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Privcap/Report

PE Value-Creation Stories

Six Essential Case Studies Detailing How PE Improves Portfolio Companies

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Six 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.

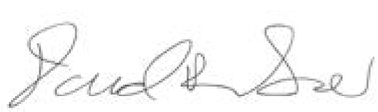
Competition for investment dollars, as well as an expected compression of returns, means that private equity investors must demonstrate an ability to change fortunes within their portfolio companies by dint of operational wherewithal or some other combination of resources being provided to management.

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,



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In This Report

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Pine Brook's Bet **on Small Business**

After the 2008 financial crisis, Pine Brook searched for an investment that matched its small- business lending thesis. In 2014, it invested in Strategic Funding Source (SFS), a company that provides loans to small businesses. Within a year, SFS's revenue was up almost 70 percent, and profit rose 100 percent.

William Spiegel, Pine Brook: Before we invested in SFS, we were focused as a firm on lending—small-business lending in particular. We felt that the re-regulation of the financial services system was going to force small-business lending out of the banking system,
creating a huge opportunity for us.

Small businesses account for two-thirds of our job creation. They're 99 percent of the businesses in the United States, and with large banks exiting the small-business space, with credit cards not a form of financing anymore, and with mortgages not being a piggy bank, there is a huge opportunity to lend to small businesses in the United States.

JPMorgan and Goldman Sachs and Well Fargo aren't making many loans to companies that need $1M or less—restaurants, dry cleaners, landscapers. Most of the people who we interact with in our daily lives are small businesses—sole proprietorships or people who employ less than

50 people. Let's use the example of a pizza restaurant. It may need to buy some chairs to build a sidewalk café in New York. Maybe it wants to add another pizza oven. Or maybe the landscaper wants to add another lawn mower [and] double his volume. So these businesses need capital in order to grow and to employ people.

So this was a theme that we had, [and] when we develop a theme, we're in search of a team.

David Sederholt, SFS: We are big believers in small business—the average guy who's out there banging out a living every day—and it's a totally and completely underserved market. We've been growing, but there's that point where you're too big to be small, too small to be big. And Pine Brook has enabled us to go across that gulf in a very quick way.

Andrew Reiser, SFS: What we were really looking for was not just a group with capital, because there are a lot of groups with capital. Pine Brook is much more than just an investor. They are very active in our business, helping us work on understanding different data sources, introducing different opportunities to us, as well as helping us set direction for the company.

Ben Johnston, SFS: We need to keep up by building the best systems that allow for the fastest throughput, that allow us to integrate the best data to make a quick decision, first on pricing and then ultimately on underwriting, which will allow us to not only keep up with the leaders in the space but hopefully surpass everyone else. ■

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What Victoria Capital *Saw* in Colombia's Corona

Victoria Capital co-managing partner and chairman Carlos Garcia says that despite the economic downturn plaguing Latin American countries, the climate actually helped one of the firm's portfolio companies turn a profit

Privcap: Could you discuss a deal that your firm has done recently that is a good example of opportunities that are arising in the current environment?

Carlos Garcia, Victoria Capital: We invested in a company about a year ago called Corona, which is one of the largest building materials producers in Colombia. It manufactures sanitary wear, floor and wall tiles, paint, faucets, and other related building products, with operations in Colombia, Central America, and the U.S. Interestingly enough, this is a company where the vast majority of its products go to the refurbishing market, not so much to the new-home territory. As a result of that, we have seen that when you look at the consumer pattern, first they satisfy their basic needs—food. Then they go to elevating the scale of other needs, such as education and healthcare.

Now they get to an area where they want to gratify themselves and have better homes. In a cyclical downturn, you would expect that building materials would go downwards. But it's quite the opposite—we are seeing a phenomenal trend towards people spending in order to feel better about their homes.

Has the currency fluctuation changed the operations of that business?

Garcia: Interestingly enough, [yes] for the good. Because Colombia is a very open economy, and on the low side of the price spectrum of the product, we were facing the competition of Chinese product. The Colombian currency has devalued sharply over the last year. It's probably the worst-performing currency in Latin America. And that has pretty much shut off the foreign competition into Colombia. So we have benefited from less competition in the market. Obviously we have not yet been able to recover the full impact of the valuation in our prices. But clearly we are making it up through larger volumes, and the company continues to perform extraordinarily well. ■

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FFL Builds **Vision** for Optical with Clarkson Eyecare

FFL Partners met with more than 40 companies while looking for a partner to execute its thesis on the optical industry. Managing director Chris Harris explains why FFL chose Clarkson Eyecare, and how.

