May 2015

PRIVCAP REPORT/

PE Value-Creation Stories

Ten Essential Case Studies Detailing How PE Improves Portfolio Companies

Sponsored by

David Snow
CEO & Co-founder
Privcap Media

Ten Unique Stories

Over the years, I've told writers new to the private equity beat that they should think of it not as a Wall Street niche but as a lens through which to view trends in just about every form of commercial endeavor on the planet.

Private equity and venture capital firms invest in every industry sector, in companies at every stage of development, and in most geographies of the world. Covering private equity as a topic means viewing a kaleidoscope of opportunities and hearing hundreds of different stories.

Despite the many different companies and investment situations, a recurring theme—especially when told by a GP—is the important role played by the private equity firm itself in shaping an outcome.

Competition for investment dollars, as well as an expected compression of returns, means that private equity investors must demonstrate an ability to change fortunes within their portfolio companies by dint of operational wherewithal or some other combination of resources being provided to management.

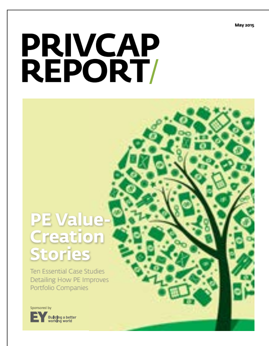
In this briefing, you will read the stories of 10 private equity investments, told by the deal partners themselves. Note that luck is not emphasized in these stories. The GPs go out of their way to emphasize a smart thesis, a smart approach to sourcing, and/or a smart operational-improvement plan that led to investment success.

Most of these stories also have affiliated video interviews that you can access—just click the icon that you'll see at the top of the page.

We hope you learn something of value about the private equity firms featured herein, and appreciate the varying ways the GPs have of identifying and unlocking value in a challenging market.

All the best,

David Snow
@SnowNotes



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Privcap Media

David Snow
Co-founder and CEO
Gill Torren
Co-founder and President

Marketing & Sales

Matthew Malone
Senior VP, Marketing & Digital Strategy
Jacqueline Ostrov
Marketing Manager
Neil Golub
Director of Business Development
Doug Weber
Sponsored Content

Content

Mike Straka
Editorial Director
Andrea Heisinger
Associate Editor
Zoe Hughes
Editor, PrivcapRE

Design & Production

Gerson Lopez
Production & Design Coordinator
Nathan Pardee
Video Production Manager
Jessica Holterhoff
Media & Marketing Coordinator

Contacts

Editorial
David Snow / dsnow@privcap.com
Mike Straka / mstraka@privcap.com
Zoe Hughes / zhughes@privcap.com
Andrea Heisinger / aheisinger@privcap.com
Sponsorships & Sales
Gill Torren / gtorren@privcap.com
Neil Golub /ngolub@privcap.com
Doug Weber /dweber@privcap.com

For subscriptions, please call 855-PRIVCAP
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Seeing **Value** in **Infection Prevention**

Baird Capital was looking for an investment in a company related to preventing hospital-acquired infections. They found it in Zurex, says the firm's Mike Liang.

Privcap: One company in which Baird has invested has products aimed at preventing hospital-acquired infections. Why was that an area of interest to you?

Mike Liang, Baird Capital: [We] thought it was an interesting area in terms of where providers weren't getting paid for people who had been diagnosed with hospital-acquired infections and had to treat them out of their own pockets. So it's going to be a big concern, and we started looking at the numbers. One out of every 20 patients gets some type of hospital-acquired infection. The estimates are somewhere around $30B at a time when everyone's trying to figure out how to save costs. It seems like a natural, interesting area for investment.

As we started looking into this area, we made an investment in an interesting medical-products company called Zurex Pharma, Inc., based in Middleton, Wisc. We had tracked this company for a couple of years. The reason we liked Zurex was that it was an interesting platform of anti-microbial solutions that could be used in different applications. One of their lead programs is skin prep for surgical-site infections—[there's a] very large market there, and it's used for every type of operating procedure. And they also had an interesting solution, with good clinical data already, as a catheter-lock solution. So any time someone has a catheter and people need to put solutions in and out at the end of it, you have to try to clean it to keep the catheter open but also keep it from being infected. Today what people use is either normal saline, or sometimes they use heparin, which is good as an anti-coagulant but does nothing from the anti-infective perspective.

What we saw is an interesting company with a great platform of products that we could develop, in an area that we were already very interested in. And so far so good: That company is doing quite well. That's an interesting example of what we'd love to be doing more of. ■

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Bain Capital
Keeps Warm With Canada Goose

The firm's Steve Pagliuca says the outerwear maker fit into a niche, and it's getting ready to take the brand global

The timing of Bain Capital's investment in outerwear company Canada Goose couldn't have been better than before the polar vortex in the winter of 2015.

