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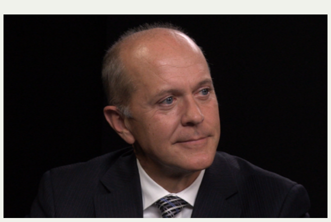
VIDEO SERIES

Briefing

Anatomy of a PE Deal

A discussion of the relationship between Arsenal Capital Partners and its portfolio company Chromaflo.



Scott Becker
Chromaflo Technologies

Mauro Bonugli
RSM

Timothy Zappala
Arsenal Capital Partners

Anatomy of a PE Deal

Key Findings

1. Good chemistry brings a good result
2. Focused operating teams are key
3. Success can be planned for before the close
4. PE firms look at different metrics
5. The right tools build growth

The Panelists

Scott Becker
President, CEO
Chromaflo Technologies Corp.

Mauro Bonugli
Director of Private Equity Consulting,
RSM

Timothy Zappala
Partner,
Arsenal Capital Partners

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1. Good chemistry brings a good result

Most of the time, private equity firms target companies for investment. But sometimes it happens the other way around. Companies—or the people running them—go in search of a PE partner with the skills and knowledge to take them to the next level.

That's what Scott Becker, chief executive officer of Chromaflo Technologies, did. Several years ago he was CEO of Ohio-based pigment dispersions company Plasticolors when he identified an opportunity to take his business global. But he needed the right partner to make it happen.

"I had found an opportunity within a large German company to carve out a piece of their business that would fit very well with ours, and at that point I realized I needed to get some financial support to effect the transaction," Becker says.

Not any investor would do, however. He knew he needed a private equity firm with deep expertise in his industry to execute his plan successfully. He went through 20 firms before deciding on Arsenal Capital Partners, which focuses on small to midsize companies in two areas: chemicals and materials, and healthcare.

"Our practice is very deep and very technically oriented," says Timothy Zappala, a partner at Arsenal. "We also do a lot of carve-outs from corporate parents. Those situations tend to be relatively complex, and therefore our core team is all full-time industry professionals."

Those on Arsenal's chemicals and materials team all have technical degrees, mostly in chemical engineering, and all have run companies or large divisions. Most have done deals in the formulated materials industry.

"That allows us to be much more supportive as we develop operating plans for companies and help them develop their processes, because our goal is to take smaller entities and scale to larger operating platforms," Zappala says.

In the case of Chromaflo, Arsenal did just that. It concurrently acquired Becker's Plasticolors and Colortrend, the German carve-out that Becker had been eyeing, and merged the two companies to create Chromaflo, with Becker as CEO. Chromaflo is now a global leader in the pigment dispersions field.

Opening the Lines of Communication

Timothy Zappala
Arsenal Capital Partners

Direct dialogue between PE firms and portfolio companies is an absolute must. Arsenal partner Timothy Zappala makes a point of letting portfolio companies know that he's always available for consultation. That unfettered access is a primary reason why his firm's investment in Chromaflo has been successful.

"If there's anything that comes up—an acquisition opportunity they want to look at or a change in one of the integration plans—they can call me anytime," he says. "And because it's a single point of contact, it's a much more comfortable arrangement."

Communication doesn't just happen on an ad hoc basis. There's also a formal calendar of weekly, monthly, and quarterly meetings. And there were many daily talks during the run-up to the deal to develop the strategic road map.

"In the case of Chromaflo, we had a lot of integration activity, so we had a whole section each month where we talked about how we're doing on the integration and if things were getting delayed," Zappala says. "Also we talked about whether we're capturing the synergies that we expected from pulling multiple companies together."

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Overcoming IT Integration

Scott Becker
Chromaflo Technologies

By all accounts, Arsenal's investment in Chromaflo has been a remarkable success, with the company quadrupling earnings over the last three years. But even though the deal looks silky smooth on the outside, there's a lot of frantic paddling that goes on beneath the surface.

"Our biggest challenge, and one I never realized would be so difficult, is IT integration," says Chromaflo CEO Scott Becker. "It's quite significant. We've made a number of acquisitions, which means we're on different ERP [enterprise resource planning] systems, so we can't communicate as effectively as we'd like. Gathering data is much more complex and much more time-consuming, because our systems have not been integrated from day one."

