

In The Trenches_ Conversation with Brent Belzberg

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SPEAKERS

Brent Belzberg, Steve Divitkos

S Steve Divitkos 00:00
Brent Belzberg, welcome to the show.

B Brent Belzberg 00:02
Thank you very much, Steve. Thank you.

S Steve Divitkos 00:04
It's such a pleasure to have you here. And I have so many questions for you, I don't even know where to start. But I actually want to start at the very beginning. And to contrast where you are now with where you were when you first started. So your most recent fund is upwards of \$2 billion. And we'll get there. But what I want to know most about is that first fund in TorQuest, which I believe was in 2002. So can we start by just telling us a little bit about that first fund, you know, who is involved at the GP level? How big was it? What was the overall strategy thesis? How long did it take for you to deploy and any other color you'd like to add for us on that first fund?

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Brent Belzberg 00:47

So the truth is, the first one was really a little public company, in 1993, called Harrison, raised \$37 million. But the first fund that we raised in the traditional TorQuest, way, was raised in 2001 2002. That was \$183 million. And in many ways, it was just people that I knew in Canada and Toronto, who had seen the track record in our previous public video called, called Harrison and Canaan.

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Steve Divitkos 01:28

And was it just you? Or were you working with a partner at the time?

B

Brent Belzberg 01:31

So when I started, it was me and one young guy who had just come out of his accounting practice, who had spent a year with me and Harrison, and it was just us when we raise the first dollars, but even before the first dollars were fully raised, my partner Erik Burke joined.

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Steve Divitkos 01:54

Got it, got it? And what was the overall if there was an overall strategy or thesis for the fund? How would you characterize it?

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Brent Belzberg 02:04

So historically, I've been doing this since I was 32, or 33 years old, where we were basically looking for people who have a shortage of capital, and needed some capital to be able to buy a business. And that's how it started. And pretty soon, and it Hairston days, we began to realize that our best transactions were those where we backed an entrepreneur who had an idea or where we help people in transition in their lives. And and so that became our principal strategic direction.

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Steve Divitkos 02:49

And was it all buyout based, or was there some like growth equity component in that first fund as well?

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Brent Belzberg 02:54

So there was no money that was traditionally growth equity, as you would understand it today. But there were dollars historically, that were used to go into a company for them to buy another company, or for them to expand their business or their plant. So it did happen. But most of it was buy out.

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Steve Divitkos 03:16

How long did it take for you to deploy? And how did that compare to how long you thought it might take you to deploy at the beginning?

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Brent Belzberg 03:23

So that's great question. Actually, it was under three years, which is almost historically how it's always been for us, we've always raised historically, less than we're able to raise. We haven't been driven by fees we've been driven by by upside. And so about three years after a fund.

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Steve Divitkos 03:48

After, fundraise, or pardon me, I should say, during fundraising, you know, a traditional private equity funds structure, as far as I'm aware, is a five year investment period and a five year harvest period, so to speak. My understanding is that it's actually quite rare for a GP to take all five years that they are allotted. Why do you think that is?

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Brent Belzberg 04:09

Well, because it depends on markets in our second fund, we took longer than five years and had to ask for an extension. So in your history, at your age, Steve, you won't see many that that happens, because the market has been such that opportunities are being so available and just being where you can make a lot of money. So people have deployed quickly and attempt to get bigger and bigger funds in today's world, probably less likely.

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Steve Divitkos 04:41

And what about fund two? I mean, was raising a second fund always a given for you and Eric? Was it the plan from day one? Or was it basically contingent upon what ended up happening with fund one?

B**Brent Belzberg 04:53**

So we had no idea when we raised fund one, we just knew that my historical investment philosophy, which had been in a little public company did it work, it was too small, nobody was really interested in the stock of a small public company without consistent earnings. And so we needed to do it in a traditional structure. When we did that. We had no view of what the future would be. All we knew was that this was a good idea. We were very successful in fund one, our returns were ridiculous, very few transactions, five, and very high returns. And so we got calls from the placement community quickly. And we hired Credit Suisse out of New York. And literally, in a matter of months, we had commitments for two to three times what we're willing to take, and they weren't really happy with us because they were making fees based on the amount they could raise, and we were taking less than half of what they could actually raise.