"I was in New York City [a few weeks ago], and the jackets were everywhere," says Steve Pagliuca, managing partner at Bain Capital, which made an undisclosed majority investment in the company in December 2013.

February 2015 has gone in the record books as that month's third-coldest in New York City history, but it may actually be better known as the month Canada Goose invaded the Big Apple. The company's coats were seen everywhere, made conspicuous by their red, white, and blue logo placed on the upper left sleeve.

"Canada Goose was a small company that occupied a niche, and in our research on consumer preferences, the big words that came out were 'warmth' and 'quality,'" Pagliuca says. "We felt there was a large functional segment that would need that warmth and quality, and we really hit it off with [Canada Goose] CEO Dani Reiss, who is really driving the whole strategy."

Whether by accident or design, that strategy now includes celebrities, athletes, and supermodels who have flocked to the patented goose-down-filled parkas by the gaggles, helping what started out from a premise of making "the warmest coat on the planet" into the most sought-after winter coat of the 21st century.

"We bought in before the first polar vortex, and now we have 'snowmageddons,' so I don't think we could have two better years to own the company," says Pagliuca.

Indeed, since 2005, annual sales have increased from just $5M a year to some $200M and climbing, as the parkas that cost $800 and up continue to sell out in store after store, perhaps surpassing Bain's wildest dreams for the company.

"We're trying to figure out how to get more populated," Pagliuca says. "Jackets are flying off the shelves, so we are figuring out how to get the right distribution agreements and in the right stores, globally." ■

Fact Box

- Canada Goose started as Metro Sportswear in 1950
- In 2004, Canada Goose jackets were featured in the movie "The Day After Tomorrow"
- Bain invested in Canada Goose in December 2013

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How GTCR's Leadership Strategy Built Devicor

GTCR's Dean Mihas talks about a carve-out and subsequent exit of portfolio company Devicor, and how the firm's "Leaders Strategy" helped in the transaction

Privcap: You recently exited a platform company that GTCR built up called Devicor Medical Products. Could you give us a brief overview of what Devicor is?

Dean Mihas, GTCR: Devicor is a medical-products company based in Cincinnati, and they sell a bunch of products, mostly in and around the breast care space. Their main product is a system that performs a breast biopsy [the Mammotome Breast Biopsy System]. So the situation is a woman has a mammogram, and there's some abnormality that the physician wants to extract and test for cancer. We have a system where the woman would go in for an outpatient procedure and get that lesion removed via biopsy. The company sells directly into 10 countries and distributes into another 40 countries.

Your firm is known for taking a management-first approach. You find the talent, and then you find the companies.

Mihas: We call it the "Leaders Strategy" at GTCR. It's been the same strategy the firm has pursued since it was founded in 1980. Very simply, our investment process all starts with identifying a high-quality management

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executive who we want to work with, in combination with developing a thesis in a particular area of the industries we cover. Devicor would be a great example of this Leaders Strategy, but inside of healthcare we had developed a thesis in and around one area of the med-tech market, which in this case is the interventional-radiology department of the hospital where a number of outpatient procedures are done, including these biopsies.

Then we went out and met a number of executives who have led companies in and around the interventional-product space. And as part of that, we met Tom Dalton, who became the CEO of Devicor. We formed a formal partnership with him in advance of having any company or assets. We did that with Devicor, but in well over half the companies that we end up investing in, we have a management partner that we've identified and a thesis we're working with, and we are out looking for companies to buy.

Devicor was strategically sold to another company. So you've completed the round-trip of that private equity investment.

What were the drivers of success in the deal?

Mihas: It started with the foundation of having a thesis and having a management team. We proactively approached a number of companies; one of those was Johnson & Johnson [J&J]. They had this product line that we were familiar with, and it fit our thesis. We were able to negotiate a deal with J&J that took about 12 months from beginning to end, to buy that set of products. And it's fair to say that J&J would not have sold that to us had we not had the management team we had in place.

Mammotome was a business that didn't really fit inside of J&J. So we had a vision that we could pull this product set out, the biopsy system and a couple other related products that they sold with the system, and create a standalone company out of it. [We could] put more time, attention, and focus on this business, renew the product offering through a very targeted R&D effort, and as a result get the top line growing again. It had stagnated a bit under J&J, and [we wanted to] make it into a much more strategic asset.

