




PRIVATELY SPEAKING

The Chicago School

*Chicago-based GTCR has one of the most prolific heritages in all of private equity, dating back to the 1980s. As the firm begins to deploy its tenth and largest fund, chairman Bruce Rauner is in the process of handing over leadership to the next generation of principals. **Graham Winfrey** meets Phil Canfield and Collin Roche, two of the three heirs to the throne*

PHOTOGRAPHY BY DANTE TATUM



"Stan was at a strategy meeting in the mid 80s and said, 'Boy, this business is getting really competitive. We've got to have a way to differentiate ourselves'"

Paying a visit to GTCR in June, it's hard to believe there is a bigger private equity firm in the city of Chicago.

The conference room in GTCR's sprawling three-storey office where *PEI* meets principals Phil Canfield and Collin Roche is so massive that management teams use it as their headquarters when starting new companies. In a space this grand, atop one of Chicago's tallest skyscrapers, it feels wasteful to have a three-person meeting.

"If you go back into the internal offices where we all work, they're more modest," Canfield assures me. Modesty is a trait common to

both men, who repeatedly find ways to weave self-deprecating asides into our discussion of the firm's more than 30-year history.

Founded by Stan Golder in 1980 as Golder, Thoma, Cressey, a spin-out group from US bank First Chicago, the firm started out investing in a variety of industries. "There was some telecom, there was some business services, there was a lot of healthcare – that's consistent – but there was also a little bit of consumer and a little bit of retail," says Roche. "We winnowed out those areas that probably weren't as good a fit or where we maybe

didn't have the knowhow or knowledge base, or just didn't see as good investment opportunities." Today, it operates in just three core sectors: financial services and technology, healthcare and information services and technology.

In the process of refining its focus, GTCR has spawned a number of spin-outs by ex-executives, including Thoma Cressey, which later split into Cressey & Company and Thoma Bravo, and Flexpoint Ford, formerly known as Flexpoint Partners. "Each of those firms is doing something somewhat different," says Roche. "Ironically, we don't really bump into them much."

Today, GTCR has 40 investment professionals, 80 total employees and invests largely in non-cyclical businesses with a high degree of recurring revenue. Since 1980, it has invested more than \$8.5 billion in over 200 companies, taking more than 38 public. It is also in the process of handing over leadership of the firm from chairman Bruce Rauner to Canfield, Roche and fellow principal David Donnini – a transition that has been in the pipeline for the better part of the last decade. No last-minute succession panic here.

Canfield, a University of Chicago Booth School of Business alum, is co-head of GTCR's financial services and technology group; Roche, a Harvard Business School and Williams College graduate, co-heads the firm's information services and technology team. Both joined GTCR as pre-MBA associates in the 1990s, after the firm had become famous for its unique investment thesis known as 'the leaders strategy'. While neither was around to witness the creation of this strategy, the story passed down to them suggests it was more a result of happenstance than any grand plan.

"Stan was at a strategy meeting in the mid '80s and said, 'Boy, this business is getting really competitive. We've got to have a way to differentiate ourselves,'" Canfield says. "Someone said, 'Hey these deals where we backed a CEO and then bought some businesses — first of all they had really good performance, and second, other guys aren't doing that, so maybe we should focus on that.'"

The rest, as they say, is history. GTCR is known today for having one of the most intense, relentless and successful focuses on CEO recruitment in the private equity industry, and its *modus operandi* is always the same: seek out an ideal CEO for a given platform, doggedly pursue him or her until the offer is accepted, then help the CEO build a company. In many cases, the CEO is hired before a single acquisition is identified.

BETTING ON LEADERS

This approach has brought GTCR some conspicuous successes. Take Tim Whall, the former president and chief operating officer of security alarm monitoring company SecurityLink, with whom GTCR has now teamed up three times.

After GTCR purchased SecurityLink from SBC, Whall took it from negative earnings to profitability in under six months.



Having spent three years in senior management roles at ADT, Whall left to team up again with GTCR, to purchase the security monitoring division of Honeywell for \$315 million in another carve-out. Pulling the business out of Honeywell "wasn't easy to do," says Roche. "All the practices and processing and [the] financial area were all tightly intertwined with

Honeywell's operations."

After selling the business to tool manufacturing company StanleyWorks in 2007 for \$545 million, Whall served as chief operating officer of the company for one year, before leaving to partner with GTCR for a third time on the 2010 acquisition of electronic security company Protection 1, which GTCR still owns. "We're off to a great start one year in," Roche says.

