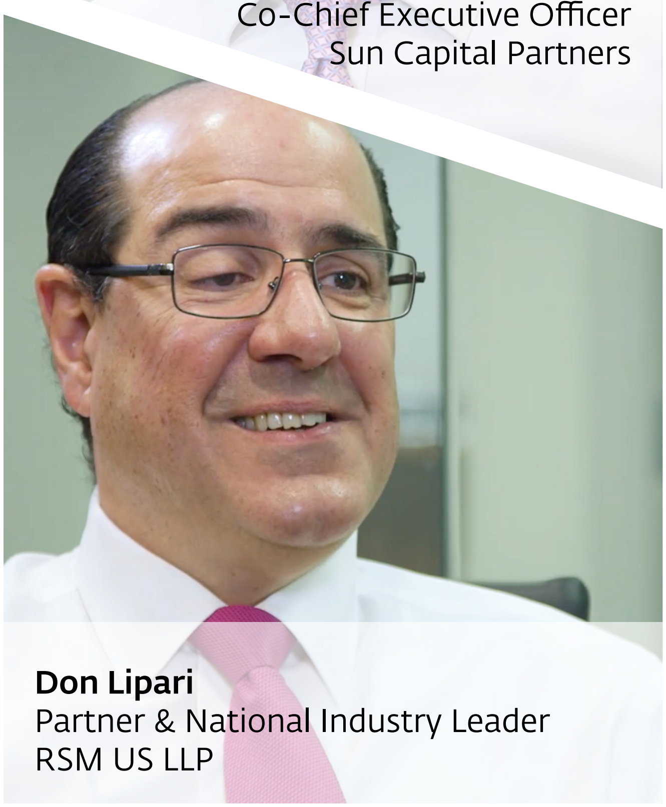
POWERHOUSES IN PRIVATE EQUITY

Marc Leder
Co-Chief Executive Officer
Sun Capital Partners



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The Rise and Refocusing of **Sun Capital**

Don Lipari of RSM interviews Marc Leder, Co-CEO of Sun Capital Partners

Don Lipari, RSM US LLP: Hello, this is Don Lipari, head of private equity at RSM. Welcome to another segment of Powerhouses in Private Equity. Today I have the pleasure of talking with Marc Leder, co-CEO and co-founder of Sun Capital Partners. Welcome, Marc.

Marc Leder, Sun Capital: Thank you, Don. Good to see you.

Lipari: You joined Lehman [Brothers] in '87.

Leder: Yeah, January of '87.

Lipari: Talk about the Lehman experience.

Leder: Loved working there. Really smart, driven people. Interesting work, great clients. That's where [co-founder] Rodger [Krouse] and I became good friends. We started out together as part of a class, and we all kind of moved up together. Then while Rodger and I were working our way up at Lehman, private equity emerged as an industry.

Lipari: Yeah.

Leder: As much as we loved working with clients and advising clients, we thought it'd be really interesting to see what happens after closing, after the acquisition closes. We both had an entrepreneurial spirit, and that's why we decided to start Sun Capital in 1995.

Lipari: Let's talk about that launch, because it was a little scary, right? The two of you coming out of Lehman. Talk about the strategy when you built the concept of Sun, talk about the culture you were looking to create, and talk about raising that first fund as two professionals out of Lehman who didn't have a fund at the time.

Leder: Sure. So our so-called fund number one was 12 investments. They were all individually financed. So we did not raise a fund.

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Lipari: Fundless sponsor.

Leder: Exactly. We had no track record. We were two investment bankers, who had a dream of getting into private equity. The irony is, we had great friends from Bain Capital, Apollo and other firms. They all told us, "You guys are great bankers, terrific people. But private equity is a very different business. Stick with investment banking." Now many of them are investors with us and have made a lot of money investing with us. The reason we're in Boca [Raton, Florida] and the reason we're called Sun Capital was to focus on the southeastern United States. Plain vanilla, traditional buy-outs in Florida and the Southeast.

Lipari: Industry agnostic in those early days?

Leder: Yes. The strategy failed miserably. It took us one year to realize it was not going to work.

Lipari: Failed in what way? It wasn't failed investments - it was, you couldn't close deals.

Leder: Couldn't get a deal done. It took us 20 months to close our first deal.

Lipari: Talk about those 20 months. Were you guys questioning your decisions? Was there a lot of tension in the air?

Leder: There wasn't tension. But what happened was, in 1995, we moved down, we met with all the deal attorneys, accountants, business brokers, regional investment bankers, told them who we were, our Lehman background, our Wharton background, our network of friends who would fund our deals. We would see a lot of deals, but every time we would get close, a seller would say, "You guys seem like really good people, but I've got two bids from firms that have got a track record and a fund. Why would I give you a chance when we've got two better buyers?" There wasn't a good answer to that. They said, "If you're willing to pay a lot more …"

Lipari: A lot more.

Leder: "…then we can talk." But we weren't going to overpay and we weren't going to bait and switch, or promise something that we couldn't deliver.

Lipari: Right.

Leder: We went all of 1995 without a single deal closing. When we started 1996, we felt we needed a different strategy. As Einstein said, "The definition of insanity is doing the same thing over and over again and expecting a different outcome." We decided to try something different, and we contacted the business brokers, and lawyers accountants and investment bankers, who showed us deals in '95 that we passed on, because we thought the management team was weak or the company wasn't performing. Finally, December 30th of '96, we closed our first deal, which was a company that was in specialty paper. Weak team, kind of stuck in the mud. The original company was called Fry Copy Systems. Then we did two more deals in '97, also both kind of scratched and dented. Back in '96, '97, no one else had thought of or was buying operationally challenged, poorly managed businesses. The whole private equity industry was targeting great companies, great teams, pristine track records.

