culper capital partners

Adam Cook | How M&A Can Create Value for Shareholders as Well as Customers

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M&A Masters Podcast with Patrick Stroth

Transcript:

Patrick Stroth: Hello there. I'm Patrick Stroth. Welcome to M&A Masters where I speak with the leading experts in mergers and acquisitions. And we're all about one thing here, that's a clean exit for owners, founders and their investors. Today, I'm joined by Adam Cook, managing partner and Chief Investment Officer of Culper Capital Partners.

Based in Norwood, New Jersey, Culper Capital Partners invests debt and equity in middle-market companies that seek true partnership solutions that go well beyond the capital deployed. So I don't want to steal Adam's thunder here. I'm very glad to have him because Culper Capital Partners is a newly-minted private equity firm which is illustrative of the growing body of private equity out there. There is a real healthy market when new firms are emerging. And that's good. So, Adam, it's a pleasure to have you. Thank you for joining me today.

Adam Cook: Thank you so much, Patrick. It's a pleasure to be with you this afternoon.
Patrick: Now, before we get into your firm, let's set the table. Tell us what led you to this part, this point in your career.

What Led Adam to a Career in Private Equity

Adam: So, you know, in 1997 or 1998, I remember myself licking customer confirmation envelopes while I was working at an audit firm. And a few folks kind of scurried into the room and went into one of the manager's offices and then came out about 25 minutes later and grabbed a few of us and said, hey, we've got kind of a new assignment for you. And while I can't talk about the details of the deal, back then it was a very large transaction.
And they had me working on a part of a team that was basically analyzing what is the present value of an underfunded pension plan would have to be funded at closing as fall day, a rabbis trust, that would have to be created. So I was automatic. I was kind of thrown in out of nowhere into this new universe of M&A, albeit a very specific portion. And I'm not sure how long that transaction went on but I was hooked ever since that time. So stayed in audit for a very short period of my career and then went into M&A and really never looked back.
Patrick: And so you caught the bug.
Adam: I call it the bug. Not that there's anything wrong with audit, but it sure beats licking customer envelopes.
Patrick: I would consider mergers and acquisitions is probably the most exciting business event out there. I'm sure there are people that really love the IPO world but I think for the larger business community because it happens to so many more people is such a milestone that that's the big event out there.
Adam: Yeah, and I've been very lucky throughout my career not only to, you know, kind of witness the value that M&A can create, not only for shareholders but also for customers, you know, bringing kind of a smaller target, you know, up to speed from a professional perspective and, you know, different revenue channels and products.
Giving employees new opportunities, you know, with more opportunities as part of a, you know, larger-scale organizations, but also spent a bunch of time early in my career and throughout the latter part of my M&A career before we'll get into what we're going to talk

about today in terms of how M&A, you know, shaped a lot of, you know, part of what I'm doing. But also on protecting the downside when a company is in trouble or there is an issue with a business, but it's got true value.

There might have been, you know, nothing that management did while the company is in trouble. It could be, you know, a, you know, a catastrophic event, it could be that their products were tied to some commodity that was spiking for a longer period of time and, you know, their product costs were out of control, you know, for macro issues, or it could be management.

But M&A often serves as a function as well, not only to preserve the true value of a company, but to preserve, you know, jobs that would otherwise go away if consolidation didn't take place. So, you know, and that portion of my career was certainly rewarding to see what the process could do for, you know, not only the creation of value, but at the employee level. I think sometimes there's a misnomer that with M&A jobs go away. I saw quite the opposite in terms of kind of the aggregate amount of employment, M&A, allowing, you know, that employment to continue in distressed situations.

Patrick: Yeah, I can't agree with you more. I think there's a cynical view of private equity. It's summed up in four words, buy low and sell high. The way you bring things down is, the traditional view is well, you're letting people go, so you're cutting costs, you're bringing cost synergies together. That's not necessarily it. I mean, there are a lot of companies that are well-run, well-managed, but they get to a point, one author called it no man's land where the management in place can only get so big.

And then they need another skill set to go to the next level. And you're not too small to run unnoticed. You get to a size where you got to take another level, another step up, otherwise you're gonna have a problem. And who better than somebody that's done that time and time and time again successfully, you know, to hold your hand and bring you there?

