

A man with dark hair, wearing a light blue button-down shirt, is seated at a dark wooden conference table. He is looking slightly to his right with a serious expression. In the background, there are large windows showing a cityscape with tall buildings. A glass of water is visible on the table in the foreground.

PRIVATELY SPEAKING

Faith in the system

*Monomoy Capital Partners, which recently closed its second fund on more than \$400m, has developed a unique system as part of its turnarounds of struggling companies that borrows heavily from Japanese business philosophies. Portfolio company employees trained in the system believe in it with an almost religious fervour. **Christopher Witkowsky** reports*

PHOTOGRAPHY BY DONALD BOWERS



Around 1:30 am during one grueling day of “boot camp”, it dawned on chief executive Roxanne Lauer that she was exhausted.

She had been working all day at one of Monomoy Capital Partners’ quarterly training exercises for employees, dubbed “boot camps”, which run for two weeks and generally stretch each day from 6:00 am to the “wee hours of the night”.

Lauer, chief executive officer of Monomoy portfolio company Hess Industries, thought she was prepared for the ordeal.

“[Prior to Hess Industries] I was a vice president at Honeywell Corporation, I went through all their ‘lean’ training and thought, ‘I want to see what [Monomoy’s] is all about,’” Lauer told *PEI* in a recent interview. Lauer volunteered for the boot camp.

“You spend the first day in the classroom ... the next day you begin your transformation. For me it was getting out on the [factory] floor. At 1:00 am I was putting up tape, dead tired, and I thought, ‘I have to be nuts to be doing this.’ And then it kicks in; this is what you have to do to make the transformation,” Lauer said.

What Lauer meant by “transformation”, in this case, is the intense process of learning Monomoy’s version of lean manufacturing.

Lean manufacturing is a business philosophy that rose out of Toyota in the 1990s. The idea is that all resources in a business should be directed toward creating value for the customer, and anything outside of that goal is wasteful and should be eliminated. In other words, it’s the act of making processes at a facility as simple as possible.

While the term is most readily associated with the automotive industry, but Monomoy has adapted it for the companies in its portfolio, which range from a bakery to a women’s online clothing retailer.

The tenets of the “lean” philosophy, known at the firm as the Monomoy Production System, are ingrained in the minds of portfolio company employees at the boot camps. Two employees are hand-picked from each of the firm’s 10 portfolio companies to attend the camps, which are held at different portfolio company facilities.



Hillenbrand: *make sure you see your portfolio companies from the shop floor upwards*

There is no hierarchy at the boot camps, so a chief executive officer like Lauer, or Monomoy’s co-founder Justin Hillenbrand, work on the factory floor with every other worker, to get direct, first-hand experience of a facility’s operations.

Monomoy’s eight operating partners will have overriding authority over the boot camp teams, but each team chooses a leader. With no hierarchy in place, team leaders can range from the bakery line supervisor with the high school education, to the senior investment associate at Monomoy.

At one point during Lauer’s first boot camp, she found herself late in the evening painting lines on the floor of a factory, tracing out the most efficient paths for forklifts to follow. The small but burdensome task eventually

allowed the facility to eliminate a few forklifts – reducing waste, simplifying tasks: Monomoy’s version of lean manufacturing.

The boot camps seem a lot more than just a management exercise Monomoy forces managers to endure. The exercise goes to the core of what the firm is all about – finding quality companies or operations that “deserve to exist”, and improving them, says firm chief and co-founder Stephen Presser. Monomoy does not look to drive returns for its limited partners through financial engineering, or even “growing our way out of trouble”, says Presser.

“We drive most of our value not in the deal itself, not by leverage, not by buying a company for as little as we can get away with. We drive almost all of our value by making the

companies we buy better,” Presser says. “Whether through boot camps or supply chain initiative or through product mix improvement or through some other aspect of operational improvement and waste elimination, that’s where we’re driving value.”

Operational improvement: it’s a term that gets thrown around a lot in the private equity industry these days, with the golden age of the buyout bubble fading further in the rear-view mirror. In Monomoy’s case, there appears to be much more than rhetoric at work; the firm really does get down to the nuts and bolts of investments.

One simple piece of evidence to support this, is the fact that co-founder Hillenbrand recently attended a boot camp and worked 18 hour days with a team trying to figure out how to eliminate a bottleneck slowing down a production line in the manufacturing of industrial air conditioners. Hillenbrand’s team was led by a Monomoy senior associate.

