Value-creation *in* Middle Market Private Equity

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To my girls for being awesome, inspirational, and supportive.
You are the joy of my life!

To Mama Pate and Hud for being the grandparents who made the difference for this kid. I'm doing alright!

List of Figures

List of Tables

Foreword

My perspective on private equity is multifaceted. I am a managing director in a private equity firm, Patriot Capital in Dallas. Additionally, I am also an adjunct lecturer for the MBA program at Southern Methodist University's Cox School of Business. Moreover, I am a member of the entrepreneurial fraternity, including multiple responsibilities for Heelys, the innovative children's skate shoe company: founding Chairman, start-up financing, and initial public offering.

Private equity is a significant contributor to a healthy economy in at least two respects. First, private equity is a source of capital for entrepreneurs to accelerate the growth and sustainability of their businesses. Of course, this comes with a multiplier effect that includes ever improving products and services for customers, job creation and career advancement for employees of such businesses, and taxes paid to support society. Second, private equity provides an attractive return on capital to investors, many of whom are pension funds—busily managing the retirement assets of working class Americans. This second point is particularly relevant given the surge in Baby Boomer retirement.

Just as any business, private equity develops and refines its processes to accomplish efficiencies and differentiation. Additionally, the better private equity firms encourage the same among their portfolio companies. The rhetorical question is how this may be best done. The better firms accomplish this by practicing what they preach, and providing a roadmap for their portfolio companies that makes sense—from the portfolio companies' perspective. This latter point is all too easily underestimated, yet is the essence of a healthy working relationship between private equity firms and their portfolio companies, whose objective is mutually gratifying results.

The private equity business model creates value in three ways: (1) financial engineering, i.e., deleveraging the portfolio company post-acquisition; (2) employing multiple arbitrage, i.e., exiting the investment at a multiple of cash flow higher than was paid at inception; and (3) enhancing the performance, i.e., cash flow, of the business during the investment hold period. I met the author of this book providentially at a Dallas/Ft. Worth Private Equity Forum event whose focus was private equity operating partners' change agency role for the all-important third leg of value-creation. John Lanier was one of the panelists. The subsequent cultivation of our acquaintance included my discovery of the alignment between his professional focus and academic endeavors. At the time, he was in the homestretch of a doctoral program. I invited him to lecture to my MBA class on customer service.

The upshot of our encounter is that he understands entrepreneurial value-creation in the private equity dynamic. Additionally, if my students are any indication, he possesses the ability to captivate the curiosity of those who may learn from his experiences. The fact that he could relate to my students as a fellow adult learner who had trod a similar path positioned him as an empathetic protagonist.

Before joining Excellere Partners, a private equity firm in Denver and former consulting client, John supported several private equity firms over an eight year period through a consultancy he founded called Middle Market Methods. This was an extension of six previous years in similar operational excellence endeavors in private equity. John's objective as a consultant was developing the 80/20 toolbox for chronic private equity value-creation challenges.

The evolution of the Middle Market toolbox resulted in a loyal following of clients, proselytized by results rooted in his advocated methodologies. The beauty of the methodology is rooted in two criteria: simplicity and universality. Whereas there are bookshelves full of intriguing topics for a myriad of value-creation topics, this book pulls together the holistic framework for how private equity firms and their portfolio companies may accentuate value-creation. There is only one catch: it takes commitment by all stakeholders to realize the full potential, but such is the case with all change.

You may rightly ask why I would endorse a book that our competitors may read. There are three simple reasons. First, we want the private equity industry, and in particular those businesses supported by them, to prosper because it is good for the economy and society. Second, we want to help entrepreneurs ask good questions in vetting their investment partners. And third, it is far more economical to share his book with my portfolio company managers than to hire John to implement the book's secret sauce!

Enjoy these pages as you follow John's insightful and entertaining demystification of private equity's value-creation principles, strategies, and tactics.

Patrick F. Hamner
Managing Director, Patriot Capital
Adjunct Lecturer, Cox School of Business, Southern Methodist University
Dallas, Texas

Preface

Career milestones and points of inflection sometimes appear in interesting packages at unexpected moments. My first professional job was in selling. I was mentored by some great sales people, but did not experience formal training in a sales technique until long after selling ceased as my primary focus. I was pretty good at sales (thanks to my mentors). Even so, upon exposure to sales technique training, I reflectively speculated how much better I could have been with the additional edge inherent in formal training. I encountered an analogous epiphany for the power of professional marketing. Along the way I also enjoyed some excellent credit and financial analysis training.

My next career phase entailed process improvement. There was a symbiotic relationship between the bean counting and process flow that I discovered quite valuable. Part of the change-management strategy of process improvement is demonstrating the cost-benefit tangibles. I had the opportunity to develop process improvement skills first in the reengineering era, and later with Six Sigma at GE. Lean manufacturing principles followed. I mix and mingle from all three.

I owe GE a great debt of gratitude. It was through their "At the Customer, For the Customer" initiative called *Access GE* that I first encountered private equity. Indeed, when I was in *Access GE*, a majority of the engagements were in support of private equity portfolio companies. All total, the private equity trek covers the last 12 years as both an outside consultant and inside-the-firm value-creation resource.

During my private equity career (third) phase, I discovered a latent teaching gene, perhaps honestly inherited through my mother, a retired college professor. Coaching portfolio companies is a fulfilling outlet. My passion is helping entrepreneurial Davids of free enterprise slay all manner of Goliaths. Indeed, the small guys have to do so in order for our economy to thrive. Unfortunately, they do not get the credit due them, but true to their character, they do not mope about it. Rather, they more productively resolve to slay another Goliath—and thankfully so.

To punctuate my credentials during the private equity phase, I earned an MBA and a Doctorate in Strategic Leadership. Both were beneficial to the genesis of this book—indeed a bucket list aspirations all. The best practices covered in the book reflect a personal odyssey of lessons learned, both from mistakes and successes. The successes not substantiated by research were culled, as luck is not a basis for recommendations.

Perhaps the single most valuable thing I have learned in my career is that those who embrace change as an opportunity have an inherent edge on the world. My fondest desire is for portfolio company teams and their private equity sponsors to find something accretive in these pages worthy of assimilation to bolster their individually tailored brands of value-creation. By the way, the best practices also work for independent small businesses. Indeed, by adopting them for their own purposes, they not only improve their enterprise value, but also enhance their succession and estate planning options.

Reviews for *Value-creation in Middle Market Private Equity*

John has taken stock of the lessons learned in his many years of real world experience and distilled them into a useful and pragmatic synthesis in this book. It is refreshing to see the attention paid to many topics often overlooked and underappreciated as value levers in investing.

Ric Andersen, Milestone Partners, USA

When I first met John, I suggested that we were separated at birth. In working with John several times thereafter, I realized he is the smarter twin. This book needs to be open on every PE firm's deal team desks. IT diligence, hiring the right people, viewpoint gaps between the firm's financial and operating members… I could go on and on. Read this book. It will change how you create value.

Lloyd Rogers, Riverside Partners, USA

Building best-in-class companies in the middle market, while creating greater shareholder value, is both challenging and rewarding. This book contains many of the principles that Excellere Partners embraces in its own value-creation partnership model, and for good reason. We worked with John Lanier for a dozen years—seven as his client before asking him to become our partner. Creating value requires a tremendous amount of strategic thinking, coupled with a disciplined process to execute strategic initiatives—this is done to strengthen the company's foundation that will support significant future growth. This book is a gift for framing a value-creation model to both private equity firms and the companies in which they invest.

Robert A. Martin, Excellere Partners, USA

Contents