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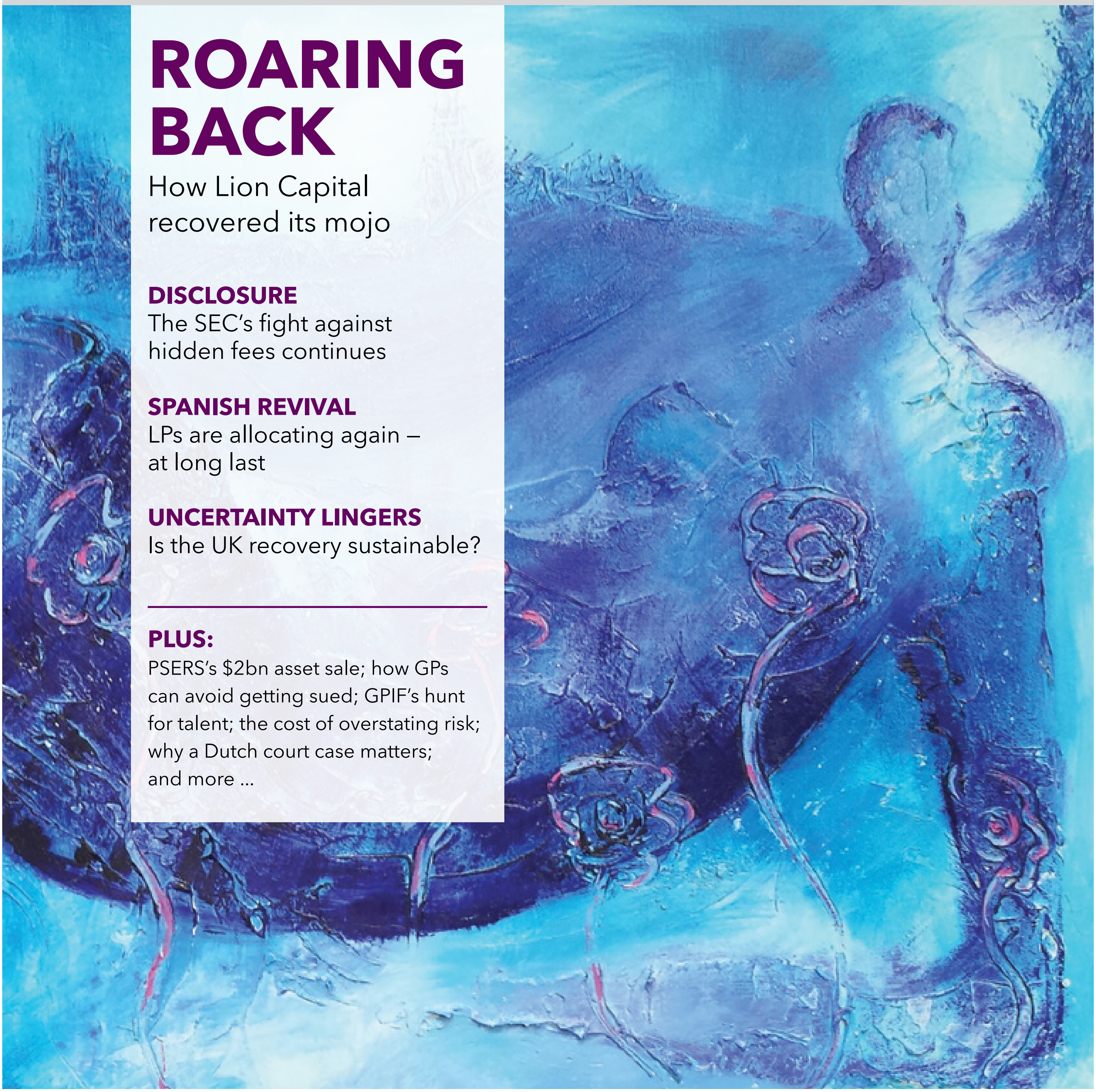