Privcap: Why did FFL focus on optical, and how did Clarkson Eyecare fit into the thesis?

Chris Harris, FFL Partners: We identified optical as an area of exploration for healthcare about four years ago. We saw it as highly fragmented, [with] a little government reimbursement, recession resistant, and without many consolidators.

We thought optical, like many other areas of healthcare, was going to experience consolidation. It shouldn't be as fragmented as it is. There are real advantages to scale, but that hadn't happened yet.

So over the last four years, we have met with more than 40 companies in the optical space, trying to find the right place to start from for our consolidation. We met the Clarkson team in St. Louis about three years ago and invested in them earlier [in 2015] in a proprietary transaction.

Since then, we've completed two more platform acquisitions and a number of single-practice acquisitions.

What's your strategy, and how are you measuring success?

Harris: The investment thesis is a hub and spoke [model]. We now have four hubs; Clarkson had two at the time of investment. We've done two other hub acquisitions. And so [we invest] in those hubs and then branch out into spoke acquisitions, or single-unit acquisitions, at that point.

EBITDA growth is important for us, as are same-store sales. Since we've looked at so many companies in the optical space, we have a database with profitability metrics and key performance indicators for a variety of companies throughout the industry. We're now seeing the acquired entities improve their performance significantly just with some coaching from the Eyecare team.

How have you enhanced the Eyecare team, and how do you approach operational support generally?

Harris: At Clarkson, we've been very involved in supporting the team and building out the team. We've added two members to that team already and plan to continue to build out as the company grows. And that's true in most of our portfolio companies.

So we have two approaches to operating resources. We have senior executives who are operating partners with us, who have background as CEOs of Fortune 500 companies, really impressive, who can come in at a board level and really provide strategic guidance.

We also have a person who's more on the ground with portfolio companies in either an interim management role or on project-based work. We use consultants from time to time on a project basis—pre-ownership, but also on post-merger integration work. ■

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The NPS Pharma Turnaround Story

Dr. Francois Nader, former CEO of NPS Pharmaceuticals, details the revival story and shares details about hard steps and strategic risks that turned a down-at-the-heels pharma company into a highly sought-after business that was sold for $5.3B to Shire Pharmaceuticals

Privcap: Talk about the early history of NPS Pharma and what that company looked like before you got involved.

Dr. Francois Nader, NPS Pharmaceuticals: The company started 23, 24 years ago in Utah. And the concept was to possibly derive drugs and therapeutics from spider venom. The main focus of the company at that time was neurological diseases, and the concept was to develop a drug and then license it. Back in 1990, NPS Pharma acquired a company from Toronto, Allelix, that brought in two products. It was a turning point, because this is when the company decided to become a fully integrated pharmaceutical company (FIPCO) with development, manufacturing, and commercial capabilities.

What did you learn during your role as a venture partner at VC firm Care Capital that was helpful as you got involved with NPS?

Nader: Venture capital is a world of investment and really taking calculated risks. So I learned at Care Capital to assess the risk. In biotechnology, risk is inherent to what we do, and the process is a very long one. It takes about 15 to 17 years from a compound in the lab to an approval by the FDA or regulatory agency. And throughout those [years], you have multiple go/no-go decisions.

What were some of the initial steps when you took the helm at NPS?

Nader: First, we looked at the head count and really let go— unfortunately—of folks who were hired to launch the product. We did not need them anymore. And also we looked at our burn, and looked at ways to minimize the burn waiting to find

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an alternative as to where do we go from here. In doing so, we took the company from about 450 people or so down to 200.

One way we could create value was through adapting and adopting a completely different business model. And we did it in a relatively straightforward way. The first element of this new strategy was to take what we had—our products—and repurpose them into indications where there was a true and mathematical need and no competition.

The second was to let go of the FIPCO model. One way to do so is to adopt a strategic, virtual outsourcing model. When we did, it became very clear that I did not need 200 people. So we took the company down to 17 people and recruited 20 to 30 additional people.

Going from a company with 450 down to 17 is fairly dramatic. How did you, as a manager, keep people from losing morale?

Nader: It's not easy at all. When we started growing, I was extremely cautious in hiring new folks to the company. The only way to do it is to be very open with the teams. What we also did, which was very important, is we were very short on cash, and at some point we borrowed to be able to give our employees a very generous severance package, because I came from the premise that it was not their fault.

