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One-on-One With

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Private Equity Firm Likes US Manufacturers Despite Issues

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Q: Where do you see private equity firms adding the most value to a business?

A: Every private equity firm is different in how it approaches its investments. At Linsalata Capital, we try to add value across the spectrum. You always want to create value on the buy-side. Financing and structuring is becoming increasingly efficient so you can do a little bit there. But, more and more, we focus on adding value to the operation and helping to drive growth in the business.

There are a number of us here that have longer careers running businesses than our careers in private equity. So we can draw upon that experience. It doesn't mean we are going to do the job of management teams. But it's understanding what management teams are going through on a day-to-day basis, being a sounding board, making sure you have a well-developed strategy and that actions are being taken to drive the business.

We have acquired businesses that are pretty broad in their level of sophistication relative to strategy. Many times, we have to work with a team to develop it. Other times, it is in place and it only needs a little fine tuning. And strategies need to be revisited during our holding period.

Another area is looking at the business with an outsider's view. Where are some areas that maybe the management team has gotten too comfortable with? What are the best practices other people in the industry or other industries are using? It's sometimes easier for us to see those opportunities than it is for the management team that deals with the business on a day-to-day basis.

Many times, it's unleashing a management team. In other words, maybe they have been too conservative. We can push them to take a little bit of risk to drive growth.

Q: What are some examples of that?

A: One that comes to mind is **Eagle & Taylor**, which was an investment from 2002 to 2005. The business was part of a larger company – **American Architectural Products** – which was a public, leveraged roll-up of window and related types of businesses. We bought the business from American Architectural which was in severe financial difficulty.

The team had gotten very conservative across the board because they were in a protective mode. We encouraged them through adding capacity and capital spending, which they weren't able to do the previous several years. We encouraged them to take on more risk internally and helped them develop programs to attack the different market segments they dealt with.

Historically, they just looked at themselves as a window manufacturer that sold through dealers and distributors. It became apparent they sold into four different markets: residential new construction, residential remodeling, light commercial construction and OEM sales. We created a separate business segment and marketing program that attacked each one of those customer segments. There was also a little tweaking of products as well for each of those markets. It helped to increase their sales growth from low single digits to 20% yearly.

Some of it was better confidence in the business. We didn't bring all the magic. But, if your competitors are attacking you because you are weak financially, lifting that burden and allowing the business to present itself as strong financially with deep resources unleashes a little more confidence in the sales team.

Q: What are the major issues facing the manufacturing companies Linsalata invests in?

A: Across the board, US manufacturers are challenged by foreign sourcing of components and finished goods. Making sure you are competitive on a worldwide basis with your products is important. You have to buy right and you have to be aware of the capabilities of other people outside the US that would challenge your position. What we will do is make sure the management team doesn't accept false beliefs that foreign competition doesn't exist in their product because of freight or because their product is higher quality or any other number of different reasons. We make sure they understand the capabilities of manufacturers in other markets.

Also, they have to manage in an inflationary environment. Many managers have not been faced with that in years, but they have been in the last 18 months. One thing we have seen is a fear of raising prices. Price increases in most industries have been non-existent. In fact, you were expected to give price decreases on a year-to-year basis. But if you are subject to raw materials price increases – plastic resins, metals, aluminum, steel, - you have got to do what's necessary to mitigate those increases and not give up profitability. We will counsel them through that process.

The other issue that we see in many of our businesses is the impact of upstream or downstream consolidation. That is happening in building products as home builders have consolidated over the past several years. You are seeing the distribution channel consolidate as well. That does have an impact on the manufacturers. It's a continued challenge to make sure you are important enough to command higher margins with customers that are becoming much larger.

Q: Will a slowdown in housing have in impact on your portfolio companies?

A: We look for businesses that are strong so that you are not faced with the situation of selling in an up or down market. That said, we are well aware the housing industry has been strong for several years. As you look out long term, the market will continue to be strong. We are, however, faced with a period where new construction will show some modest declines. But the number of new housing starts will likely be high compared to historical measures.

We like businesses that have a balance between new construction and remodeling. Many times, they don't cycle together. Right now, both segments on the residential side are showing a bit of softness. There are some indications that remodeling is not as robust as it has been. Many of the businesses are situated so that they can capitalize on the commercial side. We are still very interested in building products going forward. We don't worry about these ups and downs in the market if the business is well suited to perform over the long term.

