Lead Left Interview – Michael Babiarz

THE LEAD | July 5, 2016

This week we chat with Michael Babiarz of Clayton, Dubilier and Rice. Michael is a partner of the firm and been with CD&R since 1990.

The Lead Left: Michael, you've been with CD&R for 26 years. Tell us how the firm has evolved?

Michael Babiarz: In many ways, we still operate with the mindset that Martin Dubilier and Joe Rice had in 1978 when they formed CD&R. The firm built itself around a simple premise: blending professional investment judgment with world-class operating skills was, and still is, an intelligent and practical way to buy, improve and sell businesses. CD&R pioneered the operating partner PE model. We've differentiated ourselves from other private equity firms through our long track record and a distinctive mix of financial and operating talent. Having operating experts around a business who can step in and provide guidance and leadership if they need to provides downside protection for both our financing sources and for our equity.

Historically, we've been most successful in situations where there were operating challenges and/or complexity. A good example is divestitures from large corporates. That was a major differentiating factor in the early days. When you're dealing with a seller or management team that cares who the owner is, we do very well in those situations. They recognize the value we can bring to the table. When IBM decided to give their brand to someone for five years when we acquired their printer business (Lexmark), they really cared who the new owner was. The importance of being viewed as a trusted partner is as important today as it's ever been.

TLL: How has the firm adapted to the realities of private equity investing in today's world?

MB: We have always been business model investors meaning that we look for companies with very particular characteristics, including market leadership, broad spread of risk and clear operating improvement potential. Today we apply that business model focus and superimpose it over certain industry verticals. We have operating partners with expertise in four key industry sectors: healthcare, consumer/retail, industrials, and business services. We can bring in experienced senior executives from Fortune 100 businesses – all of whom have multi-decade exposure running global enterprises.

Examples include: John Krenicki who ran GE's $50 billion energy business and Ron Williams, the former CEO of Aetna. In business services, we have Russ Fradin, the former president and CEO at Sungard. On the consumer front we've got Paul Pressler who had senior executive roles at both the Gap and Disney, Vindi Banga, who was the #2 executive at Unilever, Sir Terry Leahy, the former CEO of Tesco, and John Compton, who had a 30 year career at Pepsico, most recently as President.

Those human capital assets give us a competitive bidding advantage. For example, when we bought High Ridge Brands, John Compton and Vindi Banga helped us by virtue of their extensive and deep networks in the consumer industry. Having their insights and strategic guidance from the beginning of our due diligence through our exit in the future, in addition to their ability to attract high caliber portfolio company senior management, is extremely helpful.

TLL: How do you view auctions these days? I'm sure you hope to avoid them.

MB: We'd love to have all proprietary deals, and about half of our investments since 2009 have been fully exclusive or very limited processes. Often times these are partnership structures where the seller is trying to avoid parting with a business at the worst point of the cycle. It can be a win-win outcome, as we saw when we and Ingersoll-Rand sold Hussmann to Panasonic earlier this year.

TLL: Do you get deal flow from investment banks? How about your operating partners?

MB: We certainly have relationships, but we've built a reputation based on partnering with sellers and management teams that can't always do what's needed with a business. For non-core businesses, it's tough for a corporate owner to invest adequately. We're an ideal partner because we can pay strategic attention to the business, invest financial and human capital into the enterprise, and give teams and the incumbent owner some equity, so they can get the benefit as the value improves.

Hussmann is a timely example. Before we acquired 60% of the company from Ingersoll-Rand, Hussmann's EBITDA and market value were going down by the day. Our operating partner knew the business (refrigeration systems) very well from his Emerson Electric days. Other bidders offered higher purchase prices, but they eventually backed down when they realized how complex separating this business from IR was going to be. The sellers didn't like our price initially, but the bankers running the sale process had seen the CD&R playbook before. The competitive bidders ran for cover in the face of complexity, but we made money by refocusing the business, re-energizing the team, and holding on for a few more years so the business could start to show progress that it was on a positive trajectory. We and IR ended up selling Hussmann to Panasonic this past April.

TLL: What's made auction processes more competitive?

MB: In general, it's been financing. It's heated up today. Bankers accelerate timing because they recognize the strength of the capital markets. We can mobilize the resources when we need to, but we try not to play in large, transparent processes unless we really have a unique edge. Over 50% of the deals we've done in our last 2 funds have been completed outside of wide auctions. In those situations, where there's increased complexity and often times innovative structuring required, we generally have the time we need.

TLL: Speaking of capital markets, are you taking advantage of the non-bank capital out there?

MB: Historically, we have not had a lot of direct lending relationships because it's a real challenge for direct lenders to provide unfunded revolvers. We've learned over the years that adequate RC capacity is critical to protecting the downside and growing the business. As a result, we've chosen to put together club deals with banks rather than with institutional investors.

Contact:
Michael Babiarz
mbabiarz@cdr-inc.com