> "The first element of this new strategy was to take what we had—our products—and repurpose them into indications where there was a true and mathematical need and no competition."
>
> - Dr. Francois Nader

When you became CEO in 2008, the market cap was $139M, but the Shire acquisition in February 2015 was for $5.3B. What did Shire see in NPS that they thought would be additive to their company?

Nader: What they saw is the fact that we had two products that got approved—both here and in Europe—for rare diseases where there was a true and mathematical need and no competition. And those two products were already marketed. They also saw a company that had a global presence—and when we needed capital, we outlicensed our ex-U.S. rights to a large pharma company. At some point later on, we bought back our rights and became a global company. I'm very proud that we were able to be present in 18 markets within a span of 18 months, which was remarkable. So Shire also acquired a network, infrastructure, and talent in rare diseases. ■

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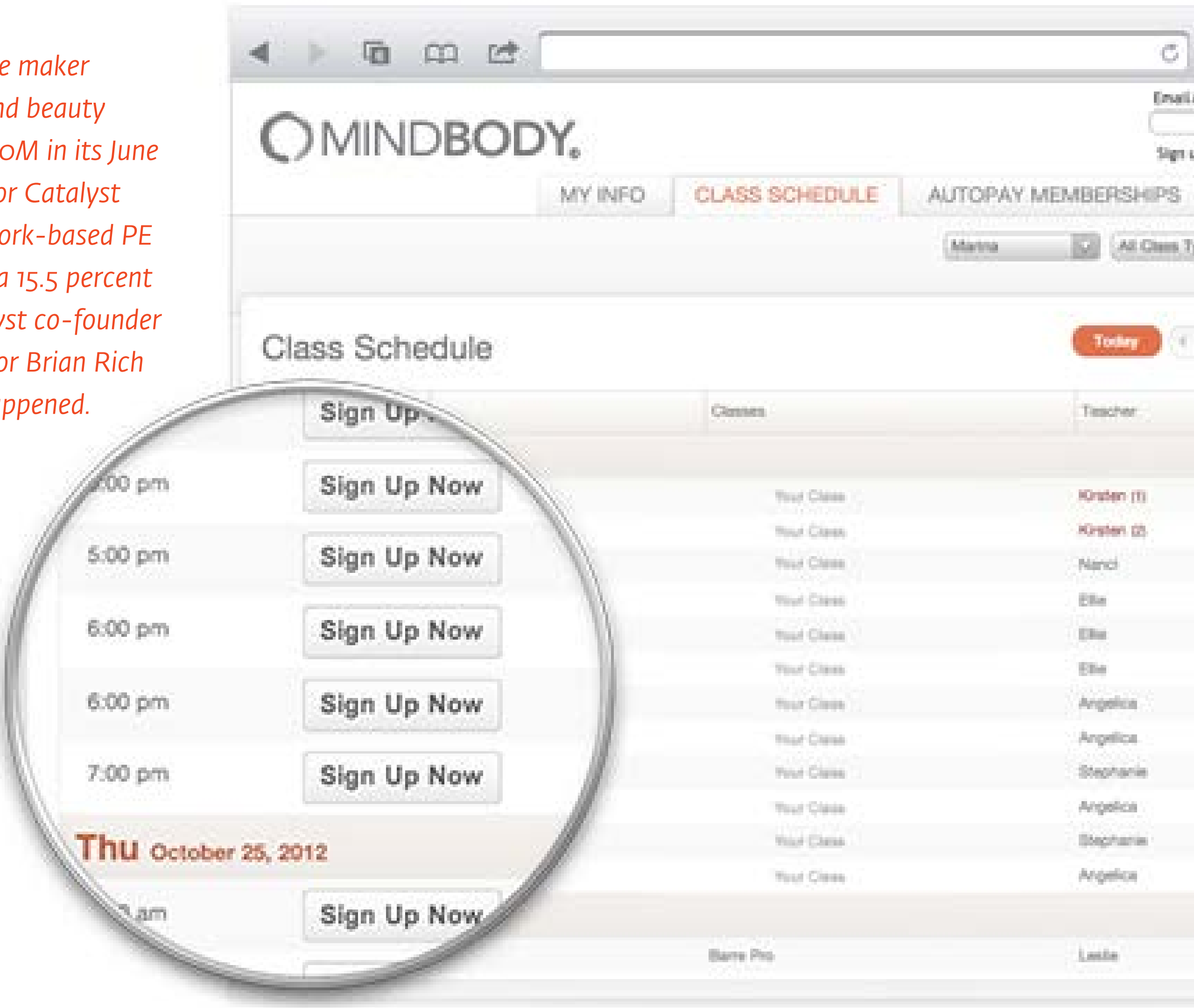
Mindbody, a software maker serving the fitness and beauty industries, raised $100M in its June 2015 IPO, a victory for Catalyst Investors, the New York-based PE firm that purchased a 15.5 percent stake in 2008. Catalyst co-founder and managing director Brian Rich explains how it all happened.