Adam: Yeah. We'll talk, it's a good point. We'll talk about the Glebar story later in the podcast. But when I bought Glebar, and I was also, I was kind of owner-operator in that situation, it wasn't slash costs. It was quite the opposite, right? Move to a world-class facility, spend millions on capital equipment and building out, you know, that world-class base not only to have a place where our customers could come in and kind of fit the bill for that, but, you know, a nice safe place where our employees could work and feel proud. You know, doubled headcount, right?

So I think we are certainly very growth-orientated at Culpers. Sure, if there's waste, you know, I think that you're robbing the entire company and all the employees that are there, regardless of what that waste is. But, you know, our mantra is to redeploy that waste into, you know, turn that scrap into gold, if you will.

Patrick: Yeah. Well, you can't save your way to prosperity is the way I always look at that. Tell us about Culper Capital Partners. And I always like asking people like you just where did you come up with the name? To give us an insight on just the angle you came and tell us a little bit about this organization.

About Culper Capital Partners

Adam: So for Culper, we're investing in, you know, middle-market businesses. We'll focus on things that we can see and touch. We will make, you know, debt investments where we're riding along with, you know, whether it's a BDC or, you know, traditional lending companies where we'll take, you know, more passive, you know, pieces of debt.

But really focused in on the platform equity side where we're putting our own money to work along with our business partners to find bespoke opportunities where, you know, it's well beyond the capital deployed. If someone's just looking for capital at a platform investment, we're probably not the right partner. We are going to be more of, we're not going to work at the company. So not be management, but we're going to be more owner-operator than, you know, just strategic advisor. So what does that, you know, what does that mean?

That means, you know, our team, you know, focused really on industrials. solutions, medical device, health care services, where we could put our M&A experience to work like traditional private equity to find add-on opportunities that will bring arbitrage and create additional revenue channels to sell through our market channel. You know, arbitrage, if you will, product synergies. We are going to evaluate whether the ERP systems are up to date.

Often in lower middle-market companies, there's so much low hanging fruit, you know, in that investment and albeit it takes a lot of time. We're going to build a sales organization to create sales organizations that are measured, tracked, held accountable, are not just looking to maintain existing customer relationships, but to go out and get new ones, to foster new opportunities within your existing customer base as well, to consultative sell so that your customer is getting everything, maximum value out of what you're providing, right?

That ROI. So eventually, you know, their products are bought and not sold, right? So I think, you know, kind of our mantra is really, I would say, on average, we're going to spend about, you know, 40 hours a week collectively as a group where we can add that expertise into an environment where we found a great company with great people and really good leaders, but that we can help professionalize it.

You know, from a sales perspective, from an infrastructure perspective, you know, to, you know, really have, you know, employees kind of feel like they can grow as enterprise value grows and truly partner with them. Not that there's anything wrong with the traditional private equity model. But just for us, I think we're gonna look at two to three portfolio companies at any given point in time.

I would extremely doubt if it would be more than that from a, if we're the lead, and really focus on putting those resources in place. We just brought on a medical device expert that's been in the industry for, you know, 25 to 30 years in leadership positions. He was actually a customer of mine when I was the CEO of Glebar, you know, because we're, you know, kind of heavily involved in looking at opportunities in the medical device space, right? So we really want to be able to bring much more than that, you know, that check to the table.

Patrick: It's got to be real attractive for prospective targets out there, the management where you're going to make them best of breed. You're going to get them out there and have them excellent. I think they saying I heard, I'm stealing from somebody else, but nobody wants to buy or subscribe to the second-best software security system out there.

They want the best. And that's what you're specifically offering out there is bringing them to the level, they probably are at a high level already, otherwise, you wouldn't have an appetite for them. But to get to be that best of breed and stay there comfortably and move at that higher platform, it's very, very exciting. There's a great value opportunity that you guys are offering. You mentioned Glebar before. Why don't you share that experience if that's a case study that you could share with me?