Chromaflo is currently exerting plenty of energy to ensure that all its pieces fit together well. "Integrating those disparate systems is a gigantic undertaking and one that we're still working on, but we should have everything complete in the next six months," Becker says.

2. Focused operating teams are key

The collaboration between Arsenal and Becker exemplifies a trend in private equity: firms deploying operating partners not only to take over a company once it's acquired, but to work with company managers and apply sector expertise to evaluate opportunities before a deal is done.

"That's becoming more and more common nowadays," says Mauro Bonugli, director of private equity consulting at RSM. "Look at Arsenal, for example, which is very focused on a few sectors. They bring a lot of expertise in those sectors. Pre-investment, they always get involved in the deals. Obviously if you have the industry and the sector expertise, it brings a lot to the table in terms of understanding what are the risks and opportunities in that investment."

There's a difference between sector expertise and functional expertise. Functional expertise, for example, is when a firm has someone who's been a chief financial officer in different industries and can apply that experience to a portfolio company. A lot of PE firms have functional expertise in-house and hire consultants to provide sector expertise as needed.

Arsenal has built in-house operating teams that are aligned to the firm's sector focus. This approach works for two reasons. "One, we're dealing with small to midsize companies, so they tend to be a little less mature, and we need that leadership experience in order to interface," Zappala says. "Two, as we craft strategies, we find it's more beneficial if we can understand the technology around the companies. So we go very deep. We tend to stay within our area, and that combination allows us to put together much better growth strategies and interface with companies more easily."

3. Success can be planned for before the close

The 100-day plan is crucial to any private equity deal. It's the road map to value capture that must be executed in the first 100 days after the close. Arsenal typically draws up a 90-day plan and puts it to work before a deal closes, not after.

"Prior to closing, once we have a fix on exactly what our overall strategy is going to be, and when we've dialoged enough with the portfolio company so we know where we want to get alignment, we put together a 90-day plan that has all the commercial aspects, technical aspects that the company will be focusing on, and a variety of various integration-related activities," Zappala says.

Prior to closing the Chromaflo deal, Arsenal put together a 90-day plan in conjunction with Becker and his team at Plasticolors.

"We were probably done with our 90-day plan three months before the close occurred," Becker says. "It covered every single discipline, from finance to operations to sales and marketing to communications, and was heavily provided by the Arsenal group. Our goal was established well

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The Human Factor

Mauro Bonugli
RSM

Every PE professional knows that a winning investment isn't only about money. It's also about people.

"The reality is that the human capital component of the private equity portfolio is always very important," says Mauro Bonugli, director of private equity consulting at RSM. And getting the right person in the right job at the right time is of paramount significance.

"Sometimes you just have to recognize that certain leaders might not be a good fit for that specific job," Bonugli said. "But at the same time, it's very hard to change leadership. It's really common for people to say, 'I should have changed the CFO, the CEO, the COO faster than I did.' By the time you realize you want to make a change, the company might already be behind plan."

For Bonugli, the key to any transition is moving fast and knowing how to maximize all your resources. "The challenge is always, how do you hire fast enough? How do you dedicate people to the transition, even when those people also have to do their day-to-day jobs?"

in advance as well. We intended to double our earnings over a five-year period."

In fact, Chromaflo has quadrupled original earnings in less than three years.

4. PE firms look at different metrics

Clearly, Arsenal's plan for Chromaflo worked. But various PE firms draw up their own plans in various ways. Bonugli says he's seen firms with 100-day plans that are somewhat generic, put together based on an investment thesis—such as doubling earnings in five years—and emphasizing what must be done in the first 100 days to get there. And he's seen plans enacted after a close that emphasize very specific lists of strategic initiatives that must be accomplished.

"And I've seen more firms these days setting up company operating metrics," Bonugli adds. "You're always looking at financial metrics, of course, but a lot of them tend to be backward-looking metrics. A lot of private equity funds now look at forward-looking, more operational metrics to figure out what the four or five metrics are that really matter in this business, and whether they can figure out, in the first 100 days, how to extract [those metrics] on a recurring basis."

