FILLING THE CORNER OFFICE

When Cerberus Capital Management adds a new business to its portfolio, it knows just where to turn for management know-how.

Randy Glass

"We are not afraid to buy businesses that are broken," says Mark Neporent, Chief Operating Officer and General Counsel of Cerberus Capital Management, who has made a career of putting such businesses back together again. Before joining Cerberus in 1998, Neporent was a partner in Schulte Roth & Zabel LLP's business reorganization and finance group. "At Cerberus," he says, "we try to make money for our investors by basic business operations: blocking and tackling, restructuring balance sheets and making businesses more efficient. Our focus is on operational excellence."

That's not an unheard-of approach for private equity firms, of course; successfully resurrecting a dysfunctional business is one reliable path to maximizing investors' returns. Yet Cerberus differs from many traditional firms in that it has developed a proprietary team of operating executives on which it relies to help it perform due diligence, underwrite, evaluate, execute and monitor its operational control investments. Because of its team, Cerberus can focus not only on traditional buyouts of distressed companies but also on corporate carve-outs — taking only a piece of a company rather than buying a stand-alone business. In part because carve-outs have little existing management structure — a deficiency that must be quickly remedied — Cerberus can take a different approach from that of many firms, which tend either to avoid carve-outs completely or to look outside for the expertise to rebuild companies. Cerberus depends on its proprietary team of 85 industry-hardened executives and only a small, handpicked group of Tier 1 consultants. Led by Robert Nardelli, former CEO of The Home Depot and Chrysler, the firm's internal team works out of an affiliate called Cerberus Operations and Advisory Co. (COAC). "COAC is populated with former operating executives, including CEOs, CFOs and COOs," says Neporent. "And we have about 100 other former COAC members who are currently situated in our portfolio companies occupying key management positions."

What are the advantages of maintaining a large staff?

NEPORENT: We can take on projects in which the entire management infrastructure must be built from scratch. That includes installing complete systems for accounting, IT, sales and marketing, and human resources. One of our recent successes involved Talecris Biotherapeutics, a blood plasma company we bought from Bayer. The transition services agreement covered a very brief period, and we had to get everything in place right away. Thanks to our internal team and support from strategic consultants such as FTI Consulting, the outcome was highly successful.

Yes. That was a very successful transaction, with more than 20 times return on investment reported. Touching further on the topic of exiting from investments: With the IPO market still slow, do you end up holding companies longer these days? Do you get more involved, even after a business is up and running?

NEPORENT: In the past, we tended to exit investments after we completed our restructuring task and restored the company to operational and financial health. In this market, we are often holding our investments longer. So once we have fixed a company operationally, we have to figure out how to grow it during what could be an extended holding period. That means we are paying much more attention to the top line and sales and marketing than we have in the past.

Since Bob Nardelli came onboard full-time a year and a half ago, we have stepped up our surveillance of the companies in our portfolio. The technology we have developed is unmatched. We try to spot problems and see trends much earlier than we did when the economy was more robust and there was more room for error. You have to be able to measure things, and Nardelli and his team have deep experience and use comprehensive models that they check every day.

But doing an IPO is just one of many exit strategies. If that can't happen, maybe you sell to a strategic buyer. Each investment is unique, and conditions vary from industry to industry and region to region. We have had exits and partial exits this year in all forms of transactions and industry sectors. You need to be nimble and resourceful. For example, one European deal collapsed because the IPO market reacted badly to the Greek financial crisis. Two weeks later we got a deal done in a different industry sector elsewhere in Europe despite the lingering crisis.

Has the economy also affected your ability to make acquisitions? Financing has got to be tight.

NEPORENT: Blue-chip companies are expensive now, and capital is dear. We were able to source and sign up three significant middle-market deals so far this year. And though you have to put up more equity, financing is available for the right acquisitions and the right sponsors. Our sweet spot is the middle market, despite all of the media attention paid to iconic transactions such as GMAC and Chrysler. We target the corporate widows and orphans. These are noncore businesses that good companies are shedding because they want to focus on their core competencies. That creates opportunities for us that others may shy away from because they don't have the management and operating talent in-house.

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How are your companies performing this year?

NEPORENT: There are pockets of good news and areas in which sales are flat or down. Auto supplier revenues are up, but sales at paper companies are down. We have been able to enhance earnings by continuing our relentless focus on operational efficiencies. But there is a limit to how much you can cut costs. You have to worry about cutting so deeply that you start to impinge on what a company can do.

What about new markets? Are there different geographic regions you are focusing on now?

NEPORENT: We spend a lot of time thinking about Asia, looking at relationships and opportunities. We've invested billions of dollars in acquisitions and debt in Japan. And though we have yet to make any meaningful acquisitions on mainland China, we are actively looking there. And our portfolio companies are constantly looking for opportunities for outsourcing and efficiency.