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BERKSHIRE PARTNERS: INVESTED IN THE LONG TERM

BY LISA WARD

Berkshire Partners LLC makes it look easy. The Boston private equity firm scored a cool $4.5 billion in the first seven months of 2011, its eighth fund and one that, despite the uncertain economy, beat its last fund, in 2006, by $1.4 billion.

While Berkshire's performed consistently well over the past 28 years -- all of its funds ended up in the top quartile -- the fundraising highlights another achievement: succession planning. Over the past decade, three of the firm's five founders have retired. Two founders who remain active managing directors may retire before the eighth fund is fully invested, although they haven't indicated any interest in diminishing their commitment. Nevertheless, 96% of the limited partners from Fund VII chose to reinvest in Fund VIII, and Berkshire brought in new investors, too. Internally, the firm's organizational structure gets credit for fostering a smooth transition.

"We are a very flat organization. We broadly share the economics and decision making," says Bradley Bloom, 59, one of the firm's founders, adding that neither he nor the other remaining founder, Richard Lubin, 65, are on the partnership 's planning committee. "Today we are two of 14 managing directors."

Berkshire declines to divulge the exact amount of the founders' equity holdings, but no single founder owns the outsized equity interest of, say, Blackstone Group LP's Stephen Schwarzman, who holds about 39% of the firm; Kohlberg Kravis Roberts & Co. LP's Henry Kravis and George Roberts, each with 33%; or Carlyle Group's William Conway Jr., Daniel D'Aniello and David Rubenstein, each with 15% of the partnership units.

In 1984 Berkshire's founders -- J. Christopher Clifford, Carl Ferenbach and Russell L. Epker along with Bloom and Lubin -- launched Berkshire as an equal partnership. They had been working at Thomas H. Lee Partners LP for about a decade when they spun off a $59 million fund. Bloom attributes the split to different visions. The firm's powerful founder, Tom Lee, wanted his shop to focus on large buyouts, while Berkshire worked the middle market.

"We've always been focused on growth," says Bloom. "It's easier to grow a small company than a larger one." He gave the example of a retailer with a few hundred stores with the potential to open an additional 1,000 venues.

In 1986 Berkshire raised $125 million for what is officially called Berkshire Fund II, although it was the first fund raised by the firm as a standalone company. Since then the firm has raised slightly larger funds. "It's not a hockey stick; the size of the fund has basically kept up with inflation," says a source with close ties to Berkshire.

Berkshire has also developed a somewhat insular culture. The MDs average tenure of nearly 20 years, reflecting that the firm tends to recruit out of business school and then from within its own ranks. The only reason an MD has left the firm is to retire. No MD has left Berkshire to join another firm.

The 14 MDs collectively run the firm and discuss its investments. Tenure of its top professionals may have made a gradual changing of the guard possible. Epker retired from Berkshire in 2000 and passed away three years later. Clifford retired in 2008 but remains an adviser to the firm. Ferenbach retired earlier this year and also remains an adviser. Bloom and Lubin are approaching typical retirement age, but each hopes to be with the firm for many more years.

Some tout the compensation structure for building cohesion. Berkshire evaluates and pays its professionals annually instead of waiting until the end of a fund cycle. The money often vests over time. Junior staff are paid carried interest. Administrative staff has additional compensation that is tied to the performance of the funds.

Ferenbach (from top), Lubin, Bloom and Clifford *in it for the long haul*

Berkshire is its own largest investor, having about an 8% stake in its recent fund, more than any individual LP.

"The investor community is very focused on how to connect the dots between past and future performance," Kevin Callaghan, an MD at Berkshire who has been at the firm since 1987, told The Deal Pipeline last July, shortly after the eight fund closed.

Unlike PE firms that have diversified into debt or real estate, Berkshire has remained focused on equity investments. Besides private equity, Berkshire also invests in public equities through its Stockbridge Investors unit.

One of Berkshire's more successful investments is in baby clothing maker and retailer Carter's Inc. It made a 600% profit from a 4-1/2 year investment in the company. Berkshire bought Carter's in 2001 for $450 million, pumping in $125 million of equity. It took the company public in 2003, and by 2006 it had sold its last share. Under Berkshire, Carter's bought one of its main competitors, Osh-Kosh B'Gosh Inc., for $312 million in July 2005. It also entered into marketing agreements with Target Corp. and Wal-Mart Stores Inc.

Today, Carter's enterprise value is about $2 billion. In May 2011 Berkshire Partners disclosed that it had bought back a 13.2% stake.

Among Berkshire's blue-chip LPs are the endowments of Harvard, Yale, Stanford and Princeton universities, and the Massachusetts Institute of Technology, as well as new investors, including the Maine Public Employees Retirement System and public pension plans of Tennessee and Arizona. The firm also offered a slight tweak in its carried interest structure, linking it with performance.

Its seventh fund sported a 25% carried interest if it met a 7% performance hurdle. The latest vehicle provides for a 20% carry for the first six years, rising to 25% if the fund is within the top quartile in year seven. The terms also allow GPs to recoup the 5% from the previous six years; the industry standard is 20%. The modest change in its fund structure speaks to how the firm rode out the financial crisis. A majority of its companies saw an increase in sales and operating income during the downturn, a source says.

Berkshire has thus far been able to navigate the changes in the buyout industry itself, the macroeconomy and the inevitable aging of its own partners. The challenge ahead is to see that its culture, which has quietly flourished for three decades, can last another 30 years. If it does, fundraising won't be a problem. ■

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