“I slept for 13 hours the night I got home [from boot camp], to the chagrin of my wife,” Hillenbrand says.

SURVIVING BOOT CAMP

Hillenbrand is proud of his time at boot camp. “There is no better way to understand the drivers of the companies you own than seeing it from the shop floor,” he says, prefacing his story.

Hillenbrand’s boot camp was held at a facility of Monomoy portfolio company HTPG, which makes industrial-strength air conditioners used by food retailers, restaurants, sports arenas and warehouses.

Hillenbrand and his team found the bottleneck was caused

by overproduction of some of the components of the air conditioners, namely copper tubing and aluminium sheeting. The raw materials were produced and stacked all around the plant floor, forcing assembly workers to navigate through the huge piles of components to find what they needed to put together a unit.

The solution drew upon lessons from the lean manufacturing handbook. To ease the bottleneck, the team came up with a way for the raw materials to only be produced when an order came in for an air conditioner.

“They were overproducing like mad. There were reams and reams of copper tubing of all different sizes, because you didn’t know what you were going to need,” Hillenbrand says. The team “took all that away” and put in place a “pull system”, he explains. Under the revised system, when an order for a specific type of air conditioner comes in, an order for the exact copper tube and aluminium sheet needed is placed and the materials are sequenced in the correct order of assembly.

“I don’t have to make 10 of one kind of air conditioner and then make 10 of another kind. I can make whatever air conditioner I want based on what the customer needs,” he says.

The solution took out about \$250,000 of unnecessary parts, and allowed the company to relocate five employees.

The fix, which took the team three days to figure out and implement, reduced inventory, which freed up cash, increased efficiency, which allowed the company to increase profitability, and helped the company meet its growing orders, according to Daniel Collin, a Monomoy co-founder.

“The end result: you are able to do a lot more with a lot less invested in the inventory,” he says. “You need a lot fewer people for the job that needs to get done and you’re positioned to grow with a lot more profitability.”

The host portfolio company of a boot camp gets the immediate benefit of the solutions the teams create. But the graduates of the boot camp go back to their own portfolio companies and are tasked with finding and executing similar projects.

“This is an example of taking lean manufacturing and applying it to a business we buy and making it better,” Presser says. “The

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Presser: value does not come from buying low

idea is to take an example like that and multiply it 100 times in every one of the businesses we buy.”

Monomoy has graduated 120 people from boot camps, and those people have gone back to their own portfolio companies to help institute the ideals of lean manufacturing. The projects are monitored and the graduates are held accountable for the success or failures of future efforts.

To the firm’s surprise, some employees bought into the idea so much that they went back to their companies and started holding their own “mini boot camps”. Lauer, for example, has established the practice at Hess Industries, where she has a good amount of the workforce take part, including “absolutely every manager within the organisation, anybody who touches the product. I have most of my finance people going through it, our sales people,” Lauer says. “The ‘lean’ concepts pertain to every division.”

BUYING THROUGH THE DOWNTURN

Lean manufacturing is one way the firm is able to take cost out of companies it buys. The firm was founded on the premise that it could take struggling companies that “deserved to exist” and

make them better. Monomoy was established in 2005 after Presser, Collin and Hillenbrand left turnaround firm KPS Capital Partners. The three men had a plan to make turnaround investments in the lower mid-market.

“We’re not a buyer of last resort,” says Collin. “We’ve learned over time that there are some assets you should be willing to pay a little more for because they’re better assets. It helps you mitigate risks and actually generate higher returns. We’re focusing first and foremost not on purchase price but on, ‘Is this a business we want to own? Is it a business that deserves to exist,’” Collin says.

Throughout the financial downturn many firms held back from making investments, but Monomoy quietly went about the business of acquiring companies.

Around the time Lehman Brothers collapsed in the autumn of 2008, the firm bought online women’s clothing retailer Boston Apparel Group; imaging supplier Katun; manufacturing business L&P Plastics; and Atlantis Plastics, an asset being auctioned by a bankrupt company. L&P and Atlantis were added-on to the company’s plastic moulder platform, Fortis Plastics. True to the lean manufacturing ideals, the firm consolidated 14 facilities into seven core operations at Fortis.

