

# MERGERS & ACQUISITIONS

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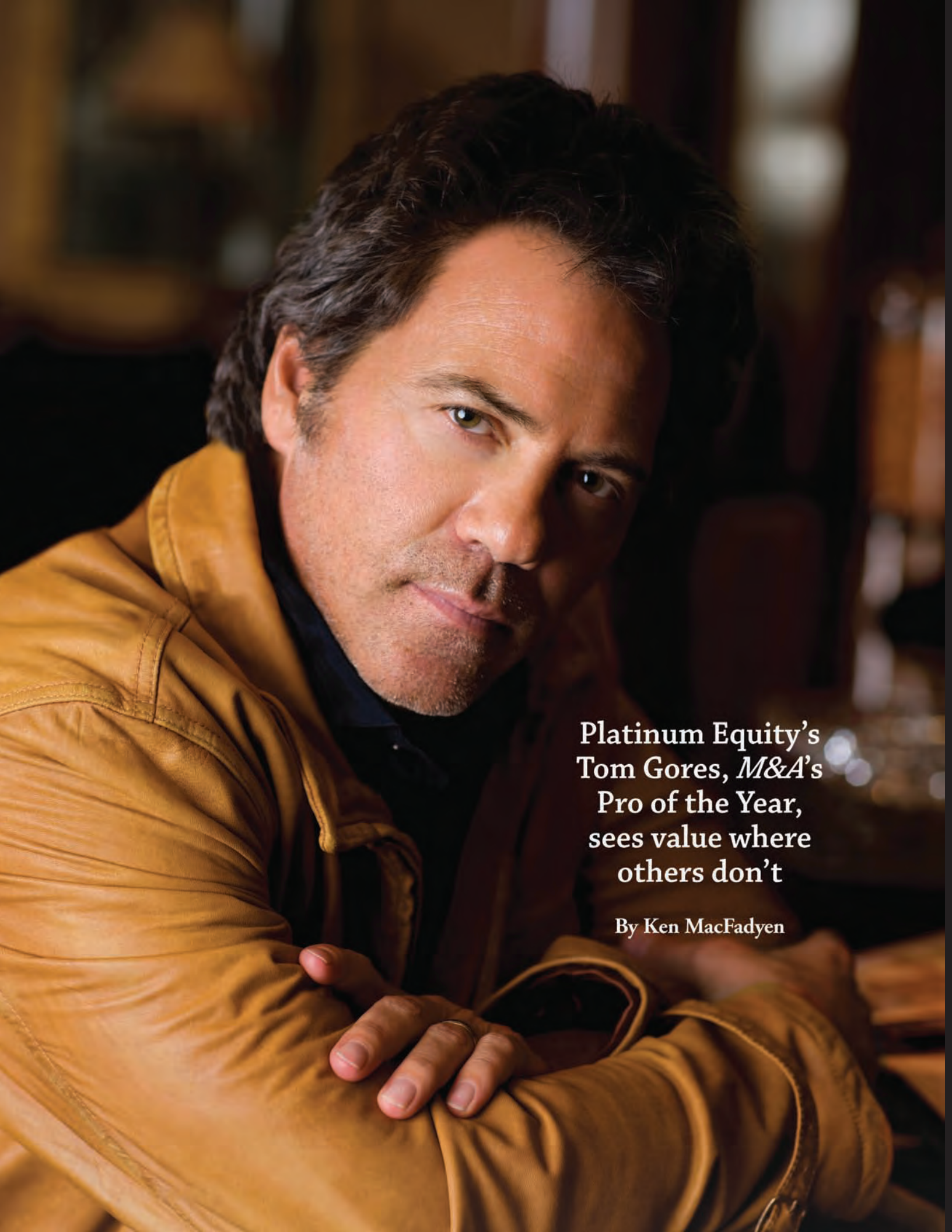
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Year, sees  
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## Unconventional Wisdom

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By Ken MacFadyen

# Unconventional Wisdom

**I**n the early 1920's, Arthur D. Little, the namesake of the well known business consulting firm, famously constructed a "silk" purse, using pork byproduct. The effort was a successful attempt to puncture the oft-repeated adage that 'you can't make a silk purse out of sow's ear.'

Platinum Equity founder Tom Gores, last year, showcased the same contrarian spirit. To some, it may even seem like an industry hasn't truly hit its depths until a Gores sighting has been documented. In 2009, with

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distress everywhere, Gores — fresh off of a \$2.75 billion fundraiser in 2008 — was seemingly everywhere too.