ROARING BACK

How Lion Capital recovered its mojo

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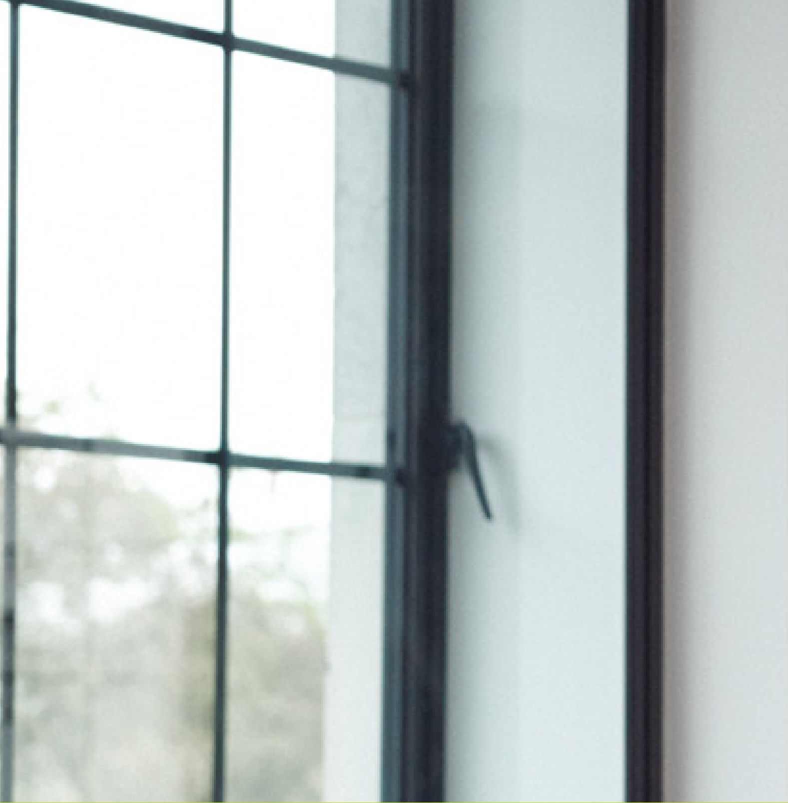

> **Matching the right management resources to the right portfolio company opportunity is the best thing that we can do as an investor**

PRIVATELY SPEAKING

Roaring back

After a shaky second fund and some headline-grabbing problems in the portfolio, Lion Capital is having a much better time with Fund III. Founder and managing partner Lyndon Lea tells Isobel Markham and Yolanda Bobeldijk what went wrong – and how he put it right again

PHOTOGRAPHY BY: JACK JOHNSTONE

Lyndon Lea knows a thing or two about brands. In fact, during the hour he spends talking to *Private Equity International* about Lion Capital, the consumer-focused buyout firm he co-founded in 2004, Lea mentions the word 'brand' more than 50 times.

"We're passionate about investing in brands about which people are passionate," Lea says on several occasions during our visit.

If knowledge is evidence of passion, then Lea has it in spades. He knows his portfolio companies inside out, scarcely drawing breath as he jumps from the science of how a ghd hair straightening iron works to the intricacies of fashion retailer AllSaints' collections. The firm's London office is a shrine to its brand; expensive art eschewed in favour of advertising posters for Weetabix and Kettle Foods and Jimmy Choo.

Lea was only 34 when he co-founded Lion with Robert Darwent and Neil Richardson, fresh from a spin-out from Hicks Muse Tate & Furst whose European operation Lea had launched alongside John Muse in 1998. Back then the firm was looking to invest across the consumer goods, food and media sectors, but over the course of the three Lion funds this has crystallised into a narrower focus just on brands.

It's been a busy time, says Lea: "Over the last 11 years, we've invested in over 100 different brands, and so the expertise that sits in this firm in terms of how to grow a business or a brand I think is pretty unique in the marketplace. There's very few firms that have been so focused and dedicated to a brand strategy."

Lion's debut fund as an independent entity closed on €820 million in the summer of 2005, a few months after it officially changed its name from Hicks Muse (Europe) to Lion Capital. Despite learning his craft at Glenisla, the erstwhile European affiliate of industry behemoth KKR, Lea is determined to stave off any trappings of institutionalism. »

» "Our model harks back to the early days of private equity. It's about shoe leather, getting out there, pounding the streets, meeting people," Lea says. "It's an entrepreneurial business as opposed to having 100-plus investment professionals and having a more institutional face on it."