Adam's Experience as Owner/Operator at Glebar

Adam: Sure. So Glebar, not just because I owned it and ran it, but is truly a gem of a company. When I learned about the company. I said, Wow, what amazing technology. I'm not sure if these folks realize what they really have here. But to be respectful of the old owner, because he made a lot of money. It was run, you know, a bit like a small delegate, you know, versus a world-class organization. While they had such talented people, including the old owner, he's one of the smartest engineers I've ever met to date and he's 85 years old. And that's an understatement. They didn't know the definition of sales.

It was, you know, if you build it, they will come, if you will. It was, well, this is the way we do things. And it was a whole lot of talking and not a whole lot of listening to the customer. And it was an engineering company. And that's great. It still remains that intimate engineering company today. But what we really did was kind of turn that into a sales organization where go out and see your customers and consult with them. Become their partner, to where, you know, again, I use the term a lot, where your products are bought, not sold.

That's really the value proposition that your customers should demand of you. And we really turned that into a sales organization over time. We also really focused in on the customer and employee experience, right? We moved from, you know, two and a half, if you will, old facilities that were kind of, you know, beaten down, we had to walk parts across the street in the winter storm to, what we considered, you know, it was more indicative of the products that Glebar sold.

The world-class facility, you know, where employees would feel good about going to, you know, it had world-class filtration, you know, everything was always kept up to from, you know, from a safety perspective, and they were really given the opportunity to thrive. So on day one, you know, we kind of decided, hey, we're moving, and we did that. We also needed to, you know, play the part, if you will, in terms of, hey, if we're going to have a fortune 500 customer base and then that level below that, not that we didn't have smaller customers, but we need to practice what we preach here.

So instead of telling the customer Hey, you can't go back there. We've got some top-secret thing going on. You know, I think that, you know, we spent a ton of money on, you know, not only new capital equipment of our own, but really mapping out the facility logistically and having it be lean and safe and something where you could be efficient. But where our customers should say, yeah, we should really, you know, not just do business with someone. I don't even like the word customer. They have to become a trusted partner.

And I think that's a, you know, real part of what we did. I think the biggest thing that we did, and certainly, we're gonna do this at our portfolio companies here at Culper, you have to incentivize people. Not that people aren't going to work hard for their paycheck. They are, but you need to align them with what you're trying to do, not only from a dollars and cents perspective, you know, but also from a cultural perspective, a safety perspective, a, you know, an overall value perspective.

I always often use the phrase, you know, if you're not adding value anymore and you're still sitting at your desk, go for a run or whatever you like to do. If you still come back to your desk that day and you don't have any value, go home. If you don't have any value to add that day, right? And that's not because I was trying to be negative, it was a positive thing, right? Meaning, you know, we celebrated failures at Glebar, right? Because if you can't celebrate failures, you're never going to be able to take those risks to win. And I think with aligning employee incentives, you know, with where you're trying to go, is uber important.

I think the most gratification I got when we sold Glebar to our client, and I still maintain a minority position, was seeing the faces of key employees that participated in that transaction with the look of shock on their face, you know, when you told them, you know, what they were going to see, you know, receive in proceeds. So I think alignment, and not only alignment with your employees, but everyone. Your suppliers and seeing value in everything that you, you know, that you do in that ecosystem of that company that you own.

Patrick: I'm very pleased that we're having this on recording. And I'm going to encourage everybody to have a real listen to this. Those steps that you took are absolutely fantastic and very, very thorough. And took a little bit of faith or quite a bit of faith, I can imagine, because these weren't small capital outlays to get the physical plant put together and everything else lined up.

But it was great because you can tell clearly that you had it in your heart at your core, that this is the direction we're going to go. We're not going to worry about short term outcomes. We've got, you know, a long term goal here and I just cannot vision anything not embracing that approach.

Adam: And I, you know, it's fun, it's a different parallel but, you know, I coach jr football and what I tell all the kids all the time is we have a philosophy here and it's no different in anything else you're trying to achieve in life, whether it's business or, you know, being a good partner to your spouse. We're raising your children but it's effort, attitude that, you know, that I can attitude, and then the toughness. That doesn't mean being, you know, brash or abrasive but being able to fight through the, you know, tough times knowing that the sun will come out.

Patrick: Resilient. Absolutely. Yeah, you've got to be there. I mean, absolute words to live by, Adam, tell us what's your ideal profile for a target now? What are you guys looking for?