On the other hand, placing so much faith in leaders inevitably brings a degree of risk. In June, GTCR agreed to partner with Emmis Communications to Acquire Merlin Media, which owns and operates media assets including Chicago radio stations WKQX and WLUP and New York station WRXP. "It's a pretty

standard GTCR deal,” Canfield says. “We’re backing a CEO and doing a corporate carve-out and a bunch of transformation of those underlying assets.” However, the CEO in question is Randy Michaels, former chief executive officer of The Tribune Company, who’s just coming off a short stint as head of a media company that collapsed into bankruptcy under a \$13 billion debt load. GTCR is betting that he’ll have better luck this time.

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KEEPING INVESTORS HAPPY

It was oversubscribed 10th fund, which was in market for just seven months before closing on \$3.25 billion in February, brought back about 80 percent of existing investors. This was the fastest fundraising – and the largest fund – in the firm’s history.

“It could not have happened that quickly if it were not for the fact that our existing investors overwhelmingly supported us,” Roche says.

GTCR began discussions with existing limited partners about nine months before it became clear the firm would be coming to market, and had a “pretty good sense” by the time of the launch that the fund would meet its original \$3 billion target, according to Canfield.

“We probably have a smaller number of LPs than most guys at our size,” he says. “It’s not like we have to go see 300 investors.”

GTCR did not use a placement agent for the fundraising, and generally expects to bring in only a few new LPs to each fund. So although it did reach out to some new investors for Fund X, both inside the US and internationally, there were “not a whole lot” according to Canfield. LPs in the fund

include the Alaska Permanent Fund, the Minnesota State Board of Investment and the Washington State Investment Board (which has committed \$300 million, well up on the \$185 million it committed to Fund IX).

The fundraising wasn’t entirely smooth sailing. One of GTCR’s new LPs said the decision to invest in Fund X was met with some resistance, due to the fact that some of the individuals who have produced strong consistent returns in the past are not at the firm any more – one big downside of spawning so many spin-outs. “That gave us some caution,” the LP says. The same investor also suggested that the size of the target was a cause for concern – “Fund X is larger than all their other funds, so they have to contend with having to spend more money” – as was the fact that GTCR does not offer a preferred return. “[That] was enough for me to just throw it in the waste basket,” says the LP, “but it’s not just me making decisions here.”

Despite this, however, for many of GTCR’s long-time investors, the decision to commit to the firm’s tenth fund was much easier. “That’s one you have to think about [the lack of a preferred return], but clearly we and others managed to be comfortable with it,” says one existing LP. “We’ve got a really good relationship [with GTCR], so it wasn’t the most difficult decision internally.”

And GTCR also has some terms that go down extremely well with investors – notably its policy of not charging deal fees. “We’ve never had that in our terms,” says Canfield. “That’s a major thing that [the Institutional Limited Partners Association] has been trying to accomplish, to get the GP to offset those deal fees against management fees.”

But while the firm's core group of investors hasn't changed, their level of sophistication has. "Our LP base has gotten a lot more data-oriented," Roche says. "The questions being asked in 2003 by one or two LPs were probably asked by half the LPs in our next fundraising cycle in 2006. And by 2010, they were all asking those questions."

Debt structures and credit facilities in particular were two subjects in which GTCR's investors have become much more interested. "LPs went a long way in terms of their understanding and currency with those concepts," says Roche.

They also began to ask questions about everything from portfolio companies' key performance indicators to how GTCR's business is run.

"For most of the LPs, if you'd been giving them that type of information 10 years ago they wouldn't have even had a place to put it," Canfield says. "But now they're big, they're sophisticated, they've got teams, they've got organisations. They've got the ability to do analysis."

But although GTCR's investors have become increasingly inquisitive, the firm has only had "marginally more contact" with its LPs, Roche claims – testament, he says, to the level



A GTCR CASE-STUDY: BIG CLAIMS

One of GTCR's biggest success stories began in 2004 when Canfield met Tony Aquila, the former founder and chief executive officer of venture capital-backed Ensera, an auto insurance claims processing business he'd sold to Hellman & Friedman portfolio company Mitchell International.

"We'd heard about him and were introduced through a mutual friend," Canfield says.

While acting as president and chief operating officer Mitchell International, Aquila told Canfield he had a hunch the best company in the claims processing space, Audatex, could be purchased from owner Automatic Data Processing. At first, the idea seemed like a long shot, as ADP had never sold one of its divisions before.

Ultimately, however, GTCR decided the opportunity was too good to pass up, and the firm gave Aquila the green light. "We backed him, he left his job and we started full time trying to buy that business from ADP," Canfield says. "It took about a year and a half."

