hedge funds and private equity firms. Hedge funds usually acquired only a portion of a company's equity and might pursue activist strategies to gain influence or board representation. They typically operated with short time horizons—often two or three years. Private equity firms, by contrast, usually purchased all or most of a target company and expected to hold the investment for seven to twelve years. Many corporate management teams were wary of hedge fund involvement due to concerns about proxy contests or leadership turnover. Private equity firms, however, were often welcomed when owners sought capital, face financing constraints, or wished to retire or pursue other interests. In some cases, the acquiring firm might hire an industry expert to run the purchased company.

Both hedge funds and private equity firms raised money from accredited investors who could commit significant capital and accept long lock-up periods. These funds specified withdrawal restrictions and guidelines that governed when and under what circumstances capital could be redeemed (Metrick & Yasuda 2011).

3. Prism Capital Partners Sources of Funds - Mezzanine Financing

When Prism made a purchase, it used only a small percentage of its own capital. The remaining funds typically came from senior debt and mezzanine financing. Prism's first fund raised $200 million, which it aimed to leverage across several acquisitions. For example, if an investment was expected to cost $100 million, approximately seventy-five percent ($75 million) would come from senior lenders, ten percent ($10 million) from mezzanine financing, and the remaining fifteen percent from Prism's fund. If this capital structure was maintained, the $200 million fund could support approximately $1.33 billion in total acquisitions. (See Exhibit 2.) This approach reflected Prism's general investment thesis, which emphasized control acquisitions of established, cash-flow-generating businesses rather than distressed, early-stage, or pre-IPO companies.

Exhibit 2. Breakdown of Prism Partners Source of Funds for Target Purchases

Source: Authors' notes

Senior lenders	75%
Mezzanine financing	10%
Prism Capital's funding	15%

Prism, like other private equity firms, needed to raise money from investors continually. A typical fund ranged between $200 million and $400 million. When the committed capital was fully deployed, a new fund was launched. To maximize the number of acquisitions that could be completed, each purchase was highly leveraged. Mezzanine financing played an important role in this structure. It was a hybrid of debt and equity financing that gave the lender the option to convert to an equity interest if the borrower defaulted. Mezzanine debt often included equity-linked features, such as warrants, which increased the value available to holders of subordinated debt and provided flexibility when negotiating with senior lenders (Metrick & Yasuda 2011). At the time of Prism's investment decisions, recent data highlighted a shift toward more creative financing structures in a slower deal environment (McKinsey & Company 2024).

Since mezzanine financing bridged the gap between debt and equity, it was a high-risk and expensive type of debt. Prism was accustomed to paying six hundred basis points over the Treasury note rate to obtain this type of financing. Mezzanine debt was subordinated to senior debt, but senior to equity. The providers of this type of funding were frequently long-term investors, and having them on the balance sheet could make the firm more attractive to other lenders because it signaled stability and patient capital.

Mezzanine interest was tax-deductible, and borrowers often structured interest payments into the loan balance. If Prism were unable to meet scheduled interest payments, some or all of the interest might be deferred. Because mezzanine financing was relatively expensive, Prism typically sought to pay down this layer of debt as quickly as possible using the acquisition's earnings.

4. Sourcing Business Opportunities

Prism got most of its referrals from investment bankers. Other solicitations for business sales come from business brokers, commercial banks, and accounting firms. The managing directors also maintained personal networks that generated referrals. Most businesses offered for sale were marketed through an auction-style process in which bankers specified a minimum acceptable bid. For larger transactions, a *"road show"* might be held to present details of the opportunity to qualified bidders.

Prism has been informed of two businesses currently available for purchase. The first was a camper rental business operating in five U.S. cities. The second was a chain of dog daycare centers with thirty locations. Based on Prism's general fund thesis, which focused on acquiring established, cash-flow-producing companies that could be improved operationally rather than speculative or early-stage ventures, both opportunities preliminarily fell within Prism's scope. However, detailed evaluations would depend on the due diligence process, and the narrative did not provide audited financial statements, asset-level documentation, or location-specific operating data. These gaps needed to be addressed directly with the sellers.

Prism also has a distinctive exit strategy. It was one of the few private equity firms that committed to selling its investments back to the employees of the acquired company (Kaplan & Strömberg 2009). Like other private equity investors, Prism sought businesses that could be made more profitable and eventually sold at a substantial gain. The commitment to an employee-based exit did not alter the firm's focus on operational improvement, but did play a role in selecting companies whose management teams were strong enough to operate independently after the sale.