The carve-out process from J&J required us to set up an entire back-office infrastructure. We had to move our manufacturing out of the J&J facility, which was down in Juarez, Mexico, and set up our own facilities within 18 months after closing the transaction. And then we had to get regulatory approval in each of the countries that we distributed in or sold the product to directly, and that took anywhere from a year to three years, in some cases, to get all those regulatory approvals. So there was a lot of complexity, but eventually we got the product out—and, after three years of effort, created a totally standalone company.

In addition to that, we completed four small acquisitions of products that were related to the products we were selling, and two licensing deals for related products. All those things in total effectively created a very different business than the one we started with, and created a standalone company that became an attractive strategic asset for a number of larger med-tech companies. Ultimately, Danaher [Corporation]'s business, Leica Biosystems, acquired Devicor. ■

Fact Box

- In 2010, Devicor completed initial platform acquisition with Mammotome carve-out from Johson & Johnson
- The standalone medical-devices business completed several complementary tuck-in acquisitions

Mammotome components and tools

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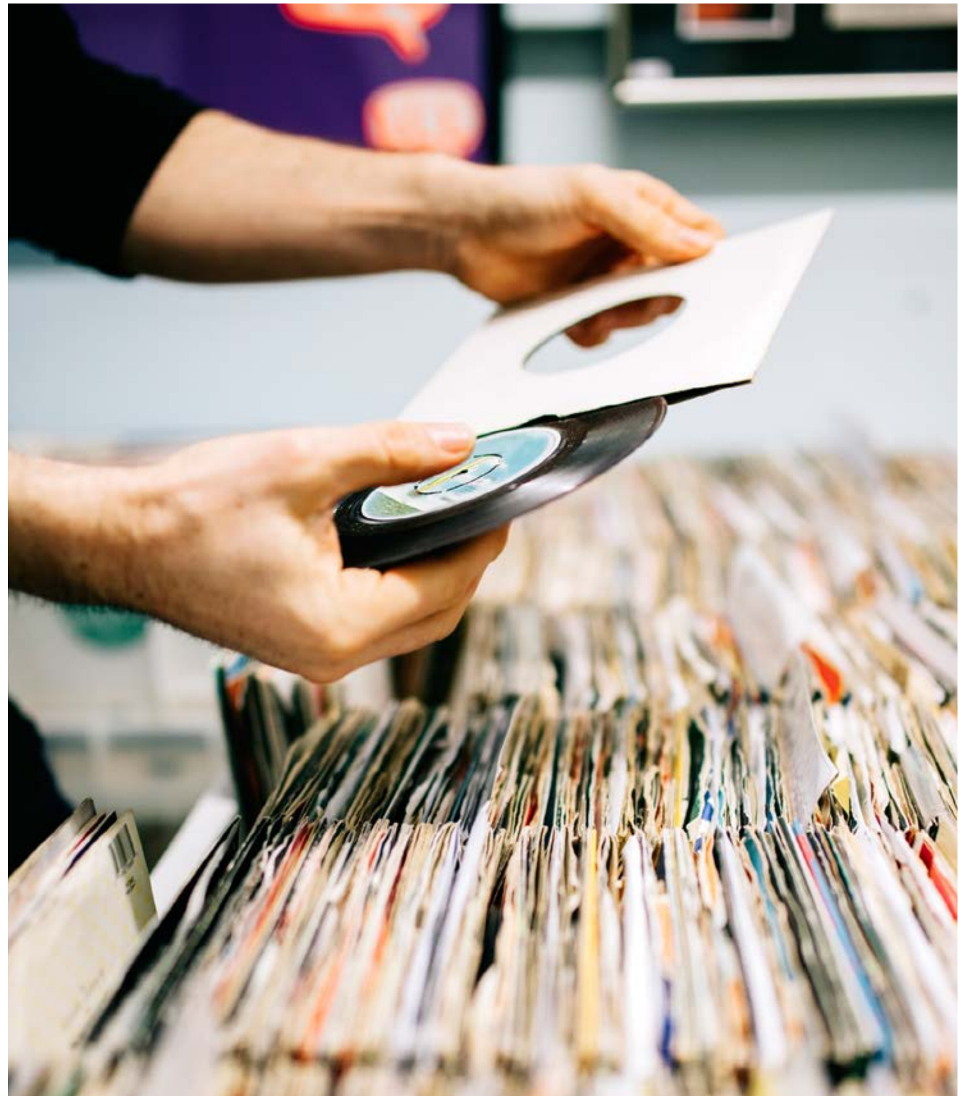
Spurring Growth in an Out-of-Favor Industry



Corinthian Capital Group invested in CD and DVD maker AVL Digital Group, focusing on its core and legacy products. The firm's Kenneth Clay talks about the deal.

