

# CREATING VALUE NOW

**Today's private equity landscape is strewn with challenges, but those who are willing to roll up their sleeves can still deliver value.**

**Here's how Kellogg alumni are cultivating growth opportunities in the post-meltdown economy.**

**“It’s** only when the tide goes out that you learn who’s been swimming naked.”

This oft-cited quote, attributed to billionaire investor Warren Buffett, is particularly appropriate for today’s private equity industry, which is trying to find its footing after a prolonged recession and the subsequent erosion of the capital markets.

Just a few years ago, readily available debt allowed private equity firms to engineer expensive deals using high amounts of leverage, hold their assets for a few years, and then sell or take

them public for outsized returns. They frequently maintained a hands-off approach that called for little more than sophisticated financial modeling.

Not so today. In 2009, the private equity industry closed its worst year since 2003, posting a 68 percent decline in dollars raised at \$96.8 billion, according to figures from Dow Jones LP Source. The number of deals moving through the pipeline has slowed; transactions that do get pushed through take significantly longer to close as skittish buyers broaden their due diligence.



The new, more cautious environment has stripped away the flash and dash of financial engineering. It is now requiring firms to deliver value to their investors the old-fashioned way, by investing prudently in companies with the potential to grow and applying well-studied improvements that foster better returns.

Drawing on a comprehensive education that emphasizes holistic training in business management and a strong grounding in finance, Kellogg alumni appear particularly well positioned to ride out the storm of a private equity market characterized by consolidation and a high rate of collapse in the post-meltdown economy.

In fact, some Kellogg graduates are uncovering hidden investment opportunities in overlooked markets, buying growth businesses and using their foundational management skills to deploy practical strategies on everything from sales and marketing to sourcing and operating tactics that enhance companies' bottom lines.

"Private equity today has changed. You have to operate businesses; you have to make them better; you have to have a long-term view in value creation," says **Scott D. Evans '99**, managing partner with Guardian Capital Partners. "You can't flip a business as easily as you did in the past."

# “PRIVATE EQUITY TODAY HAS CHANGED.

**You have to operate businesses;  
you have to make them better;  
you have to have a long-term view  
in value creation.”**

— Scott D. Evans '99

Evans, whose firm manages a \$50 million investment fund, sees significant potential in the lower-middle market, a segment frequently passed over during private equity's recent heyday as firms moved upstream to chase bigger deals on the promise of higher fees and more lucrative exit strategies.

Evans founded Guardian Capital Partners with two partners in February 2008 after cutting his teeth at private equity giant Cerberus Capital Management. The Philadelphia-based firm seeks controlling positions in companies with less than \$100 million in revenue. “We look for healthy companies that are sub-optimized, doing well but that could do better,” he says. “Maybe there's not enough management in place, maybe there's not enough guidance or governance, or maybe there's not enough capital. We make sure we bring our operational and strategic toolkit with us, as well as our financial toolkit.”

Guardian Capital Partners' first investment — a privately held teleservices company called Corporate Call Center — demonstrates the impact that a well-researched, hands-on approach to private equity investing can have on a portfolio company's results.

Pennsylvania-based Corporate Call Center specializes in handling complicated technical calls from elderly callers regarding Medicare enrollments and customer service; its clients include a variety of healthcare organizations. The company had grown steadily over

the course of 10 years, based largely on referrals. But the founders lacked the experience needed to take the company to the next level, even as they saw their opportunities for growth increasing — such as a trend among large corporations to return call centers to domestic turf. And their original investors remained more interested in collecting quarterly dividends than taking financial risks to expand the business.

After purchasing a majority stake, Guardian Capital Partners spent considerable time on site, getting to know Corporate Call Center's operations. The firm helped to develop a strategic plan, overhauling sales and marketing, and identifying ways to optimize resources. Within the first year, margins improved by 3 percentage points. The company is now on track to quadruple sales within five years, helped by a push into insurance and financial services — two additional markets that depend on highly skilled call technicians.

“We had grown really fast and I didn't have the infrastructure in place to support that,” says **Claudia Timbo**, the company's co-founder and CEO. “They did a very good, deep dive in the first 100 days of their ownership in terms of putting processes in place. They met with all of our people. I could go to them if I had problems and challenges.”

## **A holistic approach**

The skills required to stand back, evaluate all sides of a business with a critical eye and then execute solutions have been integral to the Kellogg curriculum throughout the school's history, says **Mitchell Petersen**, the Glen Vasel Professor of Finance and director of the Heizer Center for Private Equity and Venture Capital. These days, they are considered a competitive advantage in the world of private equity investing.

“We’ve been teaching with a certain philosophy for the last 20 or 30 years,” Petersen says. “What’s happened is that the world has changed and it’s come around to our model.”

Kellogg’s current curriculum demonstrates ample evidence of this approach. In Petersen’s corporate finance classes, for example, students are expected to come to the table with a working knowledge of marketing, operations and human resources, areas that must be carefully considered when making decisions that have an impact on a company’s capital structure.

