

# POWERHOUSES IN PRIVATE EQUITY

# Sun Capital in the Eye of the Distress Storm

Little more than a year after Privcap's first Powerhouses interview with Sun Capital co-CEOs Marc Leder and Rodger Krouse, we caught up with them (at their respective homes, of course) amid vastly different economic circumstances. In an interview, RSM's Don Lipari asked about how the Sun portfolio is faring amid unprecedented disruption, what they learned from prior recessions, what their deal pipeline looks like, and how prepared the firm was to work remotely.



**Rodger Krouse**  
Co-Founder, Co-CEO  
Sun Capital Partners



**Marc Leder**  
Co-Founder, Co-CEO  
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**Don Lipari**  
National Industry Leader, Private Equity  
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**Don Lipari, RSM:** Hi, this is Don Lipari, national head of private equity for RSM, bringing you another edition of Powerhouses in Private Equity. Today, I'm honored to be speaking to both Marc Leder and Rodger Krouse, co-founders of Sun Capital co-CEOs. Let me just start by asking how you and your families have fared through this pandemic.


**Rodger Krouse, Sun Capital:** I'm in Boca Raton. I have two of my three kids with me, my wife with me, and we're all good. We're all healthy.

**Marc Leder, Sun Capital:** I actually had the virus in the first week of March. I brought it back from France. But I had fairly limited symptoms. I self-quarantined and now am fully recovered. I naturally have the antibodies now, so I'm good to go.

**Lipari:** We're in an unprecedented time in our human history. What have you learned about yourselves, and what have you learned about the Sun culture?

**Krouse:** There was just a great demonstration of character and grit from our team. I was really proud of it. People knew that they had to stand up and work harder, make some tough decisions, and they were there. There were some inconveniences. They worked around them, and it was really a source of pride to see how the team did.

**Leder:** And I would add that we have approximately 34 portfolio companies all over the world. We've been investing in distressed businesses for 25 years, and also healthy, well-run businesses, but distress has always been part of our control-buyout strategy. So we had the playbook for this pandemic—not the social distancing, but the dramatic economic impact, the deep recession we find ourselves in. And we shared that playbook with our management teams, and they were outstanding at getting and understanding the challenges that were facing them, whether it be employee safety and health, cutting costs, maintaining liquidity, serving customers. And they have also stood up and been incredible through this unprecedented time.

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**Lipari: Talk a little bit more about that playbook and the strategic priorities that you implemented during this pandemic.**

**Leder:** We've invested for 25 years in the same four industry verticals—healthcare, industrial, business services, and consumer. There are certain strategies that are different by industry vertical and others that cross all of them. First and foremost is you have to protect your people. Safety first. And that's whether you're running a manufacturing business in a normal environment or running a healthcare service business in a pandemic.

The second important element in this situation is cutting costs. We've had businesses that have had no impact to revenues, but others that have seen their revenues drop by 90 percent—a retail business where all they have operating is their e-commerce site. And as much as you hate to do so, you've got to take costs out so that you can survive the pandemic and come out the other side. And then closely tied to that is liquidity. To finish first, you have to finish first. You can't run out of cash or liquidity.

The final point is, in a crisis like the one we find ourselves in, it's very easy to be focused purely internally. Maintaining liquidity, cutting costs, protecting your people are all inward-focused efforts. You can't forget your customer, because they need you more than ever right now. So whether it's our dermatology business providing emergency services. Or a restaurant providing takeout. Or a manufacturing business letting the customers know that our plant was forced to close by government mandate, but we have extra inventory we can ship them - and we'll be up and running as quickly as possible. Having a good dialogue about what their needs are going to be is very important.

**Krouse:** We want our management teams to be able to predict the future, and future needs, as best they can in such an unpredictable time. That's not really possible. No one can predict the future. What the teams have to do is prepare for a lot of different eventualities when they arise.

**Leder:** Right now, economic indicators are not particularly helpful, because they're moving so quickly and so extremely. But as the pandemic starts to abate, certainly unemployment and consumer confidence will be important to help determine the length and the severity of the ongoing recession. What's unique to Sun Capital is we have approximately 34 portfolio companies in all different industries operating on all continents other than Antarctica. And we get weekly flash financial reports from all of them. And we're seeing information across the globe and across all different industries on sales, orders, backlog, absenteeism, inventory levels. So that is an incredible amount of data that we have our fingers on and process on a weekly basis. And in fact, a lot of our limited partners look to us for updated, broad-based information on the economy or specific industry verticals, because we've got that access to data.

And then what's really new about this situation, this pandemic, is that anecdotes become very helpful. We're reaching out to our investors and offering them one-on-one Zoom meetings, whether it's just to say hello and catch up and see a familiar and friendly face or to answer whatever questions they may have.

So, regular communication as co-CEOs and leaders of our business.

**Lipari: So you're both practicing hyper-communications at this point.**

**Krouse:** Oh, my goodness, if we can see people in person, we want to see them on the screen. In many cases, we're seeing more people, because we're not doing the traveling or anything like that. You go from one moment to the next, and you see someone new on the screen.

**Lipari: This is your third recession. You had dot-com, 9/11 in 2001. You had the Great Recession. Now we're in what I believe may turn out to be the greater recession. So talk about what you've learned through your navigation of these recessions and how you're going to apply it in this situation.**

**Krouse:** Right. I'm glad you mentioned that we've been through three recessions. A lot of people who've been with us are younger, and this is really the first one that they're experiencing in adulthood. So we have to think about what we've learned and tell it to ourselves, but also to include the others going through it for the first time.