Privcap: Let's talk about a recent exit that your firm did in the form of AVL Digital Group. What was the original thesis for that investment?

Kenneth Clay, Corinthian Capital: It was an entrepreneurial business, run by the son of the founder. The business had been around for 60 to 65 years, and it was primarily making CDs and DVDs for independent artists. [It was] kind of an out-of-favor industry when we made the investment, and there was a large bankruptcy of a company that was basically selling machine time to the large record labels. And everyone thought that the CD was disappearing. We resonated well with the owner and the management team. They cared about the price, of course, but also about the business and the people, and we were able to structure a deal at our price for a company that was very much out of favor. They went from shellac records to vinyl, to tape, to CD, to DVD, and ultimately digital distribution. And so we concluded that the investment in the core and/or legacy products would have a long life, and they did. We continued to build that business.

Did AVL do any add-on acquisitions while you owned it?

Clay: Yes, they made an acquisition of a company called CD Baby, which was highly complementary. It was and is one of the leading distributors of music electronically or over the Web for independent artists. And, in fact, a significant percentage of the content on iTunes—I think it's about 25 percent of the tracks by volume—come through CD Baby. So it was a terrific marriage of both the analog side and the digital side. ■

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FIRM GENERAL ATLANTIC | PORTFOLIO COMPANY Alibaba Group

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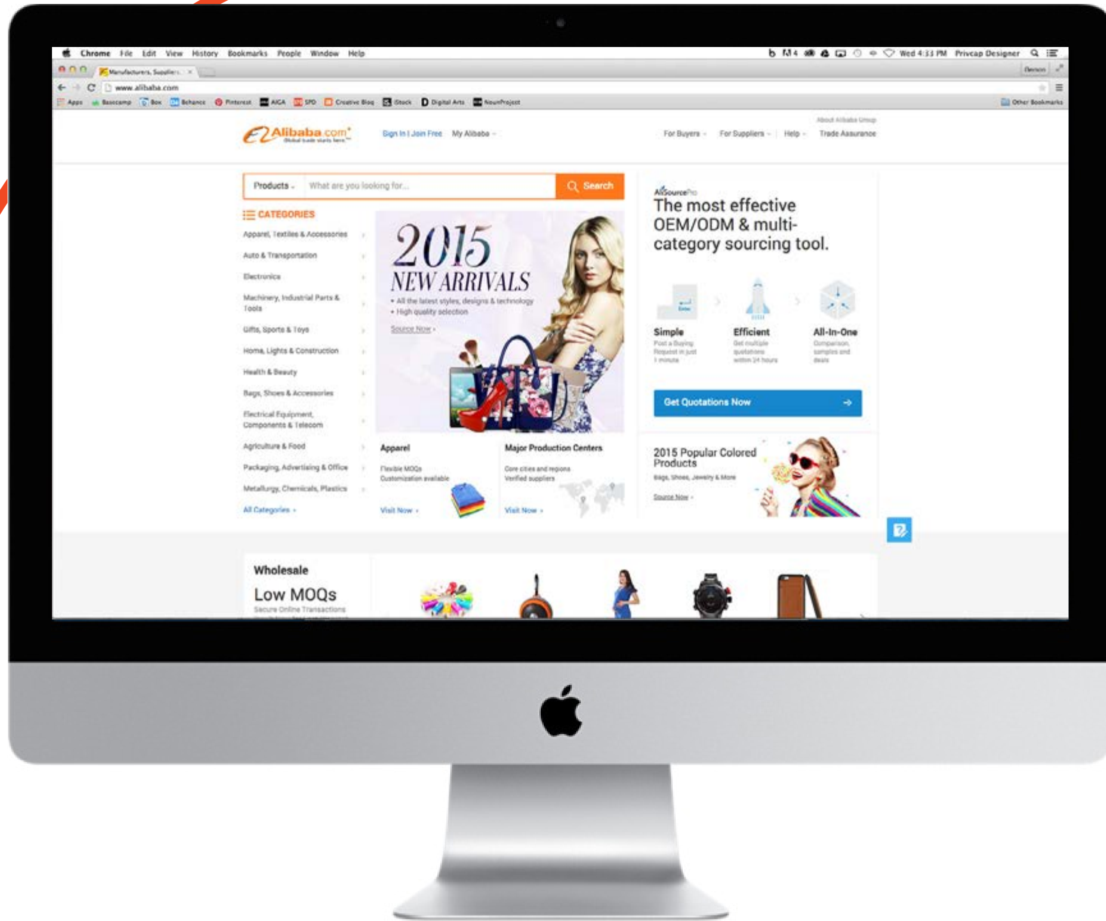

Recognizing *Value* in Alibaba

Following the largest IPO in history, Alibaba Group PE backer General Atlantic is reportedly seeing a roughly 18x increase in the value of its $75M investment in 2009. GA's Anton Levy speaks with Privcap about the deal—one of the most successful in the firm's history.

