Tony and J.B. Pritzker

The Pritzker Group

middle, but far from average

By Deborah L. Cohen

The Pritzker name is synonymous with many things: great wealth and political clout, philanthropic endeavors spanning the arts, architecture and social causes – and frequently, the awe and public scrutiny reserved for those whose families have built vast corporate empires.

Less well known is the investment strategy endorsed by two of the family's current scions, the brothers Jay Robert (J.B.) and Anthony N. (Tony) Pritzker. Talk to them about the middle market businesses they own and interact with on a regular basis, and any notions of aloofness are soon erased by an approachable Midwestern sensibility that underscores their entrepreneurial approach. Their philosophy helps to explain why investing in this segment is their sweet spot.

The billionaire investors, who for the past nine years have together run the private investment firm The Pritzker Group, bring vastly different backgrounds to the bargaining table. J.B. is a lawyer and investment banker with a penchant for high tech; Tony an engineer who gained operational acumen with manufacturing companies in the Marmon Group, the longstanding conglomerate founded by his family and now majority owned by Berkshire Hathaway.

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> "The middle market is full of really great companies that have a kind of a culture to them that's very familiar, and very attractive to us"

and very attractive to us," says J.B., 46, from the boardroom of his offices on the 40th floor at 111 S. Wacker Drive in Chicago's financial district. "And by the way, our goal is to make those big companies."

Energetic and outspoken, J.B. has just returned this late June day from a Chicago session of the Clinton Global Initiative, where he and his wife were principal sponsors of the former President's local effort to boost economic growth through job creation. J.B. patches in Tony, who is based in Los Angeles, via conference phone.

Despite their professional differences, the pair moves in lockstep when it comes to their investment tactics, often finishing each other's sentences to detail the conservative buy-and-hold methods they favor.

"I love walking around the plant floor. J.B., on the other hand, is a great financier; he knows what markets we ought to be going into," says Tony, 50, who comes across as the low-key and measured side of this fraternal equation. "I worked in manufacturing – he worked in venture capital. It's the combination of skills we bring that differentiates us."

The Pritzker Group's private equity arm concentrates primarily on acquiring control positions in mature companies in the middle market with the room to grow into dominant industry leaders. J.B. is also founder and managing partner of New World Ventures, an older component of the investment group aimed at information technology startups (Tony is an advisor).

The pair's seven current middle market holdings focus primarily on manufacturing, industrial and business services and technology companies. They include names most people have never heard of, including Peco Pallet, which rents and coordinates the logistics of the pallets used to transport goods for consumer companies such as Procter & Gamble; Impact Products, a maker of cleaning, maintenance and safety supplies; and Carter-Waters, a distributor of construction materials and equipment.

The brothers sometimes invest outside those general parameters when they spot a market opportunity. In late 2009, for instance, they created the financial services company Sovereign Gaming to purchase slot machines and lease them to gaming establishments located on Indian reservations.

"The returns are very good on slot machine financing," says J.B., himself a card player who coyly reveals participating in a recent late night round of the popular southern card game *Oh, Hell* with former President Bill Clinton. "It was an opportunistic investment."

While they don't disclose the financial results of their companies, the Pritzkers say the value of their private equity holdings is approaching $1 billion. Together these businesses support about 2,000 employees, and, despite a few hiccups, all remained profitable on an annualized basis during the recession.

Not ones to make headlines, these middle market companies belong to a vital segment of the U.S. economy that accounts for an estimated 40 percent of national gross domestic product and the employment of 24.6