We think remodeling will continue to be a strong business. The remodeling market is tied to many different underlying drivers such as consumer confidence and the used home resale market. Remodeling gets a boost when new home construction goes down as people decide to invest in their existing home rather than moving into a new home. Remodeling in the US will remain a strong market, particularly for niche products. People see their friends and neighbors taking advantage of these new features they see in their homes.

Q: Can you speak to what attracted Linsalata to some of its more recent investments like **Stanton Carpet, Holloway Sportswear** and **Overton's**?

A: Stanton is very interesting business. The management team at Stanton is very capable of building Stanton into a high-end brand. We are big believers in people that are good at what they do. It's a developing business as many people want to incorporate richer products into their home. Stanton fills that need. The other thing is that Stanton has been expanding geographically. They are strongest in the east and increasing their presence in the west. We are investing in the sales and distribution capabilities to expand across the states. It's a business that is growing at a high rate and has continued to perform strongly.

Overton's is in direct marketing. We have experience through a prior investment in Potpourri. Overton's caters to the marine enthusiast. It's definitely a targeted market. It's a newer management team that is reinvigorating the company and putting in newer marketing practices to drive growth. We will leverage our experience in direct marketing in working with Overton's management.

Holloway is an add-on to our **Augusta Sportswear Group**. Holloway brought an expanded product presence and access to a market channel Augusta was not strong in. Also, we are looking to take some of the capabilities and expertise at Augusta to allow Holloway to be the best on the cost side and drive growth.

Q: Is there a typical profile on your acquisitions? Are they mostly single proprietorships?

A: Most of our investments have been where we have acquired the business from a founder. For one reason or another, it's time for them to liquidate their holdings and diversify. Most times, these founders continue on with the business in some role. That's true in Augusta, Stanton and a prior investment, **FFR**. We very much enjoy partnering with the founders. As we try to differentiate ourselves in the sales process, we present ourselves to be good custodians of the business, to carry on the legacy, and to continue the growth. We relish those types of opportunities. We have also bought businesses of larger companies and companies from other private equity firms. We only take controlling stakes. Many of them are recapitalizations where the owner may own 20%, 30% of the business. We always want to have the management team invested along side us. Typically, we are in the middle market segment, $5 to $35 million in EBITDA. We look to invest $10 to $50 million in equity.

Q: Do you mostly acquire businesses through auctions?

A: More of the opportunities we see are through auctions. We have been fortunate, over the years, to acquire businesses through proprietary deals or with a very limited number of potential acquirers invited. We love the opportunity to look at businesses on a proprietary basis. But in today's market, sellers are aware of the value intermediaries can bring to a process. So we find ourselves faced with situations where there's an auction with many potential buyers looking at the same properties.

Q: What kinds of multiples are you encountering?

A: Multiples for good businesses continue to be very strong. It's not due entirely to the capabilities of investment banking intermediaries. The credit markets continue to be very strong. Banks and other institutions continue to lend at high multiples for good businesses. There continues to be a significant amount of equity capital in the market. Another component is the reemergence of strategic buyers in many industries. The more people interested in a particular business, the more likely it will go for a higher price.

Some businesses are not enjoying the high multiples, though. For a very cyclical business, banks won't loan as much money, so it's more difficult to drive a high multiple. Many businesses are at a cyclical high so more investors are concerned they will face a down cycle going forward. You have got to look at those opportunities and see how well a business is positioned versus its competitors. Certain industries and sectors don't command as a high a multiple. Building products companies are not commanding as high a multiple as they were last year. Automotive businesses, particularly parts suppliers, aren't commanding strong multiples. Today's market is a challenging one as a buyer. But as a seller, if you have a very good business in a good industry, it can be a very rewarding time. I expect over the next six months we might sell one or two businesses.

Q: What sectors are you looking toward in the future?

A: Naturally, we will continue to look at sectors where we have experience and have invested before. But we know the coming years will be different so we are focusing on many other industry sectors, like food and beverage. We are looking at a number of opportunities in that sector. Within healthcare, we have identified certain businesses we would be interested in: healthcare services; medical supplies and devices. We feel these fit with our capabilities and background and we can drive value going forward. We will continue to look at business services, which is an area in which we have already invested.

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