5. The right tools build growth

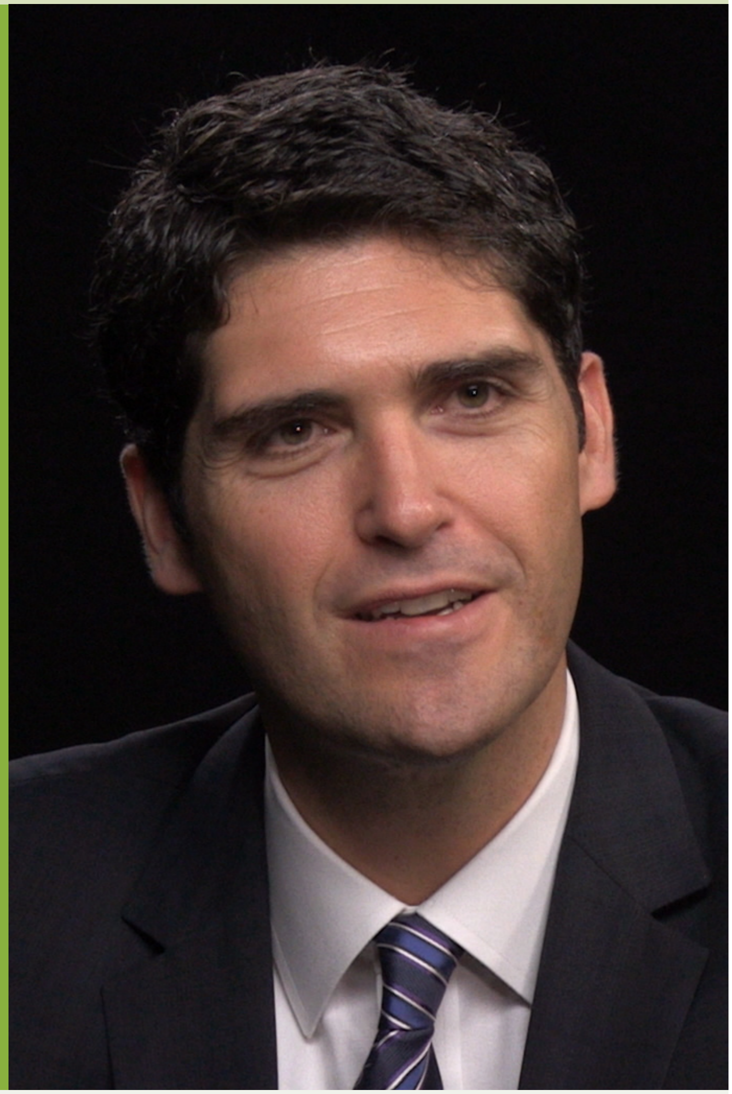
Becker and the Arsenal team identified a number of different priorities in their plan for Chromaflo that they knew must be implemented to drive growth. Priority one was transferring the technology they had in the U.S. to the global platform that they had developed through their acquisitions.

Priority two was to ensure alignment among the diverse cultures brought together in those acquisitions to guarantee that all the cultures were focused on the most important aspect of the new company, which was (and is) customers and potential customers.

Becker made these goals reality by accessing the Arsenal toolbox. "I often reached out to Arsenal," he says. "I continue to reach out to Arsenal to this day, heavily with Tim [Zappala] because he has extensive experience. There isn't a template that exists, but, more or less, experience and advice are critical to making things happen." ■

Expert Q&A

With Mauro Bonugli, Director of Private Equity Consulting, RSM



What is the ideal team dynamic, with regard to operating expertise, when sourcing deals?

When sourcing deals, what I've seen in the past that works well with the operating teams pretty much fits into two categories. The first category is around developing the investment thesis. So it comes before sourcing the deals, becomes developing a strategy that the private equity firm will follow as their investment program. And in tapping into the knowledge, sector expertise or industry expertise of those operating resources, it's important to define that investment thesis.

Number two is around tapping into the operating partners' or advisors' networks. It's clear that nowadays with advances in technology and social media, it's becoming harder and harder to find proprietary deals. So tapping into that community and that network and relationships that exist within the operating partners who actually spend many years in the specific industry is extremely valuable to sourcing those deals, and then working together to execute that investment.

Has operating partners tapping their networks worked well within PE firms?

Absolutely. Given my background, primarily in technology, I've worked with our investment teams in actually developing specific strategies. An example was the early days in cloud computing and big data and having that technical understanding of the process, working with investment teams to really identify what the trends are, and then what the potential opportunities are in the market, especially in private equity. ■