“The way we weave together ideas from different disciplines, that’s where we’re adding value,” Petersen says.

Meanwhile, the school has created more opportunities for interested students to acquire working knowledge of the highly guarded private equity industry. As part of its core offerings, Kellogg provides laboratory courses in private equity and venture capital investing, requiring participants to spend 10-week stints at private equity or venture capital firms where they gain invaluable experience.

Students can also opt to participate in periodic group treks to survey the current investment landscape, where they tour a variety of firms in select U.S. cities or abroad.



Photo © Jay Goroetzer



# “THE KELLOGG EXPERIENCE IS A GOOD STARTING POINT

to see how teams work together and what cohesive management looks like.”

— Heather Smith Thorne '06

The annual Kellogg Private Equity and Venture Capital Conference, coordinated entirely by students, brings top-name practitioners to campus. And the school's investment club allows MBA candidates to pool their industry knowledge, building on the shared learning style for which Kellogg has long been recognized.

Once in the field, the collaborative approach continues to influence alums' investment decisions. Team-building, for one, is a skill frequently called upon to ensure that the goals of an investment firm and its holding companies are in sync, says **Beth Hoffman '97**, a principal at Boston-based private equity firm Berkshire Partners.

The firm, which manages \$6.5 billion in committed capital, typically invests \$50 million to \$500 million in industries ranging from retailing to transportation, energy and industrial manufacturing, delivering top-quartile returns to investors.

“There’s a lot of consensus building. People issues are very material in all of this,” she says, stressing the need to establish strong partnerships with operating management at portfolio companies or to install new leaders when necessary. “If you don’t have the people, a great plan goes nowhere.”

**Heather Smith Thorne ’06**, a vice president at longstanding Chicago-based private equity firm Thoma Bravo, concurs. Thoma Bravo manages some \$4 billion in committed capital, often employing a “buy and build” strategy within consolidating industries such as software, financial services and education.

“The Kellogg experience is a good starting point to see how teams work together and what cohesive management looks like,” she says, noting the importance of training in human resources and organizational behavior. “You really do draw on that experience.”

Thorne spends much of her time leveraging relationships outside the firm to help uncover deals in unlikely places. One such transaction took place in January, when Thoma Bravo purchased three San Diego radio stations from Finest City Broadcasting in partnership with Broadcast Company of the Americas. The firm took on Finest City’s debt and acquired the company and its assets through a foreclosure sale.

“We started sourcing the deal from senior lenders, which was new for us,” Thorne says. “We’re value investors and we’re seeking value, but we’re changing our route there a little bit more.”

Today’s more active investment approach also requires extensive industry expertise. Increasingly, financiers are entering the field with longstanding knowledge of a specific industry, experience that allows them to evaluate the operational merits of potential investments accurately and strategize adeptly on behalf of existing holdings.

## TRUST **to get through the downturn,** STRATEGY **to move beyond it**

**If** an economic recession is like a rocky sea, destroying flimsy boats and battering even strong ones, the emergence from bad times can feel like a return to safe harbor.

But is that really the case?

Professor **J. Keith Murnighan** says that without clear strategic direction, organizations can run aground even as the market rebounds. Those that do advance thoughtfully, however, may discover new opportunities — but only if they’ve laid the groundwork earlier, even while struggling perhaps with layoffs, division closings and priorities dictated by diminished resources.

In short, a company needs “multifaceted vision” as it looks toward the future, says Murnighan, the Harold H. Hines Jr. Professor of Risk Management. “It should use the downturn to make hard decisions about its options so that the firm can invest resources in more promising possibilities,” Murnighan says.

He also believes a downturn offers a chance to build trust throughout an organization, since people are more likely to be on their best behavior and want to keep their jobs.

“It may seem counterintuitive, giving your people more leeway and trust during a downturn, but this can be a time to find out what they can really do,” says Murnighan, whose research includes negotiations and decision-making.

If the company has had to fire people during tough times, he adds, it’s best to do so “diplomatically, humanely and with a lot of support.” But the question about who to rehire after the market recovers also demands serious thought.

There may be lingering bad feelings if a company brings back former employees, Murnighan says. And rehiring the same people may limit an organization’s chances to pursue new options in a new economic landscape.

“This is a time to take not just financial risks,” Murnighan says, “but risks in people too. You want to discover how you can leverage the people you have to build a new organization that sets you up for the future.”

— Matt Golosinski

Former longtime Kraft Foods executive **Andrew S. Whitman '93** is one such practitioner. Over the years, Whitman ran several of Kraft's smaller brands, cultivating a shirt-sleeves management style. He not only gained extensive knowledge of the food sector, but considerable exposure to the private equity and M&A markets.