Lipari: Right.

Leder: So here we were, fundless sponsors, buying the deals that no one else wanted. We were like the proverbial dog chasing the bus. We caught the bus with these first three deals. We looked at each other, and we said, "Now what do we do?"

Lipari: That was by necessity that you had to look at underperforming companies.

Leder: That's exactly right. Because we couldn't compete without a funder track record,

Lipari: Right.

Leder: We're also deep value buyers, so that wasn't going to work. We had to find the companies that no one else wanted to buy.

Lipari: You had to shape-shift on the fly, essentially.

Leder: Rodger and I - it was just that the two of us. We were in one of these shared office companies, like WeWork, but they weren't so sexy back then. We would joke that he would make the copies and I would make the coffee, because he didn't drink coffee. But that's really true. We rolled up our sleeves, we got very deeply involved with these three businesses. We rebuilt the management teams, developed new strategic plans, and just intensely and with a lot of hard work, and some beginner's luck, stabilized and turned these businesses around. By 1999, we realized we'd accidentally found a great niche within private equity.

Lipari: How many deals did you do before you launched a fundraising?

Leder: We'd completed 11 of the 12. The 12th closed in February of 2001, which was after we launched what we call Fund II, but before we closed on it. After Thanksgiving, we sent out our PPM, and we started calling people. We had a track record, but we had no exits. I remember, we would call the investors and say, "Hi, I'm Marc Leder. I just sent you a PPM for our fund. What do you think?" They all said the same thing: "It's on a pile on my desk with 50 others. I'll call you if I'm interested."

Lipari: This wasn't easy for you guys.

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Leder: It was not easy. I remember one of our first meetings was Goldman Sachs, which had a big fund-of-funds business. We come to their offices, and there's six of them in a conference room. Rodger and I walk in, and we see the snow outside, and we were thinking to ourselves, it's about 80 degrees and sunny in Miami. I started the meeting with some niceties, thanking them for the time, telling them how much we appreciate them potentially having interest in Sun Capital. One says, "Hold on. We don't really have an interest. We're a fund-of-funds. We see everyone."

Lipari: Oh God.

Leder: But he ultimately liked what he heard, and within weeks told us he was interested in investing. We end up with $550 million in soft circles. We ended up begging Goldman to ultimately let us go to $200 million, which was the hard cap.

Lipari: Wow.

Leder: After the first great three funds, we thought we could fix anything. We started investing in some industries were not that healthy, not that strong, maybe declining. You can't take a broken company in a bad industry and fix it. You can't keep the performance going. Ultimately, it's a step forward and then two steps backward. We made good money for our investors, but compared to what we had achieved previously, it was humiliating, embarrassing, frustrating.

So when we raised Fund VI in 2012 and '13, we looked at what was an 18-year history, what worked, what didn't, what could we do better. We really changed three things to get back on track. One, we bought healthier businesses. We used to think paying five times [EBITDA] for a business was a bargain. If it's in a crappy industry, it's no bargain. A company that's struggling, where you pay seven, eight times, because the company is struggling, but the industry typically trades for 10 times EBITDA - it's a better deal and it's a better value.

The second thing was, we dramatically enhanced and improved our toolkit. We have what's called the Sun Transformation System, which is a fancy branding opportunity for our toolkit, but we have a very extensive toolkit we've built up over 24 years: Tools to drive revenue growth, reduce costs.

Finally, we now have the bandwidth to implement the rights tools from our toolkit. When we were managing Funds IV and V, we got to over 90 portfolio companies. Our LPs told us it was too much to manage, but after the great success of Funds I through III, we thought we were right and they were wrong. We're down to 38 companies as of now. People say to us, "How can you manage 38?" We say, "Well, after managing over 90, 38 is pretty easy."

Lipari: What a great story. Talk a little bit about the culture. So now you're in business. What culture did you and Rodger set out to instill at Sun?

Leder: Believe or not, we didn't set out to instill a culture. In fact, when I was, you know, 18, 19, sophomore or junior at Wharton, and taking courses on management and leadership, and they talked about culture, I literally rolled my eyes. To me it was all about the numbers and manufacturing and operations and execution. What's this culture crap? Rodger and I did not set out to create a culture. We set out to get our first deal done, raise the money for it, parlay that to get our second deal done, raise our first fund, as we just discussed. The culture just evolved as a reflection of who he and I were. Rodger and I both have some very similar values. Incredibly hardworking, very direct, very open, very transparent. We always say what we mean, we always do what we say. We attracted people that were the same. The culture just evolved by itself. That's what typically happens when you've got two people, and you grow to three, and then we grew to 11, and then to 17. But then at some point, when you grow to 50, 60 people, when you open other offices, which started with New York, then L.A., then London, then Shenzhen, then you have to memorialize your culture, you have to communicate it regularly, because the more people and the broader you are geographically, the higher the probability is that you'll lose your culture.

Lipari: Okay. Your Hall of Fame induction. Give your abridged comments.

Leder: Well, I guess, I thank Rodger for being an incredible partner, going on 25 years. One CEO, after meeting me, said, "You know, I've heard about you and Rodger. Having met you, I now totally get it. He's the brake pedal and you're the gas." Then, recognizing a great team effort here at Sun Capital. We have really amazing people. I have a blast every day. There's nothing better than loving what you do every day when you do it. ■