Not being reliant on market timing, Monomoy invested just before the financial markets started to roll toward recession and continued to make deals as the economy collapsed. In 2009, the firm kept active with add-on acquisitions. Before the credit bubble burst, Monomoy ensured its portfolio companies were positioned to weather a financial downturn (by, for example, not using a lot of leverage).

“Our strategy doesn’t change whether we’re in a recession or out of a recession,” Hillenbrand says. “Some things may get expedited, we’re still going to consolidate facilities ... we’re still going to deploy lean manufacturing. A lot of times a recession presents a catalyst to get everyone focused in the same direction.”

THE LP VIEW

Monomoy raised \$280 million for its debut fund in 2006, which is close to fully invested with some money left over for add-on acquisitions and one more platform investment. Leaning on the performance of the investments in the first fund, Monomoy was able to collect more than \$400 million for its second fund, which closed in December. Fund II will be active in 2011, the partners say.

In the early part of the fundraising process for Fund II, some limited partners had concerns about the firm’s decision to enter the market with a new vehicle, because they hadn’t yet seen any exits from the first fund. The firm had delivered some returns to investors mostly through dividend recapitalisations, Hillenbrand says. Monomoy made a conscious decision not to exit any of

its investments in 2009 just to expedite the fundraising effort, because it didn't want to settle for modest returns, he says.

"We decided to maximise shareholder value rather than show exits at modest multiples," Hillenbrand says. "We had a number of portfolio companies we could have sold in 2008 and maybe early 2009, but it wasn't the right decision from a long-term perspective and we didn't want to make decisions based on a fundraise that went against maximising value."

Instead of presenting a list of exits, the firm was able to demonstrate to LPs increases in EBITDA and reduction of debt in the portfolio. "Investors could dig into all the numbers and see it was real, rather than post a sale at a modest multiple of capital just for the sake of having an exit," Hillenbrand says.

As of 30 June, Fund I was generating a 1.79x multiple and a 22.7 percent net internal rate of return, which, says one market source, is "pretty good" for a 2006 vintage fund.

One Monomoy LP in both funds confirms that there was some concern that the firm was being "premature" in raising Fund II, but the firm was able to show that it had positioned its existing investments well in the downturn.

"They were very aggressive in 'battening down the hatches' to make companies very efficient," the LP says. "They recognised it was a game of survival and they came out looking strong."

The firm's lean manufacturing system also played a part in giving LPs confidence Monomoy investments would pay off in the end, even without the solid proof of an exit, the LP says.

"You had to really look closely at what they were doing with companies for longer-term success," the LP says. "If you look at the performance of their companies, you can see the value created." The LP goes on to cite the "lean manufacturing" element as "a big piece of success for them on the operating side".

And the exits have come as the environment has improved. The firm recently announced in January it was selling specialty chemical producer SRC to Buckingham Capital and Stelaris Capital for an undisclosed amount, an exit that would generate a 5x return.

Even with the numbers on their side, fundraising was not easy. The environment was much changed from the first time Monomoy raised a fund, Presser says. LPs, especially, had different attitudes.

"Fundraising in 2010 was not for the faint of heart," he says. "Those of us who raised funds in 2010 had to do everything differently."

LPs were doing more diligence than ever before, and some investors in the market were questioning their continuing commitment to the asset class.

"We had to work very hard to make sure we communicated that our strategy was a differentiated strategy, and wasn't sort of a plain vanilla buyout strategy," Presser says.

The firm also faced questions from LPs about the guidelines published by the Institutional Limited Partners Association in 2009. Those guidelines have caused much consternation on the part of GPs but many of the so-called Private Equity Principles are



Collin: buy business that 'deserve to exist'

more appropriately applied to larger firms, Presser says. "There are aspects of the guidelines that made their way into our partnership agreement and some aspects didn't," Presser says.

PROSPECTS

Armed with \$400 million in dry powder, the firm is ready to hit the market in 2011 for opportunities. The North American market today, even with all its uncertainties, looks as inviting as ever to Monomoy. With faith in the tenets of its lean manufacturing philosophy, and the growing evidence that portfolio company employees are more than willing to buy into the lessons of the system, the firm believes it is positioned to do great things whether the market turns down, goes up or stays stagnant for the next few years.

"It's what we do; it's what we've always done," Collin says. "We built an infrastructure that is scalable, where we can hold people accountable and drive through change as we buy these businesses and make them better. It's much different from a plain vanilla buyout shop hiring a third party consultant to put together a \$1 million pitch book." ■