Today Whitman applies his industry expertise, along with valuable investment connections and related resources, as managing partner of Chicago's 2x

Consumer Products Growth Partners. The firm provides growth capital to branded consumer businesses in expanding markets such as pet care, organic foods and specialty beverages.

"I talk about what we do as 'industry help that comes with a bucket of cash,'" says Whitman, whose firm relies on its industry veterans to step in and assist portfolio companies with everything from accounting to the development of sales and marketing campaigns.

"Our whole team is from the industry, some small company, some big company," he says. "We're all consumer products folks."

Elsewhere in the private equity field, Kellogg-trained practitioners are employing similar high-touch tactics to boost the value of their holdings, a trend they say is bound to continue. In the post-recessionary economy, there is little chance of delivering returns from poorly run businesses.

"Near-death experiences have a way of changing things," says **Laird Koldyke '89**, managing director of Chicago-based Winona Capital Management, which specializes in lower-middle-market companies in sectors such as niche consumer goods, leisure products and educational services.

"The ability to simply pay up and use leverage — those days are gone," he says. "You really need to know what you're doing today to make investments." •



**“I TALK ABOUT  
what we do as ‘industry help that comes  
with a bucket of cash.’”**

— Andrew S. Whitman '93

# Revamped HEIZER CENTER prepares future private equity leaders

**Honoring late investment pioneer and Kellogg donor Ned Heizer '51, the research center takes a multidisciplinary approach to creating value**

**W**idely credited as a venture capital and private equity trailblazer, **Edgar “Ned” Heizer Jr. '51** made a lot of money over a career spanning decades.

Yet when he died Dec. 3, Heizer, 80, was remembered by family, friends and business associates as a man primarily concerned with creating companies of enduring value. His deals included Federal Express, International House of Pancakes and Amdahl Corp., a high-tech venture that grew into a multibillion-dollar business.

Heizer also served his industry and educated others — including lawmakers — about the importance of private equity to the American economy. He helped found the National Venture Capital Association and worked to gain passage of legislation in 1980 that reduced hurdles to participation in the industry.

“What a perfect person to be the donor and namesake for the Kellogg School’s Private Equity and Venture Capital Center,” says **Mitchell Petersen**, the Glen Vasel Professor of Finance and the center’s director.

Originally endowed in 1988 with a gift from Heizer and his wife, Molly, the Heizer Center for Private Equity and Venture Capital supports an abundance of research, experiential learning and educational opportunities, including guest speakers, seminars and conferences. Now the center will also handle the logistics associated with these and other initiatives — a responsibility formerly held by students. As a result, students will have more time to focus on more valuable aspects of their education.

“This important structural change unleashes the students’ creative power,” Petersen says. “The center, for its part, then serves as the ‘institutional memory’ — the archive for the school’s private equity and venture capital offerings, providing ongoing continuity.”

The center will also work to reconnect Kellogg and alumni working in the finance field. When graduates contact the school seeking ways to contribute, the Heizer Center can direct them to opportunities that best meet the school’s needs and satisfy their interests and expertise. Such connections may result in philanthropic contributions or curriculum and program enhancements, says Petersen, and may also bolster the recruitment of Kellogg graduates.

“We’re trying to build a foundation for all kinds of industry knowledge and to create win-wins for our students, alums and others in the finance world,” Petersen says.



**Ned Heizer and his wife Molly in 1989.**

The center is an apt manifestation of Heizer’s passion for research and education.

“He was a very smart guy with varied interests, and he liked people,” says his son **Skip Heizer**, who noted his father’s numerous academic credentials: bachelor’s degrees in chemical engineering and business from Northwestern University, a law degree from Yale and a CPA.

Not surprisingly, Heizer tended to research his investments thoroughly. “Once he made a commitment to a company, he was in,” Skip says. “He genuinely wanted the entrepreneurs to succeed, and he played through on almost everything he did.”

“Ned was probably the best analytical business thinker I ever met,” adds **Charlie Palmer '65**, president and partner of North American Co. and a longtime friend who helped start Heizer Corporation. “He would get all the facts before applying business judgment.”

**Judy Dorr**, former Heizer Corporation CFO, recalled Heizer as a “down-to-earth guy” who excelled at bringing talented people together and then trusting them to get the job done. “At Heizer, you really felt like you were part of a team,” says Dorr, who today is CFO at Draper Fisher Jurvetson Portage. “We were laying the path for a lot of venture companies to come.”

In recognition of Heizer’s “profound and lasting contributions” to private equity, the Illinois Venture Capital Association bestowed its Stanley C. Golder Award on the Kellogg alum in 2004. **Maura O’Hara '96**, the association’s executive director, describes Heizer as an optimistic innovator who transformed his industry, lobbying to allow institutional investors to participate in private equity. In particular, she cites his efforts to advance the Small Business Investment Incentive Act of 1980, which paved the way for private equity firms to go public.

“Before Ned Heizer, that was impossible,” O’Hara says. “He totally moved the agenda on this.” — **Matt Golosinski**