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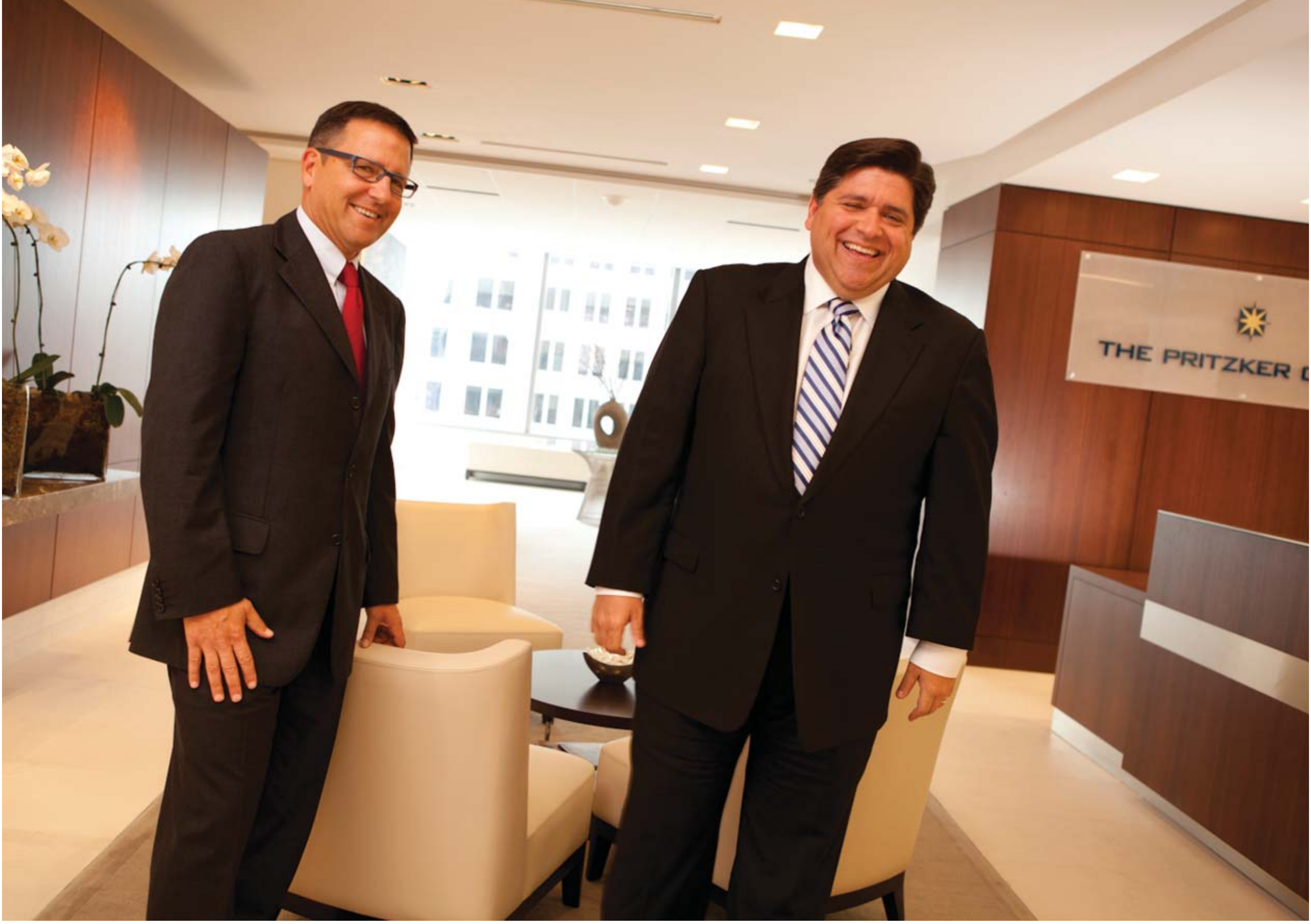

million people, according to the financial services firm Deloitte Touche Tohmatsu. Companies with annual revenue between $50 million and $1 billion also comprise some $6.1 trillion in overall revenue, surpassing the S&P 100, the firm's research revealed.

"It's just enormous when you consider its impact on the economy and jobs," said Thomas McGee, national managing partner with Deloitte's Growth Enterprise Services. "This historically has been an element of the economy that has been an important contributor to job growth as we emerge from an economic recession and downturn."

But the segment also suffers from something of a middle "syndrome," McGee said; not flamboyant enough to capture the spotlight of the big public companies and lacking the flash of startups. Even so, more than 80 percent surveyed by Deloitte said they expected their revenue to grow in the coming year, McGee said, despite expressing a "real caution" about economic outlook.