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Privcap: How did General Atlantic come to invest in Alibaba Group?

Anton Levy, General Atlantic: Back in early 2008, Jack and Joe were looking to see if they could help monetize some of the Yahoo! position that ultimately consummated itself later, in 2011. We met them through that process and began to develop a relationship. Every couple of years, they bring the top 15 to 20 business leaders across their entire organization to the U.S. They asked if we would be willing to sit down with them and talk about what we've done to build a successful investment organization. The next day, they reached out to me and said, "We think you have an interesting culture, approach to business, to partnerships, and to how you work with entrepreneurs." And they said they would love to find a way for us to become shareholders of Alibaba Group.

What did you like about Alibaba's business in 2009, when you made the investment?

Levy: The truth is, liquidity is really hard to get in the marketplace. The size and scale of the liquidity they had is what brought us in. They've been able to monetize it for years, but the opportunity to generate the liquidity, plus their team, is what initially got us incredibly excited. We had also spent a lot of time looking at Chinese e-commerce, and we were looking for a long-term opportunity in Chinese e-commerce. We did not sell in the IPO, and our view is that the business is going to be multiples the size of its current state over the coming years. We think that the growth's going to come across a whole bunch of different lines of business. We think they're relatively early in the monetization of their user base. They're already 80 percent of all mobile e-commerce in China, and when we made our investment, they had 70 percent of the Chinese e-commerce market. Alibaba is now over 100 percent of the entire profitability of the Chinese e-commerce sector.

How did General Atlantic add value to Alibaba?

Levy: They're an incredible team, and there was a lot of two-way dialogue. And there was a lot of discussion around really high-level strategy, about what they were doing on the M&A strategy side, and a little bit of how they were looking to build the team in different regions. When they were looking outside of China, we had a number of conversations around India, around the U.S. So most of the discussions have been relatively strategic in nature. There was a handful of tactical back-and-forth [conversation about] different businesses they were going to get in, different acquisitions they were going to make, investments they were going to make—things at that level. ■

Fact Box

- General Atlantic invested a reported $75M in Alibaba Group in 2008
- Alibaba's 2014 transactions totaled $248B—more than eBay and Amazon combined
- Alibaba's 2014 IPO raised $25B—the largest in history

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Portland PE Scores 'Triple Play' in Caribbean Telecom

In 2005, Portland Private Equity bought struggling Columbus Communications for $80M. Ten years later, it sold the company for $3B.

Privcap: Where did you see the value in Columbus Communications?

Michael Lee-Chin, Portland Private Equity: When you're in developing countries and you have the perspective of being an investor in a developed country, it's like you've seen that movie before. So we saw the cable movie before, played out in Canada, and we therefore saw the ingredients for a replay of that. Seeing the conditions prevalent in the region, we could see exactly how the movie was going to play out. We just pressed the start button.

We made our first foray [into the telecom sector] by owning Cable Bahamas. And we got into the undersea business by default, because the incumbent telco at the time was charging too much. So having gotten into it, we saw there was an opportunity in 2005 to have bought the Arcos Network, for which in the late 1990s, early 2000s, Motorola spent $450M laying 20,000 kilometers of undersea fiber. On becoming operationalized, it went bankrupt. At the time, we didn't have the smartphone, Google, etc., so there was just not enough broadband traffic.

So we bought Columbus Communications out of receivership for $80M. We spent $20M reorganizing it, and today that business will give us cash flow as measured by EBITDA of about $150M. That's our wholesale business. Then we have our retail business, selling the "triple play" in Trinidad, the eastern Caribbean, Jamaica, etc., and today that business is giving us another $150M in EBITDA. So we founded Columbus in 2005 with zero cash flow, but there was just huge demand, and the competing entity then was an incumbent monopoly, which was inefficient. That inefficiency is what gave us an opportunity. That business is now giving us cash flow of over $300M. And [London-based] Cable & Wireless Communications just bought us out for $3B. ■

Fact Box

- In 2005, Portland Private Equity bought Columbus out of bankruptcy for $80M
- Columbus International operates in 42 countries in the Caribbean and Latin America
- In March 2015, Cable & Wireless bought Columbus from PPE for $3B

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How BC Partners Grew Migros

BC Partners took Turkey's successful food retailer and made it even better, says the firm's Nikos Stathopoulos

AS AN EMERGING MARKET WITH VERY attractive demographics and little penetration by private equity, Turkey presents an interesting opportunity for investors in the asset class. Beginning in 2006, BC Partners had the country on its investment radar. By 2008, the firm completed Turkey's largest private equity deal ever.