Culper's Profile for an Investment Target

Adam: Yeah, I mean, I think it's a founder-owned business or a second-generation business that truly has a differentiating product, whether it's manufactured or distributed is that they're in the second inning, right? So think 20 million bucks a revenue, 4 million of EBDA, but that founder slash owner is saying, Hey, I recognize I'm in the second inning. I've done an unbelievable job with this business.

But not only do I need money, but I need more than that, right? I need someone, you know, and when I say someone, a group of folks who could kind of come in, you know, and build for the future. To say, Wow, I'm listening to these ideas and they make a whole lot of sense. And, you know, I'm gonna roll X percent of my business and you know what, the next time we sell it, if we do sell it, my minority position, it looks like it's going to be worth more than the entire enterprise value next time. That's the type of partner I want that is willing to listen.

And we have to be willing to listen too. I remember at Glebar, I had a 30-day plan 60, 90, 180, 365, three-year five-year and I went in. You know, I sat there and interviewed every single employee. I actually went to my first customer visit in Ireland and after we landed after a nine-hour flight, went directly to a company and actually pointed to a poster and said, Hey, what's that? I said, that's what you do, sir. I had no idea what even the picture was. Talk about humbling.

Alright, so you have to be willing to listen. So those plans that I had put together after I went on those customer visits, did a lot of listening not only to customers but our employees and suppliers alike. Three months later, pretty much 75% of those plans that I put together had materially changed, right? So I, you know, I think that there really needs to be, you know, that openness there. And hey, look, you know, I think Glebar, for example, I got it from the second inning to the bottom of the fourth.

And I think the next fire and that bottom of the fourth from, and this is not being boastful, but I think was pretty impressive. It's an unbelievable company today that our clients going to do phenomenal with. But, you know, my belief as well is that, you know, you should only own a business as long as you are going to continue to drive that value. And you know what, there probably comes another point where, you know, I removed myself as CEO, you know, last June because I said to myself, okay, now is the time to bring in that professional CEO, okay?

Which I did from Stryker, a gentleman from Stryker, but then in addition to that, we really needed to start focusing in on M&A which was my background and we went out and did an add on. That is, you know, really impactful for the business. Had we not done that, had I not recognized that that was time, we probably wouldn't have been able to go out and get that deal done.

There'll come a point, you know, because we were a change agent in Glebar when we came in where we said, hey, look, we need a new fresh set of eyes. This thing now is a potential for it to go from, we got it from, you know, C to F, well, somebody else needs to come in now with a whole new, you know, thought process and, you know, disciplines, if you will, to get it from F to S. And I really do believe that. So we'll never stand in the way of a company's growth or their potential.

Patrick: Outstanding. If you could, share with me your experience with rep and warranty insurance. Good, bad or indifferent if applicable?

Adam: You know, so as I was thinking about this podcast and thinking of rep and warranty insurance, I thought back to approximately about 15 years ago, I forgot where I was and what I was doing, but I was talking about a rather large deal. And, you know, hearing more about rep, warranty insurance and back then, it was for really large transactions. And I remember I wrote a one-page article, I forgot where it was published, but M&A insurance with a big, you know, exclamation point. I probably still have it at home.

It was probably very, very generic and, you know, probably didn't get a lot of reads. But, you know, now it's completely changed the landscape of transactions. I mean, we're working on a deal now with enterprise value of, you know, 30 to 40 million and rep and warranty insurance is available. So, to me, why is it important to the seller? I think that, you know, it obviously limits the amount of, you know, escrow baskets that they have to, you know, put up for a year or more, so that's great.

They get to, you know, they get to extrapolate more cash upfront without having their money hung up in an escrow account, earning little to nothing, and get to go ahead and invest that. I think for the seller, certainly, you know, it provides risk mitigation. But I think more importantly than that, for the seller, I think it further illustrates, you know, that you've got to do your diligence, right. So the insurance provider is not going to underwrite the transaction unless you really dive deep in the areas that they're going to give you protection for.

So I think it's really focused buyers, if you will, I should say, to really dive deep because the insurance companies require it. Not that they didn't dive deep before but I think it's further risk mitigation as it relates and correlates to purchase price. So I think it's changed, you know, discipline a bit, and I think it clearly, you know, helps the seller in terms of, you know, that cash, you know, that cash being available. But, you know, that offers a level of protection to the buyer that otherwise wouldn't be available, especially the lower middle market, folks.

