

Private equity chief hotly pursues midsize private businesses

Cheryl Hall

cherythall@dallasnews.com

Published: 20 March 2012 10:19 PM

Dan Patterson is back in the saddle, roping in private equity deals. He figures he could be in for a three-year 'magical' ride.

The 59-year-old chairman of Transition Capital Partners LP says that buying the privately held midsize businesses his firm prefers became almost impossible during the economic bust. But critical pieces began to fall in place in late 2010 and are now aligned.

Owners are more confident about selling now that business is healthier. Prices for these businesses are still half to two-thirds less than they'd be if the companies were public. Bank loans, gone for two-plus years, are back at favorable interest rates. And individual investors, wary of re-entering the wild world of traditional large equity funds and public markets, like investing in one private equity deal at a time.

"The wealthy family offices that we raise money from want to know exactly what they're investing in," Patterson says

There aren't many firms that do what he and Transition do or that have had such success.

Think 40 percent average internal rate of return since Patterson founded Transition 19 years ago. The worst deal to date yielded 18 percent, he says.

The 11-person private equity firm in Uptown across from the Crescent looks for businesses with services or products that other companies can't easily replicate, Patterson says, "We don't invest in commodity, cyclical businesses, or ones with account concentration or anything else that could snuff them out in short order."

Three deals fell apart in late 2008, one purchase closed in January 2009 and then the action went on hiatus until late 2010. Since then, Transition has bought six companies, sold one and should close two more purchases by July.

He figures he has at least three years before prices get too high and he goes into net selling mode.

`A great deal'

Patterson, who has been part of the Dallas investment scene since 1979, formed his company in 1993. had several false starts and finally put together his first deal in 1995.

Jim Holland, who runs the private equity interests of the Lamar Hunt family, was his client on that purchase of three geriatric hospitals in small Louisiana towns.

The idea sounded offbeat at first, says Holland, operating partner of Trinity Hunt Partners. "But we built that into a substantial company, moved it to Nashville. It turned out to be a great deal for us."

Why did he take a chance on an unproven guy?

"I could see the intelligence was there, the drive and the detail orientation, all necessary in this business," Holland says.

Transition sifts through 10 to 20 deals that business brokers bring it each week to winnow down to a handful of purchases a year. That's Patterson's comfort threshold, "We don't compete with the really big private equity funds. If we did, we'd be out of business. They don't buy companies worth \$50 million or less. That's our lifeblood."

Last year, Transition paid \$17 million for GBS Enterprises in Sutton, Neb., which sells mattress encasements that prevent bedbug infestations. It hopes to sell its patented wraps through mattress retailers and wholesalers that sell to apartment complexes and lower-tier hotel chains.

"The business has been very stable for 10 years. The meltdown didn't affect it at all," says Patterson, adding that fear of those costly critters continues to grow.

It also bought Mach Speed Technologies Inc., which supplies inexpensive MP3 players, iPod knockoffs and kids' electronic toys to nonelectronic retailers such as Kmart, Sears and Staples, "Instead of a \$100 MP3 player, ours sell for like 20 bucks," Patterson says.

"Dan has found things that I can assure you I never would have found," says oilman bobby Lyle, who's been doing deals with Patterson since 2008. "There are several things that are probably going to mature, and well exit within the next 12 to 24 months_ We've had some pretty nice appreciation in value."

Everyone buys in

Patterson is always the lead investor, usually putting up 10 percent with his personal "skin."

It takes at least \$50,000 to invest in a deal. People coming on as board members, outside executives and management can get in with less, but everybody has to have money in the game.

Craig Levering, a full-time investor since he sold Crawford Electric Supply Inc., a Dallas-based \$400-plus-million electrical and lighting distribution company, in 2007, likes that. He's in on eight Transition deals. "They do thorough due diligence and make sound decisions. That's why people are flocking to them."

Perhaps Transition's quirkiest investment came in 1998, when it bought a company that was the only remaining maker of software that connected mainframe computers to data storage systems. But mainframes were dinosaurs headed to extinction.

As customers abandoned ship, Transition hiked prices on those who still had to have the software. "We got all of our money back quickly and made a 28 percent internal rate of return even as the company went out of business," Patterson says. "It is nice to have a monopoly — even in a dying business."