S**Steve Divitkos 06:04**

That's super interesting. I didn't know that. Can you walk us through the decision of how and why you decided to take far less than you could have taken? Because, you know, the stereotypical fund manager, you know, I guess there's a structural or monetary incentive for them to raise the biggest fund possible. How did you guys come to that decision?

B**Brent Belzberg 06:24**

In fact, I think we still took too much money, because we moved from being a, you know, a few guy is doing a few transactions to being a very formal, one mandate with lots of people. And we thought that what we should do is compete with everybody else who look just like us. And that was a mistake for us. And we did pretty badly on the first couple of deals, we raised in fun, too. And we learned a lot of mistakes, a lot of lessons from our mistake. But we knew that we couldn't manage more than that, we were very young to the business, the team was very new two to three years of existence. And people underestimated how important culture is and how important working together and experience is.

S**Steve Divitkos 07:16**

Now, you mentioned that your deployment period for fund one was under three years. So am I safe in assuming that you raised fund two before you had any realizations in fund one? And if so, did that present you with any challenges from the fundraising perspective in fund two?

B**Brent Belzberg 07:36**

So I think that's fair, I can't remember exactly. But no, it did. Because you can see the earnings trajectory of every one of those businesses, which had been entrepreneurs, businesses that had not been as sophisticated as you might have thought they might have been, which gave us our reason for existence. And so we had no problem at all raising fund two. It was very interesting.

S**Steve Divitkos 08:08**

So you mentioned a few mistakes. And that's where I'd like to go next. I recognize that this is a big question. But if you were to kind of zoom out and evaluate your first two funds, let's say, some of the most memorable mistakes. So these could be your biggest mistakes that maybe cost you the most money, where you learn the biggest lessons. So could you just walk us through some of those mistakes, and maybe the lessons that you extracted from them.

B**Brent Belzberg 08:37**

So first of all, I would say that there's a formula for private equity that everybody everybody thinks is the typical formula, which is pay the most you can at an auction to make sure that you win the transaction and finance it as aggressively as you're allowed to do. And so the first transaction that we did in fund two, wasn't that different, we were so excited that we'd won the bid. What we should have known is that we paid more than anyone else, what we were also excited about was that we're able to do it during a process, which should have meant that we didn't have the appropriate amount of time to do the appropriate due diligence. And thirdly, we backed the guy who was in the company who, who didn't have exactly the same values as us. And so then the second one, everyone was doing roll ups at that time. So we backed two guys in two different markets, who had come together to try and give us the size that we needed in order to do a transaction that was a roll up. Both of those we did a terrible job of it. We didn't have the experience, and we didn't have the full understanding of what to do. And we've done both transactions too quickly. So we stopped. And the times didn't help, either. And I know one of your questions is, how important is the year that you raised it as opposed to the value you add. And it proved that we bought both of those at the top of the market in 2006, or 2007. And so we really stopped investing at that point and try to make something out of what we've done. And then we put in a lot of bids in 2008, 2009, and won nothing. And by 2010, we were open for business. And every transaction we did in 2010, proved to be a gigantic success for us gigantic, partly from the lessons we learned out of the first year, but partly out of time.

S**Steve Divitkos 10:58**

I wonder what the generalizable lessons that have stood the test of time you extracted from those? So is it, you know, don't move too quickly? Is it don't try to time the market? Is it roll ups are a bad idea? Is it broker processes are a bad idea? Like, are there any, like kind of time tested broadly applicable lessons that you've learned, then that you're still leaning on today?