Platinum kicked off the year with the acquisition of DAUM Commercial Real Estate Services, and before 2009 was done, jumped from commercial real estate, to newspapers, to auto parts, and of course, to IT and software. Platinum also managed to showcase a taste for any and all types of transactions, moving adeptly between carveouts, taking privates and bankruptcies.

Tom Gores doesn't pretend to think he has the answers to remedy an industry. And he won't even wage a guess as to when a particular sector has bottomed out. "We've made a lot of great returns by not predicting," he says. Rather, Gores' strategy is to understand the inner workings of a given segment and "then figure out how to fix an individual company."

After 2009, he has his work cut out for him. Beyond DAUM, Platinum acquired newspaper The San Diego Union-Tribune, Alcoa's Wire Harness and Electrical Distribution business, Netherlands-based electric garbage truck manufacturer Geesink Norba, and two IT services and software companies, Canvas Systems LLC and Pomeroy IT Solutions. Platinum's most notable deal from last year may have been its biggest disappointment as its \$3.6 billion acquisition of Delphi never made it out of the bankruptcy court after being upended by Delphi's creditors.

Still, according to Gores, he believes 2009 will end up being among the best vintages from Platinum's first 15 years, and he acknowledges that he's "already seeing" the results.

*Mergers & Acquisitions* spoke to Gores, 2009's Pro of the Year, covering both the highs and lows of the year that was. The following is an edited version of the conversation, which took place in early March.

**Mergers & Acquisitions:** *What was notable last year wasn't just the level of activity, but also where you invested. What gave you the confidence to put money to work, in the places you did, when so many others were content to stay on the sidelines or were too busy working out issues in their portfolio?*

**Gores:** I think a lot of people couldn't get their arms

around where the bottom was last year. I'm not 100% confident today that the economy is truly back, but our operating team gives us the comfort that if the market continues to slip, we can adjust. It's basically our insurance policy. As long as we're acquiring sound businesses with flexible capital structures, we don't feel like we have to try to time the market.

Another factor behind our activity last year was our ability to move on multiple fronts. Culturally, as a firm, we have to be able to move concurrently, so when problems arise in our portfolio, we can still pursue new investments. We told our investors in 2008 that our strategy for last year would be to 'mitigate and



pursue.' Platinum started 15 years ago, we have 12 partners now and the average tenure is 12 years. We've worked through a lot of tough situations together. We didn't experience any kind of culture shock when the economy started going sideways. Our M&A teams were able to focus on new opportunities because they were confident in the work that our operations team was doing behind the scenes.

**Mergers & Acquisitions:** *A lot of people hesitate to discuss the mitigation side of the business. Are there any particular fixes from your portfolio last year that reflect some of these undertakings?*

**Gores:** Acument Global Technologies is a fastener company in the heart of Michigan. A significant part of its revenue comes through the automotive space, so its sales were literally falling off a cliff, which created debt-covenant pressure. We had to make adjustments and move very, very fast in doing so. Acument's revenue dropped nearly 40%, so we had to focus on where the

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revenue was coming from and make sure we could secure those customers. The biggest thing is that we didn't panic.

**Mergers & Acquisitions:** *How do you define 'panic' in a situation like that?*

**Gores:** I think in most cases panic creates paralysis, where you don't do anything because you're waiting for the market to return. Another form of panic is surrender — just throw your hands up and send the company into Chapter 11. We saw a lot of that last year, where certain private equity sponsors just decided they were better off bankrupting a company than figuring out how to help it survive. We don't think that way. When you understand a company's operations on a deep level, you can almost always talk to the customers to figure out a way to survive together.

The options in times of distress can be to do nothing or to send it into Chapter 11. At Platinum we've learned to move hard and move fast. CEOs in general are optimistic people, so they usually have a tendency to wait for the markets to return. We'd say, 'We don't see it.' It can be tough on our CEOs, but we were able to get the companies structured to come out on the other end. I'd say that we had four or five companies that faced significant issues, and every single one has been a good story for us.

Ryerson is a good example. The company had a significant amount of debt when we bought it. When steel prices went down, it obviously encountered some problems. And demand took a dive. But we turned our attention to things like inventory management, and over the course of the last year, we were able not only to survive the downturn, but also to pay down between \$800 million and \$900 million of debt, which put the company in a very good position. We just refinanced it, and we think that in the next 12 to 18 months, we'll be able to look at a possible IPO.