One is to fundamentally know that we're going to get through this. We've gotten through the other ones. They can be scary to begin with, but we're going to get through it. Don't assume you know things, particularly when things are so hard to predict.

**Leder:** One thing I would add is it's also very helpful to be well positioned, heading into a recession. So the prior recessions, we had a pretty broad mix of heavy turnarounds, companies losing a lot of money, with limited management teams, and healthy, well-run companies that we call good to great, that had a lot of momentum and sales and earnings growth and good margins and an outstanding team. And what we found in past recessions is the good to great companies were much more resilient. You don't really want to head into a recession with a lot of EBITDA-negative cashflow-burning businesses, because no matter how talented and experienced you are, they're hard to save in that kind of economic environment. So beginning with 2017, three and a half years ago, at our investment committee level, we discussed the economic environment and felt that we were very far into the economic recovery. We knew a recession was imminent. So starting in 2017, we've mainly been buying good to great, very recession-resistant businesses.

**Lipari: Marc, when we last spoke, I think it was about a year ago, you talked about the importance of continual improvement. Talk a little bit about applying that principle as it relates to Sun Capital and its continued evolution.**

**Leder:** Sure. So, as we discussed before, our first three funds, our first decade of results were very strong. We grew too quickly. We got too big. We added too many portfolio companies. As a result, Funds IV and V, from 2005 to 2012, were profitable but well below our capability—quite mediocre, to be completely candid.

**Lipari: Rodger, I'll direct this question to you. Since we last spoke, Sun closed Fund VII at \$2.3 billion. The vast majority of that committed capital remains as dry powder. Talk a little bit about Sun's expertise, operational capabilities. What do the opportunities in front of Sun look like?**

**Krouse:** I'm glad you asked us, because our operational capabilities are really core to who we are. And it starts, really, from the beginning. We had operating partners before the term operating partner was even invented. We had operating partners in the 1990s, and we use these operational capabilities certainly in distressed situations, but also in good to great as well. So we use them in good times and bad. Now, certainly with what's going on in the world, there are going to be more distressed opportunities for us, and we're going to expect a larger share of Fund VII to see distressed opportunities than Fund VI, as we were 10 years into a recovery as we were finalizing Fund VI's investment. We have around 75 percent of our fund uninvested at this standpoint. We think that companies are going to need capital and they're going to need our operational expertise, and we're really excited with the opportunity.

**Lipari: Anything to add there, Marc?**

**Leder:** Well, you said that there should be a lot of opportunities, post-virus or pandemic. We actually closed a deal on Monday of this week, May 18th, a specialty retailer, with 33 fairly large stores, all of which were closed [At time of interview]. And we bought this business. It's in hibernation. Our capital will help save the business, save the jobs, and allow us to reopen stores as the government permits. We priced it to burn a certain amount of cash until we can reopen and get volume back up to more normal levels.

**Lipari: Is the deal pipeline robust?**

**Leder:** It's not really robust at this point. We find it's a bit of a barbell. There are certain forced sellers that have been coming to market. There are certain healthy businesses that started processes and are continuing at those processes. The pipeline is not very, very large at this point.

**Lipari: Rodger, could you just peer into your crystal ball and give me an idea of when you think the pipeline for Sun will be back to December 2019 levels?**

**Krouse:** Look, we're private equity guys. We're not fortune tellers.

**Leder:** I'll throw a quarter out: I would guess Q3 of this year. People have been in lockdown for several months. They're going to want to go out and enjoy the summer as best they can. I think there will still be a significant hit to the economy, a lot of bad news. Hopefully, and maybe this is just the optimist in me versus the fortune teller, but I'm hoping by the end of the summer, things will start to really return to normal.

**Lipari: You're not anticipating the challenges in the Great Recession, with limited access to capital as we come out of this pandemic?**

**Krouse:** There's going to be somewhat of a strain on capital, but there's so much that the financial institutions and the governments learned from the global financial crisis. Banks feel better about their position at this point.

**Lipari: Marc, are you at all concerned that as we settle into the new normal, which I'm anticipating, will result in adjustments to business valuations? Are you at all concerned that the sellers are going to wait out to get back to valuations, pre-pandemic levels?**

**Leder:** Well, as Rodger said, what we're seeing is a barbell right now. Sellers that must raise capital to save their businesses, or sell for that same reason, and healthy businesses unaffected by the pandemic where, while they may take a small discount right now, because financing is not as abundant, they'll still get a reasonably fair value. But there is typically an adjustment period. If prices come down where sellers are a little shell-shocked because they were expecting a higher value when they thought about selling pre-crisis, they will need to readjust to the new world, the new valuation, if it does indeed change.

**Lipari: Would you comment on the technological capabilities of your [portfolio companies]? I know it's very varied, but were you able to employ a mobile workforce?**

**Krouse:** Sure. And we'll start with ourselves. Since we're in a hurricane zone, we planned for this. So we literally turned a switch. We decided to go home one afternoon, and the next day everyone was up and running electronically. But since we addressed this early, when there were signs of the storm before it was actually upon us, the companies really moved correctly and were able to do this, those that could work from home or working from home and have been doing so for really a long time. And it's worked out well. ■