GTCR purchased Audatex, which had a global customer base of over 50,000 clients in 31 countries, for \$975 million through its Solera insurance outsourcing platform, beating out firms including TPG Capital and Silverlake. The deal immediately gave Solera a global footprint.

After purchasing the company, Aquila got to work transforming the business. "He completely redid the sales organisation," Canfield says. "They had reporting all up into one centralised structure and he basically made every country manager kind of their own CEO reporting to him. He just drove a ton of growth and at the same time was able to take a bunch of costs out of the business."

"I was very cautious about who I went with as a private equity partner," says Aquila. "A lot of private equity houses say, 'We get behind management,' but when you really look at it, they develop their thesis almost in a black box, versus the GTCR model which is very integrated with the management team in order to really evolve and cultivate their thesis. They say to you, 'What is your thesis? What businesses would you like to buy?' So they come at it a little differently."

The nature of the working relationship with GTCR was also a crucial factor in Aquila's decision to partner with the firm. "They're more personable and still candid," he says. "What I appreciated about them was we got to know each other, not only professionally but personally. We had a lot of discussions without the HP calculator. Most private equity guys, if you take that away from them, they would probably decompose."

GTCR sold its last shares in Solera, now a \$5 billion business, in 2008.



of communication the firm has always had with its investor base.

TURBULENT TIMES

GTCR is expecting a busy last two quarters of 2011, Canfield says. “I think it’s going to be a really exciting deal-making environment for us over the next six months. We have a lot of CEOs that we’re talking to right now who have active investment ideas and businesses we think we can buy and drive transformation. So I would anticipate a lot of activity.”

Of course, when you need to put somewhere between \$750 million and \$1 billion to work every year just to deploy your fund within its investment period, “a lot of activity” is the only

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option. And while GTCR does have a proven strategy, macroeconomic factors both in the US and abroad are bound to cause problems as it looks to invest its largest ever fund, particularly in terms of debt availability and general M&A activity.

“The financial markets are definitely getting a little shaky,” Canfield admits. “The one fly in that ointment could be if the S&P 500 lags down a couple hundred points because of what’s happening, mostly on the sovereign debt side across the globe.”

Roche agrees, pointing to the US’s slow growth economy and local imbalances. He accepts that neither are likely to change overnight. “It’s a turbulent world, and we expect that



to continue,” he says. “We don’t see it as a blip, we just see it as the continuation of the turbulence.”

Still, GTCR is no stranger to tough times, given its experience in the wake of the dotcom bubble in the late 90s. “When the bubble burst we found ourselves with a bunch of businesses that were more concentrated on IT services, many of which were good investments, but by virtue of the demand drop and everything [else], that was a bad place to be,” says Roche. “We were left with a very challenging portfolio, and that taught us to be more disciplined in terms of getting diversification.” Still, Roche insists it did the firm good in the long run – he attributes much of the firm’s subsequent success to the lessons GTCR learned during those difficult years.

What’s more, Canfield argues that GTCR’s current pipeline of opportunities in the information services and technology sector is the strongest it’s ever been – so much so, in fact, that the firm has had to add extra staff to help shoulder the burden.

“We just brought in an early VP level guy who joined us laterally from Bain,” Canfield says. “I’m glad we did, because he’s working really hard right now and nobody else would be doing that work if we hadn’t.”

Things are also picking up in Roche’s area, he says. “In the financial services and technology sector, relative to a year or two ago, the quality of the opportunities is very high.”

GTCR’S LAST THREE BUYOUT FUNDS’ PERFORMANCE

The firm’s 2000 and 2003 funds both yielded strong returns for investors

Name	Fund size	Vintage year	Net IRR
GTCR VII	USD 2.00 bn	2000	25.70%
GTCR VIII	USD 1.85 bn	2003	27.20%
GTCR IX	USD 2.75 bn	2006	1.50%

Source: PE Connect, Probitas Partners

Then again, Roche also told *PEI* that GTCR expected to have completed more transactions than it did in the first two quarters of the year. Is this a sign that good deals are proving hard to come by? Or was the firm being overly optimistic? Roche argues that the latter is probably closer to the truth. “In our business it’s always kind of a fool’s errand to think you can predict down to the quarter. Gosh knows I’ve made that mistake, and I keep making it”

Yet GTCR’s performance numbers – and the enthusiasm for its latest fund – suggest that the firm must be doing something right. Maybe they’re just too hard on themselves. “If you talk to our LPs, you’ll know our reputation is for guys who beat themselves up,” Roche admits. “Almost to a fault.” One thing’s for sure: if it can repeat its past success with Fund X, nobody will be complaining. ■