BC Partners, a Pan-European investment firm, acquired an 80.5 percent stake in Migros, Turkey's largest supermarket chain, for $3.3B. As BC Partners managing partner Nikos Stathopoulos puts it, the investment thesis was "relatively simple."

"We were buying the market leader in the food retail sector, [which] tends to be a defensive sector," he explains. "[The business] had substantial growth opportunities driven by the fact that it operates in a market with 80 million [people] in a population where the demographics are extremely attractive."

Stathopoulos, a managing partner at the firm, notes that 50 percent of Turkey's population is below 30 years old and that its gross domestic product is growing at a substantial rate, outpacing any other European market on BC's radar. (The firm includes Turkey as part of its Pan-European focus.) Furthermore, Stathopoulos says the dynamics of organized retail in Turkey are in the very early stages of development. Compared with the rest of Western Europe, where the organized food retail subsector represents between 80 percent and 90 percent of the entire sector, in Turkey it represents only 40 percent. This means there is still a lot of room for organized food retail to grow.

Migros was founded 60 years ago and currently has close to 1,200 stores across Turkey, accounting for 15 percent of the country's organized food retail business. BC Partners took the company private in 2008, relisted it on the Istanbul Stock Exchange in 2011, and sold half the firm's stake to Anadolu Endustri earlier this year for $2.7B.

"We were able to double the number of stores [from] when we bought the business in the last six years," Stathopoulos says. "That resulted in almost doubling the sales."

Having taken the company private, executed an initial public offering, and sold half of its investment, BC Partners has set the stage to for a complete exit in the near future. Stathopoulos predicts the firm will get out of its investment in Migros entirely in the next couple of years.

To be sure, he remains cognizant that there could be pitfalls. He cites the potential depreciation of local currency, which BC Partners has experienced during its ownership of Migros, as well as possible geopolitical risks that typically loom over any emerging market.

None of these points are enough to sway his upbeat opinion on Turkey. Stathopoulos continues to be bullish on Turkey as an emerging market to put private equity to work. He still very much likes the demographics and growth potential of the country.

"The main fundamentals of the country remain strong," Stathopoulos says. ■

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Z Capital **Revs Up MSDP** *Acquisition*

The firm's Jim Zenni discusses building out the maker of automotive-performance parts for a specific market

JIM ZENNI, president and chief executive officer of Z Capital Partners, is putting the pedal to the metal as he builds out automotive-performance parts manufacturer MSDP for the hot-rod crowd. Zenni's firm bought the portfolio company in late 2013 and followed that up with an add-on acquisition of ACCEL Performance Group shortly thereafter.

"If you own a 1975 Chevy Chevelle and you are looking for the latest, greatest fuel-injection system to put on your car, we have that market," explains Zenni. "You have a lot of baby boomers that are buying cars they know and love from their past."

Most of the parts and products MSDP sells are used to enhance or improve acceleration, fuel injection, or ignition. Zenni says the hot-rod enthusiast market is growing both demographically and geographically.

Z Capital acquired the MSDP platform from a lender that owned the company. The private equity firm acquired all of the lender's interest, both debt and equity, in MSDP to acquire the company.

"We identified the company as having pretty significant potential in its sector," Zenni says. "More importantly, it was owned by a lender at the time, and it had an interim management team, which is never optimal."

The firm took over the company and quickly installed a permanent management team that has grown the business and increased margins.

"It was not so much a turnaround as it was an optimization," says Zenni.

As Z Capital management started looking at the MSDP marketplace, the firm quickly identified potential add-on acquisitions to support the business's organic growth. One of those bolt-on companies was ACCEL, which made similar products to those of MSDP. In addition to cost synergies, Z Capital recognized the complementary sales channels: MSDP's products are typically offered through distributors' catalogs and online; ACCEL's goods can be found in retail-oriented settings.

Z Capital relied upon operating partners to help with integrating the two companies. Without this effort and no matter how complementary both businesses were, the strategy of bringing them together would have fallen apart.

"Our initial plan is to execute on strategy," he says. "You have got to execute on it for [the conjoining of MSDP and Excel] to be successful."

While Z Capital's fund structure allowed for the firm to initiate capital calls to execute add-on deals beyond the investing period, MSDP's performance has been so strong that it allowed the firm to pay down enough debt through free cash flow that the firm did not need to approach investors.