B**Brent Belzberg 11:27**

Yeah, well, you know, our average amount of due diligence on a transaction now is somewhere between six and eight months. In addition, the amount of time we've known the person we're backing, or the guy whose business we're buying is in excess of four or five years. So that's our philosophy today, it isn't always the case. But it is what distinguishes us from most people in our business, and which has given us our level of success. And both of those lessons are fantastic for us. And there are some sectors that we did the first time, one of them being retail, we've never done another retail transaction since because we're not good at. And because it doesn't meet our skill set. So there are things that we just don't do. And that's one of them. And we don't do commodity businesses, and we don't do things that are too heavily real estate oriented, because we can get the returns we want. So there are things that we just don't do, partly out of the learning that we learned at the beginning of fun, too. And one of those is generally quick options. And the second one is retail businesses.

S**Steve Divitkos 12:53**

So we're going to talk about the vintage of a fund in a moment. But before we do, I want to ask you about the size of a fund and the link to the funds strategy. And I hope I can articulate this question in such a way that you understand what I'm asking. So as any GP raises bigger and bigger funds, you know, the risk of oversimplifying, you either do more deals of the same size, or you start to do bigger deals. But like the market for larger companies is more efficient, I would say than the market for much smaller companies. So in my case, maybe this is a very selfish question. My funds thesis is very much centered on investing in small companies below the radar of firms like yours. And I think that that might limit the size of my next fund. Because again, if I start investing in bigger and bigger companies all eventually start to violate the thesis that led to the formation of fund one in the first place. So I guess my question to you is like, Have you ever encountered any similar tensions throughout your career between the size of the fund and the strategy driving the fund to begin with?

B**Brent Belzberg 13:58**

Yeah, absolutely. It's the questions that we get asked during fundraising are, does your strategy change as you get bigger? And second of all, what's going to happen to you? So, those questions happen every single time we fundraise, and so on the first question, which is what you blast. We don't think our strategy has changed at all. You know, because we buy businesses generally from entrepreneurs. And we keep those founders involved in the transactions for a very large extent. We still believe that we can see an appropriate amount of opportunities here. Your question is an interesting one, because the world's changed a lot and I don't want to take a shot at you. But when you started in this business, there were dozens of people in the search business and now there are 1000s of people, not funders, but 1000s of people participating in the search business. And you still believe you have a marketplace because of your particular expertise, and because of the way you deal with things, and those of us who believe in you believe the same. Same is true for us, we don't change our strategy. Yes, we do slightly larger transactions than we did before. We still think there's a market for the smaller ones. But it's interesting as the world turns from just institutional investing to high net worth individual investing, there's lots of capital available for smaller deals as well, multiples on those have gone up from four to seven or eight, multiples on transactions that we're talking about have gone up from six or seven to eight or nine. So there's been growth in pricing of all levels of the marketplace. And what we get by going a little bit bigger is likely more sophisticated management teams.

S**Steve Divitkos 16:11**

I mean, I wonder, you know, again, your first fund in 2001 2002, is 183 million, your most recent fund is 2 billion. Obviously, there's a big difference between those two, you know, most GPS, I mean, if not all, at least those who I'm familiar with, you know, every subsequent fund gets bigger. I'm wondering like, was there ever a moment where you considered like simply staying the same size from fund to fund? And if so, why did you elect to not pursue that strategy, recognizing that almost nobody does, but has that thought ever crossed your mind?

B**Brent Belzberg 16:45**

For sure, we thought about it 100 times, and then every strategic meeting, we discuss it again. The difficulty is, it's gone from being a single purpose, or a single person or a double person business, to one that has 50 employees. And each of those people join you because they believe they have an opportunity, and many of them will be better than you at what they've done. So you don't get the best people if you don't grow. So you need to grow for that reason. In addition, by being a little bit bigger, you have an opportunity of doing smart deals, and middle sized deals and bigger deals. So it makes your market a little bit better. But the main reason is, you can't keep your people happy if you don't grow, and you'll lose them. And so you have to believe in them. So that was he and Eric, and there are basically four or five pods of people in our organization today. So on a per pod basis, we're not that much bigger.

