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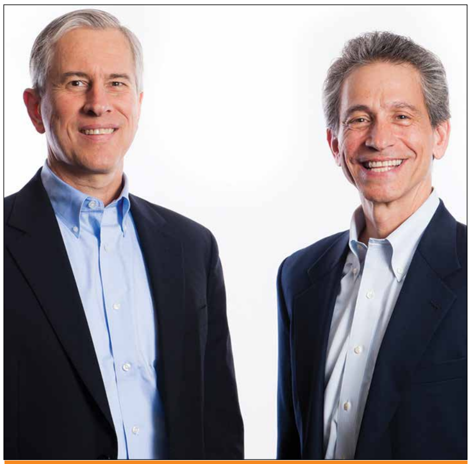
INSIDE THE DEAL

Eleven lessons learned, from 25-year-old Riverside Co

By Stewart Kohl and Béla Szigethy, co-CEOs, The Riverside Company



Béla Szigethy and Stewart Kohl

The Riverside Company has enjoyed a lot of success since our founding in 1988 by finding great little companies and making them bigger and better. We've sold more than 100 companies in our history, and collectively we grew them more than 2.5x in size during our ownership. We adore smaller companies because there are more ways to improve them, making the upside much greater. It's been a good run and we're working harder than ever to keep it going for another 25 years in our fast-changing, hyper-competitive world.

Along the way, we've learned lessons from commonly encountered problems such as customer concentration, management performance and fraud. But rather than rehashing these Business 101 chestnuts, we want to share with you some of the more interesting lessons we've learned—the hard and easy ways.

1. Macroeconomic events, even major recessions like 2009, don't single-handedly kill companies. Struggling companies are almost always felled by other mistakes. The good news is that a great management team can work past almost anything the economy throws at them.

2. Technology is changing every industry so quickly that it's becoming harder to predict the future. This is causing shorter holds, greater uncertainty and greater upside opportunity. We now act with far greater urgency to improve companies shortly after acquisition—sometimes before!

3. Great investors seek ways to say yes while most investors find every reason to say no. By considering how to transform a company, investors have a greater likelihood of creating a 3x or higher return. If they're too worried about the downside, an investor will figure out how to avoid losing 1x.

4. If it's not working by year two, let someone else drive the bus. Deals that don't meet projections and are drifting sideways or downward need a new home. This could mean simply reassigning the deal to someone new inside your shop or, more likely, selling while you can still salvage most of your investment.

5. People with something to prove often do. Having some managers with personality quirks and sharp elbows can be a great asset. Chips on the shoulders are not always bad. They often become chips off the old block.

6. If it looks too good to be true, it probably is. Sellers sell for a reason. We bought a fresh vegetable company because the product tasted good, healthy eating was trending, and the company had a strong track record. But it turned out that the weather had been extremely cooperative prior to our acquisition. Mother Nature proceeded to poop on our parade for three years in a row, and we lost much of our investment.

7. Just because the other guy made money doesn't mean you will. Today, investing in a yellow-pages company has well known perils, but years ago investors in yellow pages transactions made a ton of money from predictable cash flows, steady growth and franchise value. By the time we got involved, technology was shredding those cash flows, and we let our fingers do the walking out the door with a total loss.

8. If the other guy just lost a ton of money, it may be time to pick up his pieces. More often than not, the crowd is following trends that started happening several years prior. Crowds are not trend-setters or a ticket to great returns. We bought a capital intensive satellite company out of bankruptcy at the bottom of the telecom market after some really ugly outcomes for others, and proceeded to deliver a large return for our investors.

9. Experience can be a great teacher, but teachers need continuing education to keep up with new trends. No one geography or industry is a good place to invest forever, and what was good 10 years ago may not be good today. And vice versa: some "bad" industries can be full of opportunity years later. Software was considered a no-no through the early 1990s! While young investors are often unaware of the rocks and shoals, older investors may see rocks and shoals where they don't exist anymore.

10. Companies are more similar than you think. Don't let differences in languages, culture, clothes or food distract from the fundamental truths that underlie virtually every company everywhere in the world. And the greatest truth in any country is that great management makes all the difference. OK, so one Business 101 chestnut slipped in after all. We couldn't help it since this one is just so damn important!

11. Food, language, culture and other customs *do* matter. But despite #10 above, you must have deep local knowledge to succeed. A deal that is questionable in one country might not be a great deal in another, and vice versa. And the biggest reason for failure of cross-border acquisitions is cultural misfit.

These lessons served us well and helped us to find that ever-elusive alpha that investors pay us for. We're happy to share them with you. Twenty-five years from now, let us know how they worked! ❖

Stewart Kohl and Béla Szigethy are co-CEOs of lower-mid-market buyout shop The Riverside Company.

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