"From a limited-partner standpoint, it is great," Zenni explains. "We did not draw any more capital, and we probably doubled the value of the business at the end of the day." ■

Fact Box

- Z Capital doubled the value of MSDP
- The firm relied upon operating partners to integrate MSDP and ACCEL
- Zenni refers to the MSDP buildup as an "optimization"

A performance auto part made by MSDP

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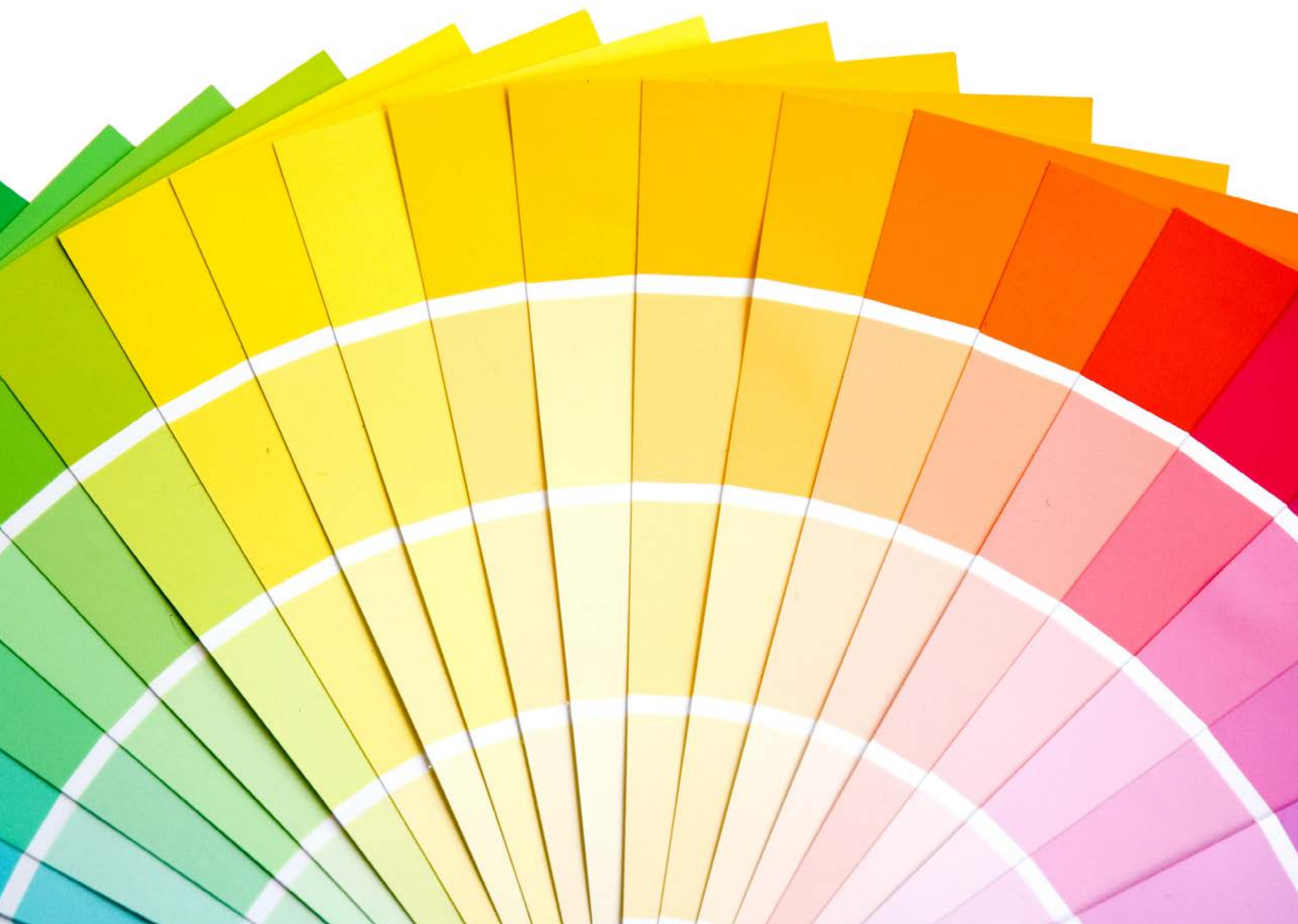

Sun Capital's **Colorful Success**

David Mezzanote discusses the keys to the firm's successful investment in Emerald Performance Materials

SUN CAPITAL IS MOSTLY KNOWN AS A distressed and turnaround investor in the private equity space, but it is a carve-out that has proven to be the firm's most profitable investment to date. In 2014, Sun Capital exited its investment in specialty chemicals maker Emerald Performance Materials after six years of ownership and more than tripling EBITDA. Emerald was a private equity dream story, becoming an outsized exit following a fairly regular-sized acquisition.