"There is a continued emphasis on productivity and emphasis on management of costs," he said. "Although you do see signs, clearly see signs, of many companies in the middle market… beginning to look at expansion."

The Pritzkers are quick to counter any stodgy perceptions about this stratum of the U.S. economy, passionately defending the ability of middle market companies to innovate, expand and sometimes disrupt the entrenched markets of their larger rivals.

"I think pallets are sexy," jokes Tony. He becomes animated when describing in detail some of the ef-

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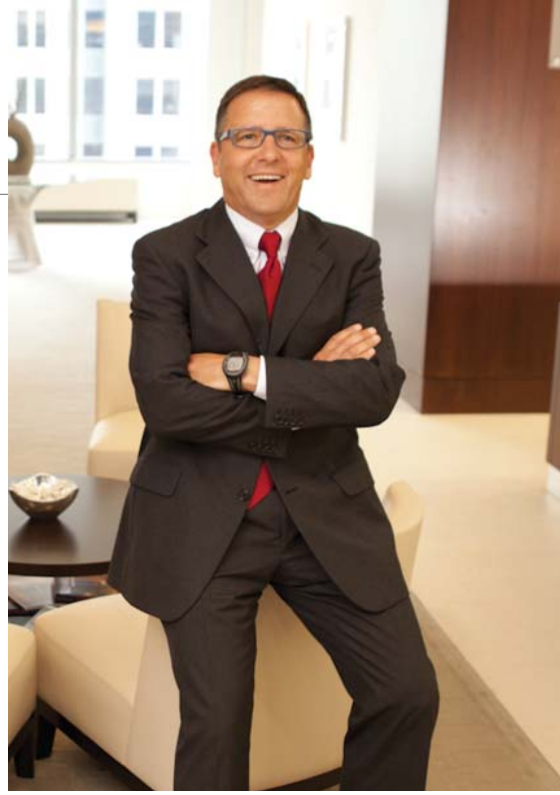

ficiencies achieved by companies in The Pritzker Group portfolio, including Signicast Corp., a maker of metal castings used in products such as Harley-Davidson motorcycles and John Deere agricultural equipment.

Ongoing technical improvements have allowed the Hartford, Wisconsin-based manufacturer to progressively reduce its process times to a range of five to seven days, a clear advantage over the eight-to-sixteen-week time frame of rivals, he points out.

"They do that because they have a system – they have robotics, they run a very tight schedule system, they run 24/7," he says. "These guys won Metalcaster of the Year, and while that might sound funny if you're not in that business, they won it for a very good reason – because they run their business so much better than anybody else in the industry."

The potential for dramatic advances is a main reason the brothers remain strong proponents of U.S. manufacturing, a topic J.B. notes was central to the economic discussions at the Clinton event earlier that day, where the loss of U.S. manufacturing jobs was a predominant theme.

"(Signicast) is a business that competes with Chinese manufacturers. But we compete successfully having a factory in Wisconsin," he says. "That's a great example of how high technology and manufacturing come together, to get this kind of quick turn modular effect in manufacturing."

The siblings' passion for the middle market is tied closely to their own personal experience, watching their father, Donald Pritzker, build the Hyatt Hotels chain into a worldwide hospitality giant, maintaining what they describe as an entrepreneurial philosophy that placed characteristics like integrity and customer service among its top priorities.

"Growing up around the hotel business around my Dad, we learned so much about how if you really service the customer, I mean really, really service the customer, he becomes so loyal," Tony says.

Adds J.B.: "People don't come back, you know, if you go to a hotel and they don't treat you well. It doesn't matter how nice the room is."

The brothers use those same benchmarks to vet all potential middle market holdings. A "sniff test" that reveals a cultural disconnect at an otherwise promising acquisition target is enough to send the Pritzkers – who review dozens of opportunities from investment bankers and other sources each month – packing.

