DISTRESSED FOCUS

John Bolduc

Bayside Capital

John Bolduc is co-head of **Bayside Capital**, an affiliate of private equity firm **H.I.G. Capital** that focuses on special situations in the lower-middle market. Bayside started in June 2004 and participates in the special situations universe through the $500 million Bayside Opportunity Fund. Bolduc, who began his career at **Bain & Co.**, was one of the original partners at H.I.G. Capital and has more than fifteen years of experience in mergers and acquisitions, private equity investments, and strategic consulting. He discusses with *LMW* Bayside's origin and investment strategy, the role of hedge funds and the firm's involvement with the lower-middle market.

What does H.I.G. Capital specialize in?

H.I.G. Capital is a private equity firm managing more than $1 billion of equity capital. The firm focuses on buyouts and recapitalizations in the lower-middle market where we can use our in-house operating expertise to create value for all stakeholders.

How did the idea of creating a separate distressed fund come to place?

Over the past 12 years at H.I.G., we would not only see healthy businesses, but also businesses that were really troubled or distressed. While these businesses presented their own opportunity, we passed on many of these because investing in truly distressed transactions through a buyout fund was like fitting a square peg into a round hole. So, we went to our LPs last summer and asked for a broader mandate to be able to better address troubled businesses, and that was the genesis of the Bayside Opportunity Fund. In short, Bayside gives us a true mandate to invest in distressed deals, the ability to provide traditional equity investments and a much broader set of offerings, including DIP loans, lender-of-last resort financings, bridge loans and the ability to purchase secured and unsecured claims.

Is your investment strategy similar to that of a hedge fund?

No. Hedge funds are looking for liquid or semi-liquid positions when they invest, and yield is a very important element. Hedge funds are highly levered so they can buy a security at 60 cents on the dollar and then sell it for 75 cents on the dollar so they look like a hero. Hedge funds will typically not be long-term investors, work within a bank group or bank syndicate, or provide the company with a long-term solution. Hedge funds become much more of a trading investor who is looking to take advantage of the situation that the company is in.

Bayside is not any of these things. We are specifically not trading. We are specifically not leveraged and really take an approach similar to a long-term private equity investor where we can make investments in the business and be very proactive in helping the company deal with the issues that it's facing. Helping lower-middle market businesses is what we've done during the last twelve years with H.I.G. so this is just an extension — addressing troubled businesses with a broader product offering. We view ourselves as much more than just a money investor. We are in it for the long-term and we are there to try to help the business right itself and get back to its former glory.

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How does your involvement with the company continue after aiding the recovery?

If we make our investment through a debt security, then our involvement is voluntary or at the request of the company. If our investment takes the form of equity, we can probably be more proactive. We have folks "in-house" that have run plants before or know what it means to make a payroll. Additionally, we are also big consumers of outside consulting services—the major turnaround firms – so that we can have the know-how and the arms and legs on the ground to affect change in an organization.

Can you illustrate your investment strategy through one or two recent examples?

Last year we invested in a plastic injection molding business called **SciTech Plastics Group**. It was a $70 million business that was focused in the medical market. It was a roll-up of different companies that was priced at the peak of the market both in terms of valuation and in terms of leverage multiples in 2001. Unfortunately, they not only had to weather the aftermath of 9/11, but the economic downturn that resulted as well. It was a business that the senior lenders stuck with for a reasonable period of time but it was clear that without new capital coming into the business and without some other dramatic changes being made, the value of the business was deteriorating.

We were contacted by **SSG Capital** about the situation. Our analysis concluded that we needed to step in fairly quickly, since a long drawn out process of trying to do a traditional transaction of buying the equity followed by an out-of-court restructuring was really not going to be a prudent course of action. We contacted the senior lenders of the business and were able to negotiate a purchase of the senior securities. We then were able to provide the business with some short-term liquidity relief. We were not buying the debt to liquidate the company or buying a loan to flip it the next day. We worked with the business not only to structure a long-term organizational restructuring plan in terms of rationalizing facilities, looking at profitable and unprofitable customers, realigning the management team and the like, but also looking at the practical aspects of the reorganization plan and decided that a bankruptcy filing was probably the best vehicle to make that happen.

We had a bankruptcy filing that was a very orderly process. We provided the DIP loan as well, so the business could operate under bankruptcy and then worked within the bankruptcy framework to become the owner of the business. SciTech today has been combined with another business and it's just doing terrific. The company has stabilized, customers are giving it a whole lot more business and we've been able to recruit a couple of key people in there. So the business was able to get back to where it was a couple of years before, with a much stronger capital base and a more realistic balance sheet.

Can you provide an example of a Chapter 11 filing that you've worked on?

An example of an out-of-court restructuring would be a business called **Transtar Metals**, a Los Angeles-based, high-alloy aluminum service business that serves the aerospace and military markets. Large aluminum foundries like to produce very long runs of product because their fixed costs are so high. No one customer can order all of the types of specialty alloy metal that they need in large enough quantities to make it economically feasible for the mill to produce. Transtar steps in the middle, aggregates the orders, negotiates prices, stores the metal and then performs certain additional value-added services. It was making in excess of $50 million EBITDA in the year 2000, but when 9/11 hit, the aerospace build rates basically stopped dead.

Government contracts, a large part of Transtar's customer base, in general, can be broken in a bankruptcy process. A bankruptcy process for Transtar would have been way too costly. It took about nine months of working with the lenders and the other various creditors on an out-of-court restructuring so that we could restructure the liabilities, save the government contracts and provide the business with a solid capital base. I'm happy to say the business is doing quite well today as aerospace volume build rates have built back up.

How would a market downturn affect that lower-middle market?

A lot of the companies that we work with in the lower-middle market can't access the capital markets, so the fact that the stock market or high-yield market goes up or down does not directly affect these businesses. We've seen this during two or three cycles since we started in 1993.

Is the lower-middle market the new hidden area of opportunity?

I don't think it's hidden. People know it's out there. I do think it is underserved. At Bayside and H.I.G. we have more than 50 investment professionals in our four offices, Boston, Atlanta, San Francisco and Miami, and I think that in order to really address and properly serve those lower-middle market companies it takes a lot of arms and legs. It takes a lot of focus and resources to be able to make those types of investments work.

Are returns lower in the lower-middle market?

In fact, most people would say they are higher. I do think that making successful investments in the lower-middle market requires more work. Often times the management team may not be fully complete. Sometimes you can't call **Goldman Sachs** and get a research report on their niche industry so you have to do your own proprietary market sizing analysis. Sometimes these businesses don't have all the systems and controls in place. It is not unusual for a company to not know the profitability of their customers.

Why did you decide to focus on the lower-middle-market?

That's really where we spent the last 12 years with H.I.G. Now we are taking those lower middle-market opportunities that are more distressed and using the Bayside Fund to attack them more effectively. We like the lower-middle market for two reasons: One is that we continue to find the lower-middle market being underbanked and underserved. There is not a lot of equity capital being provided into that market place.

Second, as I mentioned before, we see a lot of businesses in the lower-middle market who are facing challenges as they grow. They are successful business with good leadership and a good market niche but facing traditional growing pains and need a partner to help address them.