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"There is a lot of fragmentation, and I think there is a consolidation play that could be made in several areas of the specialty chemicals market—and Emerald is just one example of that."

–David Mezzanote, Sun Capital

Fact Box

- Sun Capital more than tripled EBITDA for Emerald
- Emerald's platform was formed by carving out five units from Lubrizol
- Sun Capital bolstered Emerald through three add-ons and $25M in capital projects

Emerald was the result of the assemblage of five businesses from Lubrizol, which decided to let go of non-core units. Sun Capital saw an opportunity to create a stand-alone business using these businesses as the foundation for future success.

"They were fundamentally good businesses, just underinvested and, we felt, undermanaged from the corporate parent," says David Mezzanote, a managing director from Sun Capital who was instrumental in the Emerald deal.

Sun Capital was mostly attracted to the businesses' recession-resistant nature as a result of specialty chemicals' diversity and applications in end uses. That strategy proved to be sagacious, as the firm acquired the business units in 2006, right before the Great Recession began the following year.

Mezzanote says Sun Capital's approach to uniting the former Lubrizol groups into a single company was a textbook strategy from the firm's playbook. One of the most important steps was to restructure these various divisions into four business units from five. Another vital maneuver was to execute what the firm calls a "sku analysis." This meant taking a deep dive into products the company offered. Unprofitable offerings were exited, which freed up capacity on equipment for higher-value products.

Following the restructuring, which was mostly completed by the start of the recession, Sun and Emerald embarked on a mission of growth that included three strategic add-on acquisitions as well as relying upon organic expansion in all four business units. The most significant of these bolt-on deals was for the specialty products business from Dutch chemical company DSM at the end of 2010. With the newly acquired Rotterdam-based facility combined with Emerald's Kalama, Washington–based factory, both of which produced nearly identical benzoic acid, Emerald suddenly found itself with a global footprint.

In addition to the add-on deals and organic growth in Emerald, Sun Capital authorized $25M to be put to work in two capital projects, doubling capacity for the Kalama location's successful K-Flex product. The company began selling out of the specialty chemical product shortly thereafter.

"We always felt like Emerald had the potential to grow significantly, and that's when we began our growth investments, both in acquisitions and, of course, investments in new products," Mezzanote explains. "I think it really is attributed to the hard work that we put in with the company around restructuring and investing at the appropriate time and in the appropriate locations for growth."

While Sun Capital is technically sector-agnostic, Mezzanote acknowledges that chemicals has been a sweet spot for the firm. Not surprisingly, he predicts the firm will continue to be active in the sector.

"I think there are certain sectors in the chemical market where a roll-up strategy still makes sense," he says. "There is a lot of fragmentation, and I think there is a consolidation play that could be made in several areas of the specialty chemicals market—and Emerald is just one example of that." ■

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Value Creation STRATEGY

Michael Rogers
EY

By looking at operations, human resources, and product diversification, private equity firms are getting creative when it comes to value creation, says EY's Michael Rogers

Privcap: Where can PE firms start looking in order to create value?

Michael Rogers, EY: The first strategic move that private equity firms should make, after they develop their investment thesis, is to focus on management. And what we're seeing these days is that management has become a critical component to the business. Oftentimes there are management changes at the time of the ownership change, but it's not just about changing the management. It's finding the right visionary who can take this business to the next level.

Right now, with the competition and the high multiples being paid in the market, unless you can have a management team that hits the ground running and develops its business model very quickly, you just can't afford to be wrong, because if you are wrong and you have to replace management after two or three years, you're already halfway through your ownership cycle from a private equity perspective. So now we see a renewed focus on the human capital component—taking folks that have a proven track record and funding them and allowing them to build out platforms. We see that as an emerging trend in the private equity industry.

How can firms diversify their portfolio companies?

Rogers: It's not just geographical diversification, but also product mix diversification. Many times the private equity funds had the opportunity to bring in specialists and experts around product expansion and go into horizontal markets and add new products. There's often a cost reduction component to value creation in the developed markets, contrasted with a growth-vehicle model in the emerging markets.

Why is value creation such an important strategy for PE firms right now?

Rogers: If you look at what's happening in the marketplace today—valuations are exceedingly high, competition for assets is very high, the strategics are playing very aggressively and can outpay if they want to for some of these assets—it makes it very, very difficult in auction situations to come away a winner by paying the highest price. So value creation is the absolute key to making these investments return what we think—and what the investors ultimately will require—they should to make this business very viable. ■

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