"We were looking at a company we thought was terrific. We went and visited one of their customers — a

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plant business," Tony explains. "I was talking to the person who runs it, and I said, 'Who is your worst supplier?' She immediately said, 'Oh it's these guys.' We immediately decided, look, that is not a business we want to be in. I don't think a tiger changes his stripes that often."

Tony and J.B. are often lumped into the same investment camp as traditional private equity firms, but they prefer their middle market portfolio to be viewed more like a holding company structure. And though they sometimes join forces with outside investors, they don't raise funds from institutional investors such as endowments or pension funds.

"It makes you think like an owner rather than an investor," said Jon B. Kutler, founder of the aerospace and aviation-focused private investment firm Admiralty Partners. Kutler has partnered with the Pritzkers on two prior deals and shares their affinity for middle market businesses.

"They have a lot of respect for each other's backgrounds and perspectives. They tend to not step on each other's toes as much as two guys with a common background," he said, adding: "Tony and J.B. bring Fortune 500 level contacts, relationships in banking and people they introduce to these mid-market companies as a way to create value."

Besides seeing more doors open, what often changes for middle market companies added to The Pritzker Group fold is a newfound ability to jumpstart growth, thanks in large part to the deep pockets of investors who can deploy capital without the bureaucratic limitations of a complex fund ownership structure.

Consider Peco Pallet, which they bought in February, knowing up front that the Yonkers, N.Y.-based business would require additional growth capital. The company, which controls an estimated 6 to 8 percent of the pallet rental market, has been aggressively taking on Chep, a dominant industry player.

"The pallet business is one where if you're growing, you've got to buy more and more pallets, you've got to invest as you go," J.B. says. "The hard part is making sure they show up on time and that those pallets are in good shape. It is really hard to go up against the monopoly player and be a startup and win, and they do that by being better, faster and nimbler at the same business."

Another expansion scenario is playing out at Signicast, which The Pritzker Group acquired in 2008. Bucking flagging trends in U.S. manufacturing, the metal castings maker is now embarking on constructing an additional $50-million plant on 52 acres adjacent to its Hartford facility, located about 30 miles from Milwaukee.

Walter (Terry) Lutz, Signacast's 71-year-old former owner

THE HOLDINGS

Peco Pallet

Business: Second largest pallet pooling company in North America
CEO: David Lee
HQ: Yonkers, NY
Purchased: 2011

Signicast

Business: Metal casings
CEO: Walter "Terry" Lutz
HQ: Hartford, WI
Purchased: 2008

Sovereign Gaming

Business: Slot machine leasing
CEO: Ronnie Harris
HQ: Las Vegas, NV
Purchased: 2009

Clinical Innovations

Business: Medical device manufacturing
CEO: Mark King
HQ: Murray, UT
Purchased: 2010

Carter-Waters

Business: Construction materials and equipment
CEO: Mike Lang
HQ: Kansas, MO
Purchased: 2007

Impact Products

Business: Cleaning, maintenance and safety supplies
CEO: Terry Neal
HQ: Toledo, OH
Purchased: 2010

Preferred Freezer Services

Business: Refrigerated warehousing
CEO: John J. Galiher
HQ: Chatham, NJ
Purchased: 2008

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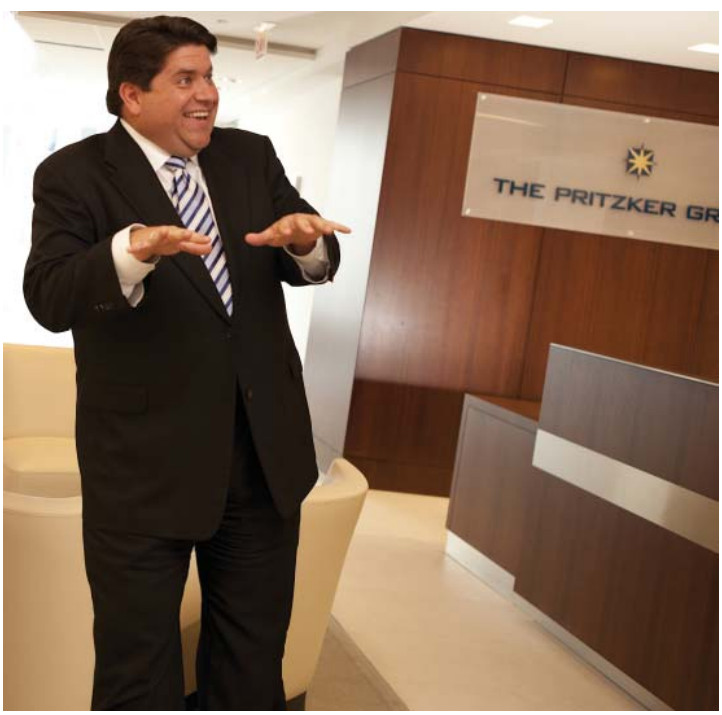
and current CEO, said it wasn't easy finding what he classified as "generational" buyers, or those with an understanding of the business, its history and its ongoing need to innovate.