Catalyst: Tapping Health & Wellness Opportunity with **Mindbody**

Privcap: You recently took one of your investments, Mindbody, public. It's basically OpenTable for yoga studios and fitness centers, correct?

Brian Rich, Catalyst Investors: It's a company that runs both the back office and also the consumer-facing side of the health and wellness businesses, yes. It's a software as a service—SaaS—business, which means that it's a piece of software living in the cloud that has a recurring revenue aspect to it. Once a company becomes a customer of Mind-body, they tend to stay customers for a very long period of time.

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Our firm started investing in SaaS businesses in 2000, before they were called SaaS businesses. They used to be called ASPs and before that, we used to invest in cable and cellular, which sound nothing like a Mindbody, but the metrics that we focus on that cause us to determine whether it's interesting or not are identical.

Really it was our investment in Mindbody back in 2008 [that] was the genesis of investing in all of those predecessor SaaS businesses, and of understanding where the value creation lies.

How did you come across the opportunity?

Rich: People generally perceive that folks like us find companies through intermediaries. We generally don't. Nine,s or nine-and-a-half, out of 10 of our investments are found directly. One of my colleagues was a speaker on a panel, as was the CEO of Mindbody. [They] just really hit it off right then and there, and the management team of the company really felt that by us putting capital into the business that we'd add a lot more than just capital, that we'd help them grow their business.

Most firms that invest capital in businesses would say "I'm investing in a management team," and we're no different. This is a great team. And we liked the opportunity set.

The customers that Mindbody had back in 2008—there were around 12,000 or 13,000 of them—were unbelievably happy. Once they started using the product, they didn't get off. That's a great sign. We loved the core metrics of the customer acquisition, and so the whole thing just worked for us.

Why did Mindbody choose Catalyst Investors as a partner?

Rich: The best companies have a lot of choices. They're getting multiple term sheets from people, and they can take our money or somebody else's money. A lot of it is what is the perception of success of the firm. And they check us out. Some of [our] investments worked out – or most of them worked out – and some of them didn't. They want to talk to both. They want to know how we behave as an investor when things get touchy. And we do have a track record of helping companies get from here to there, which is what Mindbody wanted to do.

They were already a successful company. They were a company that had been around for several years since then. They had a nicely formed management team. They knew what they wanted to do.

What was the growth plan?

Rich: We thought that the company would, first and foremost, continue to penetrate the health and wellness space here in the U.S. They're now up to more than 50,000 customers. We also thought they would do the same thing internationally, which they've done. They're in 80 or 90 different countries. We also thought they'd go into different verticals like hair salons, for example, which they've done.

Now the company is public, but Catalyst retained its stake. How did you know the time was right for an IPO?

Rich: Of the 70 or so companies that we've invested in at Catalyst, the vast majority do not go public.

With Mindbody, it was the way to go because it's a company that has terrific metrics that are readily understandable to analysts. It was a good story for the market and for the analysts alike. As you look at the different opportunity set, the company needed a bit more capital to achieve the growth prospects that it wanted to achieve. And given the fact that a number of investors have been invested in the company for a good number of years, we felt it was the best outcome for the company.

But the the IPO is not the end of the story for us, or certainly for the management team of the company. It's almost the new beginning of the company. We and the other investors in the business didn't take any shares out at the offering. So we're as interested as we've always been in the outcome of the company. ■

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Investing in **SolarEdge** When *Others* Would *Not*

In March 2015, NewWorld Capital Group exited solar technology company Solar-Edge after it raised $150M in an IPO. NewWorld's Lou Schick, one of the partners in charge of SolarEdge, explains the deal.

Privcap: Your firm NewWorld Capital Group, which invests in environmental opportunities, recently had an exit from a company called SolarEdge which went public. Why don't you tell the story of the deal?