Camper Rental Opportunity

Six Australian businesspeople formed a partnership to enter the camper rental business. Their model involved purchasing vans at an average cost of $10,000, each having been driven approximately 150,000 miles. An additional $5,000 was invested to retrofit each van for rental use, including painting them in bright, eye-catching colors. The vans rented for $2,000 per week, with optional insurance offered for an additional fee. After finding success in Australia, the partners expanded the business to the United States.

The U.S. operation consisted of 200 campers with facilities in San Diego, Seattle, Phoenix, Denver, and Miami. Vans could be rented from one location and returned to another for an additional charge. Combined annual EBITDA for these locations is approximately $2.7 million. The partners planned to retire and wished to sell the U.S. business. They retained Morgan Stanley to conduct the sale and established a minimum acceptable bid of $20 million. Morgan Stanley has committed to closing this transaction in approximately six months if at least one bidder was willing to meet this price. (See Exhibit 3.)

Exhibit 3. Camper Rental Basics

Source: Authors' notes

- Assets included 200 restored vans.
- Each van had at least 150,000 miles of use.
- Each van was purchased for an average of $10,000.
- Each van has been retrofitted for an additional $5,000.
- Vans rented for $2,000 a week.
- Retail centers were located in San Diego, Denver, Phoenix, Seattle, Miami.
- This business had been successful in Australia.
- Minimum acceptable bid was $20 million.
- The market value of the campers was approximately the same as the outstanding loan balances on the campers.

A condensed income statement for the camper opportunity is shown in Exhibit 4. The business generated approximately $4 million in annual revenue. Insurance averaged $1,000 per camper each year, while wages, rent, and repairs composed most of the operating expenses.

Depreciation and interest expense are excluded because Prism based its valuations on EBITDA. Depending on the industry and growth potential, Prism might offer between five and seven times EBITDA, applying higher multiples only when the target had significant upside. The camper business reported EBITDA of roughly $2.7 million (See Exhibit 4.) Industry data indicated that the median buyout entry multiples had remained in the 10–12× range in recent years, although smaller service businesses like Prism's targets often transacted at lower multiples (Bain & Company 2023).

Private equity firms preferred EBITDA because it approximated a measure of operating earnings independent of tax positions and financing structures, which varied among investors. Some firms thought of EBITDA as a cash flow proxy. Target-company owners focused on cash-based profitability and value maximization, not on the acquirer's tax or leverage configuration.

Exhibit 4. Income Statement for Camper Rental Opportunity

Source: Authors' notes

Revenue	$ 4,000,000
Cost of goods sold	
Insurance	$ 200,000
Repairs	$ 50,000
Wages	$ 180,000
Rent	$ 120,000
Total cost	$ 550,000
Selling, marketing, and admin expense	$ 400,000
Replacing and retrofitting cars	$ 372,000
EBITDA	$ 2,678,000

The COVID-19 pandemic highlighted risks inherent in the camper rental industry. Periods of restricted travel or reduced tourism could sharply reduce demand, making earnings highly sensitive to economic and public-health conditions.

Dog Daycare Centers

A veterinarian opened a dog daycare center with the idea that it would steer business to his medical practice. While this did not happen, he found that the daycare center generated substantial income and involved minimal investment. This led him to open more centers around his geographic area. When he found that new centers were cannibalizing the older centers, he ceased expanding. He was contacted by a corporation that sought to purchase his six operations. The corporation was successful in obtaining the six centers.

There was a growing trend of consolidation of medical practices. Doctor's offices, medical lab test centers, dental practices, physical therapy clinics, veterinarian practices had increasingly been sold to corporations. Part of the reasons for the trend was that sole practitioners were tired of the paperwork and keeping up with changes in government regulations, or they were in need of cash. There were also economies of scale to be achieved, and professional managerial experience could improve the bottom line.