"They're not going to change the culture or the way the company operates, and that's the key thing. That's why we sort of crossed out a whole raft of people," Lutz said. "They were for moving forward to the future and expanding as opportunities occurred, and supplying the capital to be able to do that."

The Pritzkers typically structure their deals differently than traditional private equity firms, which frequently minimize their equity position and pile on large amounts of debt to facilitate higher returns in a short amount of time, often planning on a five-to-seven year holding period capped by a sale, initial public offering or other exit.

A preference for capital structures favoring low levels of debt often gives the Pritzkers' companies an advantage over more highly leveraged competitors when the economy goes sour, as evidenced during the recent downturn, which resulted in sharply tightened access to credit and dwindling cash flows available to service debt.

"Because we're slightly more conservative, they're sitting there dealing with bank covenant issues and we're stealing market share," J.B. says.

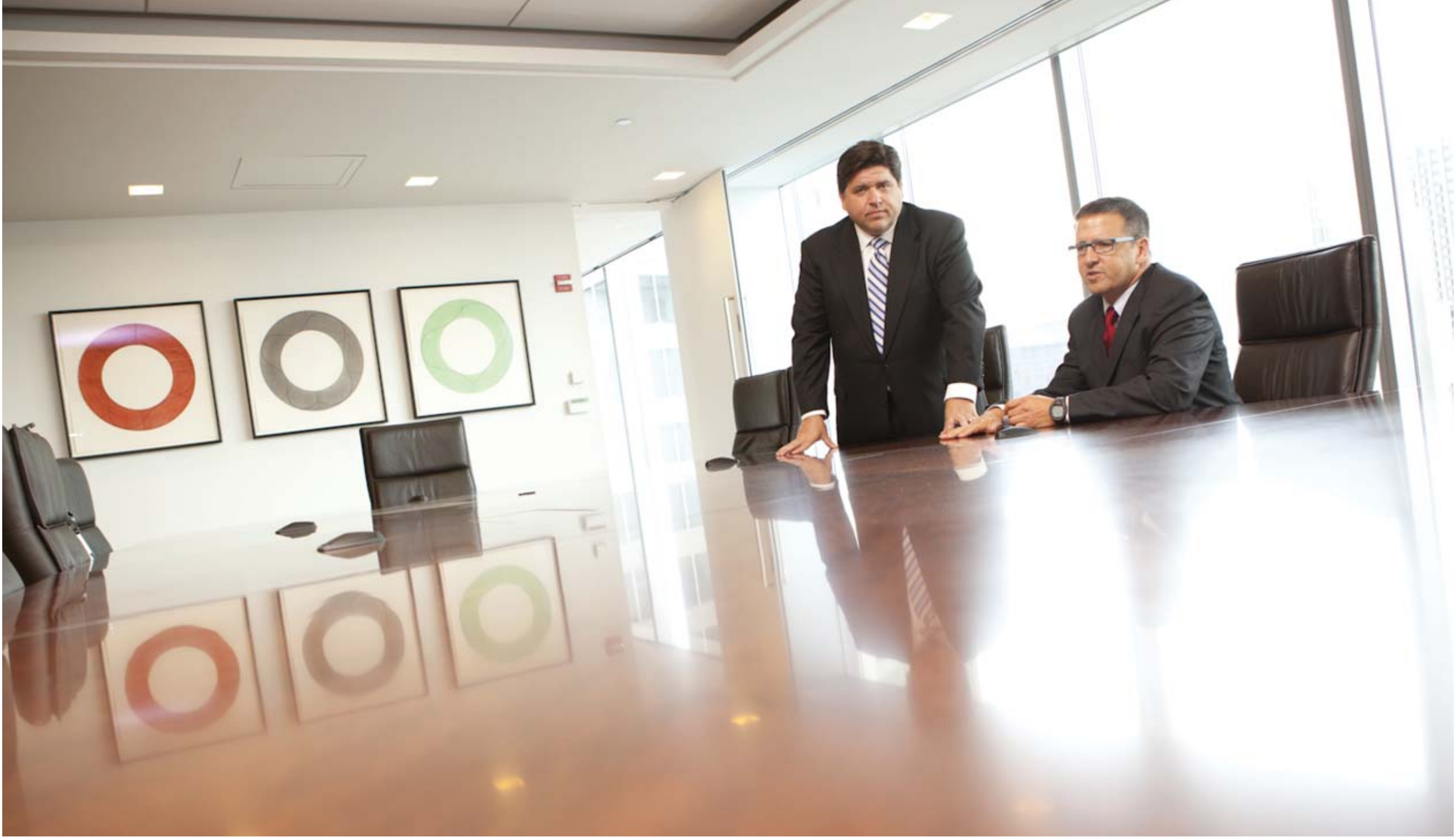


Joseph Gregoire, regional president of PNC Bank, a middle market lender that has maintained a longstanding relationship with Tony and J.B., said the risk-averse approach allows companies in The Pritzker Group to remain focused on sales and operations.

"They don't put a noose around the company so it's a challenge for them to be successful," he said, adding: "They're very involved in analyzing and understanding what the business is all about."

The Pritzkers don't measure their performance using IRR (internal rate of return), the popular metric favored by most private equity firms. Instead, they're mainly concerned with return on invested capital. When push comes to shove, J.B. says he wouldn't consider an investment that couldn't deliver an IRR of at least 20 percent, but stresses that such a measure is irrelevant to buyers looking to hold for the long term.