**Mergers & Acquisitions:** *Platinum has always been an operationally focused firm. Last year, it seemed like you set out to prove that no industry was too distressed. I've heard people say you can fix a company but you can't fix an industry. What gives you the confidence to go into an area like newspapers and try to come up with a fix that has eluded so many others?*

**Gores:** We're not that pompous to think we can solve an industry, but we're willing to peel the onion back to try to understand how an industry works and then figure out how to fix an individual company. We'll nev-

er pretend to know when an industry is going to move in and out of a cycle. We've made a lot of great returns by not predicting. If things don't go well, we want to know how to survive a downturn.

In the case of the San Diego Union-Tribune, we felt the business had some fixed costs that were pretty high and hadn't been addressed in a long time. We knew that advertising revenues were falling, but we saw an opportunity to attack the fixed costs and adjust the company to survive on a realistic assessment of both advertising and subscription revenue. We pretty quickly set about restructuring the organization. We put in new management and got the fundamentals in order. We also put money back in the business, rescinding some pay and benefits cuts imposed by the previous management and investing in a long overdue pagination system. The result is a business that is stable. At this point, we don't have the pressure of just trying to stay alive. We've re-established a foundation, so now we can begin to think about how to get creative. We can make additional investments in new technology and better content.

A lot of people try to find growth before they have fundamentally fixed underlying problems. That's a big mistake. You have to solve the basic problems first in order to set up the business to survive in the end.

**Mergers & Acquisitions:** *How do you do that in a business like newspapers, though, which a lot of people, investors in particular, view as the next buggy whip?*

**Gores:** There were several key factors that got us comfortable. The first is that we were able to buy it at a reasonable value, so starting off it wasn't faced with the wrong kind of pressure. The capital structure wasn't overburdened with debt and the business wasn't pressured by unreasonable cash flow expectations. The second is our appreciation for the customer base. The Tribune is the main paper in San Diego with a loyal readership and advertising base. That was crucial. We knew we had a foundation to build on. The third is that we felt we could make a difference operationally in a way the old owners hadn't tried.

The mistake would be waiting for the newspaper industry to return to where it was several years ago. Since we acquired it at a fair price, once we fixed the fundamentals we could afford to put more money into the business. But it's also about investing in the right areas. The company, in certain areas, was a bit fat, so we've made the paper more efficient in terms of head count. We've also been able to reduce costs by improving technology.

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The whole thing took up a ton of my time, and ultimately ended up being a huge disappointment.  
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And then, of course, there's the question of growing the reach and profitability of the online side of business. A key part of that equation is whether or not someone can figure out how to get people to pay for content. Although that's not something we're counting on, somewhere along the way I think it may happen. But it will likely be figured out by an organization that is a lot bigger than we are. Our job in San Diego is to make sure that we create a healthy company that will be strong enough to survive and see that day. For us, it's about buying in at a good value, creating the right capital structure, making a difference with the operations and really believing in that subscriber and advertiser base.

**Mergers & Acquisitions:** *Do you have a vision in terms of how the industry will evolve and solve the question of how to be compensated for content?*

**Gores:** It has to happen, because it's out of control, but it's going to take one of the big guys to do it and establish a model that the smaller folks follow. Sometimes the grand vision and strategy can be overrated if it distracts you from focusing on the fundamentals. We want to create a strong, profitable company, and then let the strategy evolve from there. Vision usually comes naturally after you've fixed the problems and established a direction.

**Mergers & Acquisitions:** *You reportedly looked at the Boston Globe assets too.*

**Gores:** It goes back to looking at each company and not judging the entire industry the same. Newspapers are local businesses. I don't think you can roll up a bunch of assets and consolidate the resources. Each one has to be run very separately if you want to resonate with the audience. But there are other assets out there like the Union Tribune, so we'll look at those.

**Mergers & Acquisitions:** *Switching gears a bit, in January, you kicked off the year with the acquisition of DAUM Commercial Real Estate Services. If you listen to the pundits today, everyone seems to believe that commercial real estate is the next shoe to drop. What's the thesis behind this investment?*

**Gores:** Price has very clearly tanked in commercial real estate. DAUM is a service provider, not a developer, so we're going to be in the middle of whatever activity is going on.

DAUM previously had several private owners. What that meant was that the company struggled to move in the same direction sometimes. For example, right now, we're looking at a small add-on. It's the type of thing the previous ownership might not have agreed on. They couldn't really figure out a 'right' direction, and you can't take too much time when it comes to making those kinds of decisions. We knew that commercial real estate wouldn't be coming back any time soon, but we can still identify ways to make a difference operationally.