Patrick: Now, since that first piece you wrote 15 years ago, there's been a lot of change. It's almost as much change as online businesses. I mean, night and day. I think it did not get a lot of traction because the cost was very big in the early days. And also the coverage was very, very narrow. For example, in Silicon Valley, you couldn't get past first base on rep and warranty because it excluded intellectual property reps.

So it accelerates the process. And I think it, particularly when you're trying to attract management over from the target over, avoiding hammering them into the ground over terms because you have a lot more leverage is really a good long term strategy. And you were talking about all the great things that you do for quality of life and trying to get people all on board with you. It starts, it can start there with management, and it's just one way that eases it through.

And I think what I'm very happy about for us is that it was a product that was reserved for the larger middle-market deals north of 100 million dollars transaction value. And there are so many owners and founders that don't get to 100 million but they get to 20 and 30 million and they could really benefit from this. And that's the one thing has happened in the last about 16 months is that a number of insurance carriers come in and they're targeting those sub $50 million transaction value deals.

They're coming in with really competitive rates, their broad coverage, just as broad as larger deals. And the eligibility standards are easier. Now, Adam, as we're in this period of the year, COVID-19 is still around, we were stumbling in trying to get our legs under us to open up a little more full and we're having some roadblocks here. How do you see from your perspective, either COVID or non-COVID on the future M&A for, let's say, you know, through the end of 2020 into 2021.

M&A Primes for a Big Comeback

Adam: Look, I mean, I think in the intermediate term, M&A is going to come back in a big way. I think, you know, M&A is obviously been hot for so long. But, you know, let's face it, there's going to be businesses that are struggling to come out of COVID on the other side, particularly lower middle market businesses where I think consolidation is going to be more important than ever before to save a lot of these businesses.

So the intermediate-term, I think, you know, we see a volume, you know, that, you know, that matches 19 or even higher, okay? I think that in the short term, I think it was Blackstone, I saw someone reference the other day about M&A is, you know, gonna continue to slow until people could shake hands again. I believe that.

You know, we're the lead investor. I'm not doing a deal unless I could look someone in the eye. And I think that's extremely important. So I think in the short term, people gonna have to get creative. You're gonna have to travel safely, to be able to go, you know, walk the floor, see how the culture is at the company. How do employees look when they're working?

You know, all of these things are really, really important that go well beyond just the dollars and cents that you can see in a spreadsheet doing diligence or on a Zoom call where you can't, you know, read body language. So I think people are going to have to adapt. I think sellers are going to have to understand that warp speed closings, you know, in 30 to 60 days, they're probably not going to happen. Maybe for add ons, but, you know, service providers are going to need more time.

They're going to have to be able to get there and coordinate travel safely. You know, so that kind of new normal is going to exist until, you know, COVID is under control, in my opinion. But in the intermediate and long term, I think it comes back. You know, it comes back in a very, very big way. And I think it's going to be a necessary tool to save a lot of these companies that at no fault of their own or in, you know, are in, you know, painful positions.

Patrick: I can't tell you how much I appreciate all you've shared with us today because it's been very, very helpful. I'm going to encourage our listeners, I think they're going to do it because you're, it was enjoyable enough listening to this the first time to repeat this. Adam, how can our listeners find you?

Adam: Best way to find us is to go to culpercapital.com. CULPERcapital.com. I think there's, you know, it tells our story there. It tells a little bit about who we are and what our approach is and, you know, Culper's tied basically to the Revolutionary War. And that's really the story is kind of, we want to, not that it has any tie the Revolutionary War, but we want to revolutionize the way that, you know, the meaning of private equity and why, you know, why deals get done, you know, beyond just, you know, multiple on invested capital or rate of return. Not that that's not important, it is but there's much more to it.

Patrick: Well, focusing on the basics of business is surprising how it can be revolutionary, particularly when you've got an engineering-centric thought process now. So I really encourage folks to go and check out Culper Capital. Adam, thank you very much. And it was a pleasure speaking with you. Thanks again.

Adam: Thank you, Patrick. Appreciate the opportunity, sir.