To be sure, there have been exceptions to this practice. One example was AmSafe, a Phoenix-based leader in seatbelts and other aviation safety products. After purchasing the company with Admiralty Partners in 2003 from the Marmon Group, they turned around and sold in 2007, the result of what J.B. says was an "outsized" offer from Greenbriar Equity Group



and Berkshire Partners. Such instances are not the norm.

"We're 40-year money," J.B. says. "Tony and I are not buying companies so that we can turn around and flip them. We're buying companies because we see long-term value in them."

Tony agrees: "We feel as though we're in a good position, because we have lots of cash and we have the staying power. If the market turns down for another year, it's not the end of the world for us."

They advocate similar conservative strategies for independent middle market companies emerging from the downturn, advice that includes reviewing any longstanding debt on the balance sheets.

"In this market, I would take a hard look at any debt I have on the business that's legacy and say, 'Can I recap that debt?'" says J.B. "Can I replace that debt with lower cost?"

Yet even in the face of economic challenges such as globalization, rising health-care costs and high government debt, he and his brother remain bullish on a segment of the economy they view as reflecting core attributes that contributed to their own family's overwhelming success.

"There's kind of this 'I think I can, I think I can, I know I can,'" J.B. says. "These are people, real stories of people that are engaged and involved. These are the companies that are going to displace the big guys. Everybody's aiming to win, and these are the guys that are hungry." **&**

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Award-winning freelance journalist Deborah L. Cohen has covered business for more than 15 years, with beats that included manufacturing, fast food and telecommunications. She writes a weekly column for Reuters and has contributed to BusinessWeek's Chicago edition, Smart Money, the ABA Journal, QSR, and Bloomberg magazine, among other publications.