EVOLUTION

Although not everything went to plan – high street lingerie retailer La Senza, which Lion acquired in 2006, went into administration in December 2011 citing "trading conditions" – Fund I performed well. Boosted by a 5x return from the partial exit of cereal producer Weetabix in 2012 and the sale of Japanese noodle bar chain wagamama for £215 million, as of June 30, 2014 Fund I was delivering a net return of 1.99x, according to figures from the Oregon Public Employees Retirement Fund.

"The best thing we did is we made a ton of mistakes," Lea says. "We kept failing. We screwed so many things up, but we were working so hard, we were so close to the coal face, that as soon as we screwed something up we said 'Oh, that's a screw up', so then we screwed something else up. So finally we kind of stumbled our way, failed our way, to success."

Fund II, a 2007-vintage €2 billion vehicle, bore the brunt of Lion's hit-and-miss experience of that period. According to the Oregon figures, the fund is currently delivering a 0.78x net return. "Quite candidly, that fund has been a pretty average performer," Lea confirms, adding that its current position in around the third quartile marks it as "far from being a rousing success".

As well as belonging to a tough vintage, Lea points to rapid expansion within Lion itself as a contributing factor to the fund's underperformance. It also doesn't help that Fund II houses one of Lion's more challenging investments – frozen food company Findus, which in February 2013, along with a number of other big food retailers not connected with Lion, was found to be selling beef lasagne made from horse meat.

Beyond this, Lea also cites an unintentional cultural shift as the reason behind the firm veering off course. "What we lost was the decisiveness," Lea says. "We were afraid to fail, and so we delayed making decisions. And in delaying making decisions, it was almost a self-fulfilling prophecy. In being afraid to fail, we kinda failed."

Despite its difficulties, Lea pulls some positives from Fund II, including developing Lion's capabilities with consumer analytics and, most importantly, learning what not to do. "You can correlate a lot of what we are doing differently in the third fund with some of the mistakes we've made in the second fund."

Fund III, a €1.53 billion vehicle, is currently delivering a 1.52x net return, according to the Oregon figures. Whereas Fund II was spent "quite quickly", Lion is investing Fund III over a full five-year deployment period. The firm is also acutely aware of leaving itself open to concentration risk. In fact, Lea recently walked away from a deal with a fashion company he'd been working on for three years due to concerns of overexposing Fund III to the fashion sector.

FOUNDING BLOCKS

When it comes to sourcing deals, the Canadian-born dealmaker wants entrepreneurs to recognise that he and his colleagues are not just "the investors". Lea says the point is to push instead to create a partnership structure around the investment.

"Financial buyers have a pretty mixed – and I'm being polite by saying 'mixed' – reputation, and I think for good reason. There's not as much focus in our industry on creating long-term value as I think there should be. When I go in and meet with a founder, I'm not going to go so far as to say we're a strategic in the category, but we're certainly not a financial. We're not coming in with spreadsheets and asking about EBITDA. We're looking at brand and potential."

A significant part of that potential – in some cases, all of it – is tied up with the founder or founders themselves, so convincing them that Lion is their best choice of private equity partner is one of Lea's most important jobs.

"Because we're brand people, when we're talking with founders, we have a lot of empathy and connection in terms of understanding their brand and being brand purists," he says. "I like to say we specialise to a certain extent in working with strong-willed people, particularly creative types. That's not an area that private equity's particularly renowned for."

Lea clearly relishes partnering with entrepreneurs. He describes fashion designer John Varvatos as "an incredible leader" and "one of the only designers I've met that really has a true, comprehensive understanding of the fashion world". Dermatologist Nicholas

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Perricone, founder of portfolio company Perricone, an anti-ageing skincare brand that Lion acquired in May 2014, gets referred to as "a complete genius".

Lea's enthusiasm seems to be driven, at least in part, by his conviction that these individuals' talents are the true value drivers. "If you don't have product, you've got nothing, and if we're passionate about investing in brands about which people are passionate, it's all about product," Lea says.

"Product comes from the creative, it doesn't come from the suits and ties. You can have as many accountants as you want in the room, but that isn't going to get you product. So you've got to be passionate about the product. And if you don't understand that, you can't work with creatives. And they're not going to get it right 100 percent of the time. They're not."

Lea insists that aligning interests at the beginning of the deal is an adequate safeguard against potential arguments further down the line.

