

The Daily Deal

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The sun also rises *By Christine Idzelis*

To gain stable footing, you sometimes have to go further than you'd like. As the economy was deteriorating last year, turnaround specialist Sun Capital Partners Inc. pushed the envelope on cost cutting, slashing more than a \$1 billion from operations across its portfolio. Even those draconian measures couldn't save everyone: Sun's portfolio suffered 16 bankruptcy filings.

But Sun, which saw overall earnings rise nearly 30% in the third quarter, appears to have survived the bloodletting.



The Boca Raton, Fla.-based private equity firm has carved out a niche in reviving troubled companies, so to a certain extent, it was naturally prepared to absorb the blow of some failures during the worst recession it had ever experienced. "We used all the same tools, all the same plays, but on steroids," says co-CEO Marc Leder.

As a normal course of business, almost half of Sun Capital's deals involve companies struggling with negative Ebitda, while the rest of its targets, though not hemorrhaging cash, aren't exactly in tiptop shape. Turning their operations around, even in an upbeat market, requires intensive work and extensive resources, which is why its staff is larger than more traditional midmarket private equity firms, Leder says. To get the job done, it has built a full-time army of 40 operations people in addition to 40 deal professionals.

Last year, the team wasted no time tightening up Sun's portfolio to withstand a deepening slump. "We took early, aggressive action, cutting cost to the bone," he says, shedding \$1.3 billion in operating costs since the fourth quarter of 2008. As lean as Sun already was, the firm demanded that each company scour its profit-and-loss statement to slash 25% of costs, excluding raw materials. It took a tough stance, says Leder, insisting that portfolio company managements not come in below that level, no matter their concerns. "Don't come back to us with 10%," he recalls saying, "We'll help you draw the line."

Sun then sat down with each company, extracting on average a 15% reduction in operating costs, he says, with a handful hitting 25%.

Even so, several -- some 16% of its portfolio -- succumbed to bankruptcy, producing \$155 million of losses for Sun. The bulk came from its failed \$1.4 billion buyout of Mark IV Industries Inc., an auto parts supplier that filed Chapter 11 in April. It was the biggest bankruptcy in Sun Capital's history, wiping out its \$135 million investment.

The firm also was forced to reset debt covenants a total of 18 times, says Leder, pumping an additional \$50 million of equity into its portfolio companies to satisfy lenders. In more than half of the cases, though, "we didn't have to put in a single penny." The companies requiring the biggest capital injections were general merchandise retailer Pamida Stores Operating Co. LLC and auto parts supplier Tyde Group Worldwide LLC, which received \$15 million and \$12.5 million, respectively.

Overall, the situation now seems to be looking up. Its holdings, consisting of 80 companies generating a combined \$25 billion in revenue, are showing signs of improvement, says Leder. Although revenue this year is still declining, it is falling at an increasingly slower pace, and Ebitda has reversed course to rise 28.5% in the third quarter.

The firm relies on rigorous reporting of cash flow statements to help it quickly identify -- and react to -- potential problems, he says. Its companies produce updates every 13 weeks, giving it a view of earnings not only midmonth, but two months ahead. It also updates trailing 12-month Ebitda every two weeks. "It may seem like a lot of work, and it is," says Leder. But it's a "powerful tool" that has helped drive performance.

That improving outlook recently translated into a few big exits. In October, it made about 15 times its cost selling Japanese jelly products maker Tarami KK to the private equity arm of Tokyo's Mitsubishi UFJ Lease & Finance Co. Ltd. And in November, it quintupled its money in the \$157 million sale of Timothy's Coffees of the World Inc. to Green Mountain Coffee Roasters Inc.

As for investments, Sun Capital's \$6 billion Fund V is being scaled back to \$5 billion to help its limited partners cope with overallocation and liquidity issues linked to the downturn, Leder says. Only a quarter of its capital has been deployed, leaving it with \$3.5 billion of dry powder.

"In the worst recession in 70 years, you might think that a distressed investor like Sun would be having a field day," he says. But this year, it expects to complete only about half the number of deals it would typically. It generally engages in 20 to 30 transactions annually, investing anywhere from \$1 million up to \$500 million in each.

The financial crisis, however, wreaked havoc on valuations. At its worst, entire industries faced rapid, double-digit revenue decline, preventing Sun from getting down to the liquidation value it likes to pay for seriously ailing targets; such hard times demanded an extra liquidity cushion that would have dampened returns. As for healthier targets, the valuation gap between buyers and sellers was often too large to find common ground.

"All that has changed," Leder says.

And that means Sun can get back to playing a more conventionally distressed market.