Lou Schick, NewWorld Capital Group:
We came across SolarEdge when I was approached by a banker who has a small boutique firm at a conference I was at. And he started telling me about a company that makes [solar] inverters.

When you think about the supply chain and the equipment necessary to do solar, inverters are a very important part that hadn't gotten as much attention. When I was approached about SolarEdge, we had already taken an investment in Astrum [now Direct Energy Solar], which was doing solar installation, and so we were familiar with panel-level inverters. Usually what people had done up until then is they would string together a bunch of panels and put an inverter at the end of the string.

You can get better performance that way, but there's also usually a cost trade-off. And so we thought we were pretty familiar with what the lay of the land was, what the advantages of string and micro-electronics were. But I was assured when I met the CEO and they explained the technology. In the meantime, we checked

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“The management was very confident that they were going to roll out essentially a revolutionary new technology.”

- Lou Schick, NewWorld Capital Group

with Astrum and they had been testing out the SolarEdge product and really liked it.

We decided we were going to try to do an investment with them. We underwrote it based on their existing technology platform with the expectation that we might exit in a trade sale.

And the management was very confident that they were going to roll out essentially a revolutionary new technology. [They] hit exactly every target that they set and I have not had that experience before.

What was the most important strategy or guidance that the NewWorld team brought to SolarEdge?

Schick: SolarEdge was a pretty mature, healthy company when we got it. And so it was less that we were able to add a lot of value, [and more that] we were able to understand. In the quarter or two before we met them, they had a supply challenge. And we were able to get comfortable with them and they got comfortable with us and we were able to work together.

So private equity firms maybe became scared off because of [the supply challenge]?

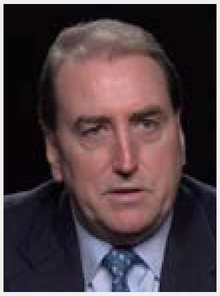
Schick: That’s right, and being able to talk the technology in a reasonable way and understand the layout of how they were managing their supply chain, as well as what the challenges were—and that they had figured out how to solve it—was something we put into the diligence. That was one of the reasons we were able to get that deal done. With other companies that we’ve worked with that are earlier along it tends to be more where we’re making strategic introductions. This company was pretty mature when we got ahold of it.

And NewWorld remains an investor post IPO?

Schick: NewWorld doesn’t hold public stocks, and so we distributed the stocks to our investor group as soon as the lockup period was over. ■

How to **Stand Out** in a Crowded Field

In an increasingly competitive acquisitions market, it's more important than ever to have a sound value-creation plan. EY's Michael Rogers explains.



Michael Rogers, Global Deputy Sector Leader, Private Equity, EY

Privcap: The PE world is becoming more and more crowded with firms vying for assets. How is that changing the deal environment, and the importance of a firm's ability to create value?

Michael Rogers, EY: It's more important than ever to have a value-creation plan in place going into these deals. Competition from corporate buyers is increasing. And in very strong M&A in 2015—near record—interestingly, private equity was [mostly] flat. That's a function of two things: valuations got really expensive in 2015, and a lot of PE firms exhibited some discipline. So corporates now have a pricing advantage—they can use synergies to create value. PE doesn't have that unless it's an add-on. Ultimately, you have to have a sound value-creation plan to compete in bidding the deal, but [also in] earning returns.

Have you seen any changes going into 2016?

Rogers: Valuations are coming down a bit; it's a soft beginning to 2016. PE will be more aggressive in 2016. Also, the LP is putting more pressure on funds. They are asking in advance to see the value-creation plan, and to see the strategy for the funds they invest.

Has the focus of the typical value-creation strategy changed?

Rogers: Historically, the effort has been around trying to make sure there are process improvements, synergies and cost savings—it's been focused primarily on cost. The newest trend is a focus on revenue generation. More value-creation teams are looking at ways to find growth, not just focusing on the cost side. That can come in the form of helping these entities keep the business footprint they have, [find] new revenue sources, and add product capability to an existing business. In some cases, you're expanding the geographical footprint, expanding an existing business, or expanding the distribution network.

Are there key value-creation strategies that a potential portfolio company would be looking for?

Rogers: People now see that operating partners or outside talent are there to help everyone succeed. There needs to be proper alignment between a fund and a company. That's the beauty of making these models work—creating alignment so the fund is positioned to add value and support folks in these businesses. This model is becoming more common in the market. ■


Real challenges unreal rewards
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