"Have we had disagreements with founders? Nothing that we haven't worked out by good debate," he says.

Part of building Lion's own brand as the partner of choice for founders is taking their wishes into consideration on exit. "The first time I sell a founder's business out from under them and don't have their blessing, the next founder that comes along to me is going to say 'dude, why am I going to go with you?" Lea says.

THE PERFECT FIT

Founders aside, the next critical human capital component in a portfolio company is the management team, and Lea places a great deal of emphasis on this piece of the puzzle. "Matching the right management resources to the right portfolio »

» company opportunity is the best thing that we can do as an investor," he says.

AllSaints, the firm's third investment in Fund III, which Lea calls "a real labour of love", is an example of a Lion portfolio company which does not operate around a founder. In fact, Lea says, few remain in the top three levels of the brand's management team that were there on acquisition.

"It was a complete management reset, and we were in there for the first year basically stabilising that business and being pretty hands-on in terms of the operations."

In rebuilding the team, Lea poached current CEO William Kim from Burberry. Despite protestations from his associates that he was too inexperienced, Lea felt Kim's varied career – and that "he dresses like AllSaints" – marked him as the right man for the job.

"He's the only guy in my career that I've offered a job to during the interview," he says. "He's been in there now for a few years and the business is smoking it. [He's] possibly one of the best hires I've ever made".

Over-reliance on qualifications rather than seeking a cultural fit has led Lion astray in the past. "If there's a mistake we made in Findus, a long time ago in our evolution, [it's that] we had people that looked great on paper that maybe weren't suited for that particular business," Lea says.

"It's not just about consumer, it's not just about in this case food, it's the type of business. It's the DNA, it's the culture. Findus is a scrappy business, it's a scrappy business in a scrappy category. You need scrappers. You don't need big fancy brand marketeers, even though they may have come from a great food background. You need street fighters in that business. And we probably made the mistake, in hindsight, of putting in great brand marketeers who were very well-qualified, great general managers, and in food, but probably not fit for purpose."

> ***I'm not going to go so far as to say we're a strategic in the category, but we're certainly not a financial. We're not coming in with spreadsheets and asking about EBITDA. We're looking at brand and potential***

Not least because of the headline risks associated with backing household names, environmental, social and governance considerations play a role at Lion.

"A lot of it comes down to supply chain and how you manage [it]," Lea says. "In the case of AllSaints we've cut a list of probably 200 suppliers down to 35, and so with 35 suppliers we can do a lot better job of making sure that we understand what their practices are."

Lion's suppliers sign up to its code of conduct, and the firm isn't afraid to take action against slipping standards, dropping a particular supplier last year for failure to comply.

"The day I ever find out that we have an issue in our supply chain, I can't even think of what that day would be like," Lea says. "But we do our best to make sure that we don't have it. We narrow the suppliers, we audit them, we get them to sign up to our conventions."

THE NEXT CHAPTER

Moving into 2015, Lion hopes to capitalise on the successes of the past year, doing "more of the same of what we did in 2014" while keeping a "lower profile".

"It's really an evolutionary process rather than a revolutionary process this year," Lea says. "I think we had a very successful 2014 and I would like to continue to just keep doing that and improve at the edges where we can."

While Lea declined to comment on fundraising plans, market sources indicate that Lion is likely to begin raising its fourth fund during 2015. Still deploying capital from Fund III, Lea said the firm is likely to acquire two to three businesses during the course of the year as well as completing a similar number of exits.

Apparently there's "quite a long list of actual names" of brands that Lea would like to snap up over the coming year, although he declined to be explicit, instead offering that he prefers to back companies in categories with "a tailwind rather than a headwind".

"Organic is definitely a strong tailwind," Lea proclaims. "The organic area intrigues me about how it can encroach on more areas of our lives, for example household cleaning products."

On the back of current success with AllSaints, which "could potentially be our best deal ever in the history of the firm", and also John Varvatos, Lea says Lion might just about be ready to take on another fashion business.

"We've got a lot of knowledge we can bring to these businesses, it's a skill set we have that positions us uniquely, and we should continue to exploit that."

But more than anything, Lea is determined that now Lion's got its mojo back, it won't let it go again. "Every year for the last five years has been a better year than the year that preceded it, and I'd like to keep that trajectory up." ■

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