Also, we saw a strategic fit for DAUM here at Platinum. Anytime we get into a deal, there might be \$100 million to \$200 million of real estate assets that are part of the company we're acquiring, so managing owned real estate is an extension of what we do. We have a lot of use for DAUM's services. We're going to operate DAUM like a traditional investment, but it will be nice to have that additional resource, and for DAUM it will create new revenue streams.

**Mergers & Acquisitions:** *How do you account for a nuclear scenario? In commercial real estate, for instance, do you make the investment with your worst-case model in mind?*

**Gores:** We always plan for the worst case. Our base case is most people's worst case. And our worst case, most people don't like to think about. I think the last few years would be considered the nuclear scenario. We're not afraid to look at that situation though, and do the math around what would happen if we had to liquidate receivables and so on.

In general, we'll pay a lot of attention to a company's track record and then try to run sensitivities to model out what happens if certain customers leave, or revenues drop off by 20 percent. It creates a lot of funny conversations with our M&A team. I'll say to model it with revenues declining by a third, or take this customer out and tell me what happens, and they'll wonder why we're even looking at the deal if that's a possibility. But I want to be able to measure my bet.

It's very powerful to think along the lines of a worst-case scenario. It helps both in troubled situations and in other cases when you're forecasting growth. I think it's what differentiates us from strategic buyers too, because sometimes they can't get away with missing their forecasts. We consider ourselves to be both a strategic and a financial buyer, and since we're going in with a worst case model, if we happen to hit the middle of the fairway rather than worst case, we'll make a great return.

**Mergers & Acquisitions:** *Can you discuss for a little bit how Platinum resembles a strategic buyer?*

**Gores:** We literally dig in. When I refer to our operations team, I'm not talking about a strategic person going in and analyzing an industry. I'm talking about going in and getting the kind of deep understanding that a strategic buyer would have. We're going to talk to everybody in the space, talk to the customers, get into the plants and walk the floor, and come away from it with the detailed understanding of the assets that a strategic buyer would have.

**Mergers & Acquisitions:** *You put in a lot of work in the auto parts space. The Delphi deal, which ultimately came undone, was a three-year process from what I understand. What was the thesis behind that one even though it never crossed the finish line?*

**Gores:** At first, we got involved through one of the divisions. Another private equity group had Delphi tied up at the time, so we were

looking to acquire a single unit being sold separately, the steering unit. Eventually the discussion turned to the whole company. What we liked about that deal was that there were so many different constituencies with complex issues that we had to work through and solve, which is something we do well.

We built a tremendous relationship with the UAW, and became familiar with Delphi management and General Motors. GM came to trust that we really knew what we were talking about. We knew the steering division better than GM did. Then the administration's auto task force got involved and we had to convince them that we were the best owners for the assets. They were putting up \$2 billion, so they couldn't afford to make the wrong choice. They did a tremendous amount of due diligence on us and once they were satisfied, made us the stalking horse bidder.

We dedicated a lot of effort and money to the Delphi project, and in the end, had things figured out so well and had such a compelling plan in place that the creditors didn't want to let the business go. We had already spent a lot of time with management, developing a strategy and consolidating product lines. The whole thing took up a lot of my time, and to be honest I was very disappointed it didn't work out. But we take chances like this every day. This one, unfortunately, didn't end up on our side. I don't regret any of it.

Looking back, our willingness to bid on the assets and come to the table when nobody else would is what ultimately helped Delphi emerge from bankruptcy. So maybe we did the automotive space and the economy a little favor. And I was also proud of our willingness to walk away and not overpay for the business. Sometimes not doing a deal is harder than doing one. We could've increased our bid, but it just didn't make sense. We always have to stay disciplined.

**Mergers & Acquisitions:** *At least you were able to use some of that institutional knowledge. That same month you acquired Alcoa's Wire Harness and Electrical Distribution.*

**Gores:** Without a doubt. The Alcoa unit we acquired is actually a competitor with one of the Delphi units. Once we became involved in the Alcoa situation, it didn't take us very long at all to come up to speed. That's one of the good things about this business.

**Mergers & Acquisitions:** *How do you see the auto parts space coming out of its current hole?*

**Gores:** There is still way too much capacity. In the space today, you either have to consolidate or be consolidated. You need to have a certain amount of volume to stay alive. Also, I think you have to really be careful about trying to predict volumes. This is the mistake Delphi made. Instead of being a hero and predicting the future by saying this or that will happen, you have to adjust to the big boys and let them determine demand. That also means that you have to be able to produce products quicker.

