

# Lessons of Growth from a Serial Entrepreneur

By Catherine Heal

*Excerpt from a Speech given at the Canadian Innovators Forum  
by Eric Berke, Managing Director, Torquest Partners*



Over 20 years, Eric Berke turned the company, Gustin Kramer, around and in the process learned so much that he subsequently co-founded one of Bay Street's top funds, Torquest. Within 4 years, the now \$550

million fund has reached an astonishing internal rate of return of 79%. Yet, the same seasoned investor admits that when he and his family did a classic leveraged buy-out of Gustin Kramer, he had no idea how to structure an investment deal. Eric shared a few lessons of growth he had learned with a roomful of CEOs at the CEO Retreat held by the Canadian Innovators Forum in March 2006.

## Keep a keen eye on key figures

Typical of a management team after a buy-out, Eric and his partners faced many challenges – cash shortage, a weak balance sheet and a lack of clarity in how to take the business forward. During the 13 years when he tackled these challenges, he also kept a keen eye on key figures such as the firm's costs of capital and market value. This way, he could set realistic goals and when faced with critical decisions, he would make informed decisions.

## Debt or equity?

This was a question Eric continuously pondered on throughout the 13 years of running his business. The answer depends on how you feel about the opportunities your business face.

When Eric first started looking for capital, every advisor he approached said, “we are happy to bale you out, but give us some equity”. Eric wanted to keep ownership of the business and grow it so he decided to hold on to the firm's equity at the early stage. That meant he had the pain of walking up and down Bay Street wearing out the leather on his

soles looking for financing. He got to know everyone on Bay Street in the process, which was the beginning of his investment career.

Eric took in a debt at an interest rate of 23%. “We had no foresight into how we were going to pay [off the debt]”, he admitted.

Eric and his partners spent the first 3 years putting the income statement on a solid footing. In 1994, Eric bought all the shares of the business and took full control of it. Knowing that equity was the primary resource that would create returns, Eric continued to hold on to the equity while proactively managing the liabilities.

Between 1994 and 2002, by selling new products, selling losing divisions and acquiring businesses strategically, the firm's revenue grew by 2.5 times.

In 2002, private equity fund managers were looking for investments and, by then, the equity of Eric's firm had a much higher value. Eric again had to decide whether to continue holding on to the firm's equity or sell some equity and diversify his investments. The business was ready for further growth but it was also starting to face governance compliance and other operational issues, all of which required cash. Though the strategy of holding onto equity had served Eric well, he decided it was time to use a different approach this time. He approached some private equity investors and sold them the idea that he wanted to acquire a US competitor. Ninety days later, a deal was closed.

## Does selling equity mean giving up control?

To this question, Eric gave a definite “No”. Imagine yourself to be a fund manager for a minute. After the due diligence was done, you found the company which you were considering investing in promising. You were confident of the management team's capability so you closed the deal. Now

what? Unless you are prepared to run the business yourself, your best bet is leave the management team in the driver's seat. The fund manager's roles are to advise, support, bring valuable contacts to the management team and, yes, monitor management's performance. Fund managers might use performance based options to align the interests of management and the fund. Once certain objectives are accomplished, the fund can exit and let a different fund with different objectives take the firm to the next stage. At this point, as long as the fund gets a good return, if the management team ends up with a higher value than the fund itself, it only means that it's a deal well executed. This is Eric's and many fund managers' approach. His point is that the balance of power shifts to the management team after an investment deal is closed.

#### **What qualities do investors look for?**

In addition to an outstanding management team and the firm's performance at the transaction time, investors need to have confidence that the firm's value is likely to increase after closing. The way a CEO communicates to the investor counts. Eric pointed out that "investors never buy the hockey stick scenario". If your company's earnings have been steady in the last while but you are telling an investor that you expect earnings to go up rapidly

like the shape of a hockey stick after a major capital investment, you need to provide solid information and reasonable assumptions to back up your projections.

Ultimately, an attractive deal to an investor is a business that has multiple competitive advantages that together act as a spring board to increase profits within a reasonable time frame, say 3 to 5 years. Truly outstanding competitive advantages are often unobvious to casual observers. Therefore, you as the CEO or your agent need to communicate to investors in a convincing way what the competitive advantages are and why they will be sustainable.

The principles behind Eric's strategy are simple but require discipline and astuteness – keep a keen eye on the value of your business, make informed decisions and set goals for the next stage. When you are ready to raise funds, put yourself in investors' shoes and understand their perspectives.

Eric sold his business and co-founded Torquest in 2002. As an investor, Eric can leverage his investment skills and business savvy by simultaneously helping multiple businesses while diversifying his investments. Judging from Torquest's performance, that was undoubtedly a good move.



Eric Berke joined Torquest Partners Inc., in 2002. Prior to joining Torquest, Mr. Berke led the turn around and sale of Gustin Kramer, a manufacturer of paper and non-woven consumer products, where he served as the company's President and CEO and controlling shareholder from 1994 to 2002. Mr. Berke serves as a director for Granby Income Fund, CNC Global (Chairman) and Daymen Lowepro and is on the board of the Canadian Venture Capital Association. Formerly he served as a director of GCAN Insurance Company and Crescent School. He is a member of the Young Presidents' Organization since 1994. He holds an MBA from Boston University and a B.A. from the University of Vermont.

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