Over time, the corporation obtained a total of thirty-one dog daycare operations. Six of the thirty had turned out to be unprofitable and would be closed. Of the remaining twenty-five centers, six had undergone facelifts and new signage and were expected to become more profitable. As can be seen in Exhibit 5, the typical center had an EBITDA of $200,000. Most centers operated in rental space. Thus, rent and wages were the primary expenses. A typical center generated about $1 million in annual revenues. Since most transactions were paid for by credit cards, cash was the greatest current asset. (Credit card transactions turned to cash in less than twenty-four hours.) There was little inventory and almost no fixed assets. The current CEO was expected to stay on after the change in ownership. The CFO needed to be replaced. The opportunity was brought to Prism Partners by J P Morgan. Prism had been informed that it would take at least $30 million to close the deal (See Exhibits 5 and 6).

Exhibit 5. Dog Daycare Basics

Source: Authors' notes

- Minimum purchase price: $30 million.
- Number of day care centers being sold: 25.
- Number of day care centers that had been newly renovated: 6.
- Average annual EBITDA per day care center: $200,000.
- Personnel facts: The current CEO would remain with the purchasing investor.
- The current CFO will needed to be replaced.

Exhibit 6 provides an income statement for a typical dog daycare center. To get a total picture of this investment opportunity, all entries on this income statement should be multiplied by twenty-five. Thus, total EBITDA would be approximately $5 million. Because these centers had few fixed assets, depreciation and interest expenses were minimal.

Exhibit 6. Income Statement of a Typical Dog Daycare Center

Source: Authors' notes

Revenue	$ 1,000,000
Cost of goods sold	
Wages	$ 250,000
other costs	$ 100,000
Rental expenses	$ 150,000
Total cost	$ 500,000
Selling, marketing, and administrative expense	$ 300,000
EBITDA	$ 200,000

5. Your Assignment

You are a senior analyst at Prism. The managing director has asked you to evaluate the two investment opportunities presented. The first step, as part of due diligence, is to develop a set of questions for the appropriate parties involved in each opportunity. The case narrative intentionally provides only high-level operational and financial information; it does not include audited EBITDA figures, seasonal revenue breakdowns, asset-level inspection reports, or detailed cost histories. Identifying these gaps is an essential part of the due diligence process, and your task is to determine what additional information would be required before Prism could make a fully informed decision.

After identifying your due diligence questions, analyze each opportunity and prepare a recommendation for the investment committee regarding whether Prism should pursue one, both, or neither of the projects. Your recommendation should explain the merits and drawbacks of each option and specify the amount that Prism should consider offering for any viable target. In addition, describe how Prism could expand or grow the investment you recommend, assuming one is chosen. The structure of any offer should follow the general framework shown in Exhibit 1, while also considering whether alternative financing structures might offer advantages beyond Prism's typical model.

a. Due Diligence Questions - Camper Rental Opportunity

As part of your due diligence for the camper rental opportunity, you should begin by reviewing the company's financial records. Determine whether historical EBITDA figures have been audited, and request revenue breakdowns by location and by season to assess performance variability, recognizing that these details are not provided in the case narrative. Pay particular attention to insurance and maintenance costs and how they fluctuate from year to year. Next, evaluate the firm's assets and operations. Consider the current condition of the 200 vans, the schedule for replacing or retrofitting vehicles, and whether any liens or loan obligations are associated with them. From a market perspective, compare U.S. demand patterns to those observed in Australia, taking seasonal factors and risks—such as declines in tourism during economic downturns or pandemics—into account. You should also assess legal and regulatory matters, including compliance across the five U.S. locations and any outstanding liabilities. Finally, review management and staffing to understand the organizational structure and to determine the extent to which operations rely on the founders' experience (IBISWorld 2024).

b. Due Diligence Questions - Dog Daycare Opportunity

For the dog daycare opportunity, due diligence should begin with a careful review of financial performance. Confirm whether the financials for the twenty-five centers are consolidated, whether they have been verified, and how profitability varies by location. Identify the proportion of revenues coming from recurring versus new customers. On the operational side, review property and lease agreements, and compare the performance of the six recently renovated centers to the others to evaluate whether renovations translate into improved returns. From a market perspective, assess opportunities for expansion while avoiding cannibalization of existing centers, and evaluate how competition influences pricing, customer acquisition, and occupancy rates. Review management and staffing considerations, including the importance of the current CEO's leadership and plans for replacing the CFO. Finally, examine regulatory and insurance issues, including licensing requirements, historical insurance claims, and compliance with health and safety standards that may affect operations (IBISWorld 2025).

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