**Mergers & Acquisitions:** *Does the relationship between the OEMs and*

*the suppliers, which has been pretty one-sided, have to change?*

**Gores:** I think the OEMs have been tough on suppliers. There needs to be more sensitivity to volume commitments because it's the suppliers who get stuck. They're the ones doing the engineering and ramping up production, so there needs to be more protection for them. Either that or the suppliers will end up being owned by the OEMs. It's a tricky business; one of the trickier ones around.

**Mergers & Acquisitions:** *Can you talk a bit about the Geesink Norba transaction? It's a cross-border carveout of manufacturer of garbage trucks. It seems like there were a lot of moving pieces.*

**Gores:** Our business development folks found that one. Their job is to stay squarely focused on building relationships with corporates and investment bankers, so a lot of our acquisitions of corporate divestitures come out of their outreach and relationships. Geesink Norba was a European division within OshKosh, and while it's a reasonably sized business, OshKosh was looking to sell and focus more on other core areas.

This was one of those situations where the seller was looking for the right buyer. They didn't want any liabilities to come back and haunt them. Plus, the unit has some large customers that it shares with OshKosh, so they wanted a buyer who could go in and turn it into a standalone entity without alienating anyone. This is something we've been doing for years.

**Mergers & Acquisitions:** *Your last big investment of 2009 was the taking private of Pomeroy IT Solutions, a company that in February merged with OAO Technology Solutions. What was it that attracted you to Pomeroy?*

**Gores:** We really know the IT space, so that helps us. We had actually first looked at this business a few years ago and Jacob [Kotzubei, a partner at Platinum], did a really nice job keeping his eye on this. This company is in the same position as a lot of mid-sized IT providers; it either needs to consolidate or be a consolidator. It's not quite as acute as the auto parts segment, but IT companies really need to build volume and create a sizable footprint.

**Mergers & Acquisitions:** *Can you talk a bit about the merger with OAO? It's interesting that you acquired each separately and then executed the merger afterwards.*

**Gores:** The OAO deal was one of those really fast moving situations. We wanted to do a careful review of both companies to make sure they were a good fit for one another. It would have been very difficult to figure out the synergies and how everything fit together within the window we were working under. Given the speed of the process, we wanted to assess OAO on its own. We had an idea what the synergies would be, but it's dangerous to try to price a company on hypotheticals.

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**Mergers & Acquisitions:** *A familiar chestnut in private equity is that the best vintages for the asset class always come during downturns. If you had to characterize 2009, do you think these investments, five to seven years from now, will be the ones that turn out to be among the best in your portfolio?*

**Gores:** I do. I feel really good about every deal we did. We're actually already seeing it.

Beyond just deploying capital, I think we're working in spaces that are really compelling. I like the fact that we got to know these industries more intimately. They are areas that are morphing, so there will be more opportunities in future years. We still have to do the basic things. You're always going to have to execute and you can't get ahead of yourself or become arrogant. When you get too comfortable, that's when you stop listening to the people on the ground.

**Mergers & Acquisitions:** *It doesn't seem like you're slowing down at all in 2010. You recently acquired the Genmar boating assets and I've read that you're a frontrunner for Miramax. Has the opportunity set begun to shift yet? Or is this year going to end up looking a lot like 2009?*

**Gores:** I think 2009 was a definitely unique year; 2010, right now, feels much more stable to me. I don't think we're going to see the

same kind of inactivity throughout the market. One of reasons people weren't buying last year, which created an opening for us, was that they didn't know where the bottom was. Now, I think, people are starting to feel more comfortable. But industries and businesses are always in transition.

If you're willing to peel the onion, there's a big opportunity for companies seeking the right owner. That's what works with this model; you can do really well in good and bad times as long as you stay disciplined and don't try to predict growth.

**Mergers & Acquisitions:** *If you look at the fallout from Cerberus' failed investment in Chrysler, it seems like there can a lot more pressure for these deals that go against conventional wisdom. Does the fact that so many people are watching and perhaps doubting create more pressure and even more risk?*

**Gores:** There is a certain amount of pressure, but I'll always go back to the substance of the details. When we acquired the Union-Tribune, I had some of my banker friends ask why we would acquire a newspaper when the whole industry is crashing around us. This is when we just go back to what we know and stick to our model. There's going to be a lot of noise in our business, but you can't base your decisions on the wrong kind of pressure. **MA**

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