S**Steve Divitkos 17:58**

I see. I see. So I'm gonna go a little bit out of order here, because you've set me up for my next question quite well, as you've just articulated, you've expanded your firm over the years. And in so doing, you've had to distribute carry, or basically the profit that you get off of investments that you make, you've had to distribute that among a greater number of people. At the beginning, it was just you and Eric, now, you mentioned you've got 50 plus people. I'm wondering if you remember, like the first instance in which you had to give somebody carry that otherwise would have been yours. And to equate this to folks not running private equity businesses, you know, could be hiring an experienced member of the leadership team, and she's asking for equity, and a lot of founders are very, very hesitant to give that up. So I'm wondering, did you ever struggle with this decision of giving these types of economics? And if you did, if you could talk to that version of Brent right now, what would you say to him?

B**Brent Belzberg 18:54**

So I never did. When Eric joined me, most of the fund was raised at the first day he walked in, I offered him the share of the carry that he has today. So I never thought that that was an option other than to do that. And and and I know that someday, this place will belong to the next generation of people around here. So it's the nature of the business on Bay Street or Wall Street that that's what you do. That's how people get paid. There's never sufficient fees to pay people just at a base compensation and to maintain the quality of people that you have around here. Stay if that's the case, and we have no turnover and I mean, no turnover. So that's why it's a necessity and why they ever feel bad about it. My assumption always is that my net worth is going to increase exponentially if I have the best people, and if they're compensated appropriately. It can't be done, if I do it all myself. It's very different in operating business, it's not the culture of those things to necessarily share them, the number of businesses that we buy, where there's equity, owned by more than the founder is rare. And it's very interesting, because on every one of those, we have an option plan or a web loan plan, or both, long term incentive plans on every single one we do, and it's probably the first time most of those people have actually owned real equity. And is it smart? You know, a lot of those people just don't understand it. And because of their base compensation, they would prefer short term gains to long term gains. But that's our philosophy on how we have to keep people invested and working towards the long term in these businesses.

S**Steve Divitkos 21:15**

Speaking of the growth of your firm, you have expanded your firm naturally, and it's not just you making investment decisions anymore, maybe in fund one it was or I guess, suppose it was likely you and Eric just making the investment decisions, but I suspect it's not just you and your sole discretion anymore, as it might have been. And again, giving up this type of control stuff, and a very, very difficult thing for founders to do. How did you manage to do it? And how might you advise a young fund manager who is struggling with the idea of giving up that decision making authority that she has become so accustomed to over the years?

B**Brent Belzberg 21:55**

so you have to be brave on this topic. Because if you don't, you won't get people who were empowered, it's very difficult to control every operating decision. And expect people to take responsibility and have authority. We have a system on our investment committee, where there are seven people, each one of them could veto a transaction, but it's never ever happened in 22 years, what happens is that the transactions get developed over the time that we're looking at them. They come back to Monday morning meetings, if somebody doesn't like the industry, doesn't like it, they send the guys back or the women back to make a different decision to look at it again, to look at things again. And it's worked perfectly. What's evident is the returns have been okay. And we've never had to use the veto. And so I don't, you know, that's a place where you have to be humble, and you have to believe that other people around you are as smart or smarter than you are. If you don't do that you shouldn't be in our business. And, you know, yeah, there's risk associated with it. But if you don't take that risk, then you don't get people who feel responsible.

S**Steve Divitkos 23:33**

And that would be the case, even if let's say that you have somebody who is, you know, more junior to you, who's really pushing to make an investment decision. And in your gut, you're saying, I really don't think this is the right thing. That would strike me as a really difficult decision. Because on one hand, you have experience and context and pattern recognition that might, you know, be worth listening to, certainly, I would presume that it is. But on the other hand, you don't want to kind of cut the legs out from underneath your partner's. I mean, those must be incredibly difficult decisions to navigate. If your gut is telling you not to do it, but perhaps you want that person to learn that lesson him or herself.

B**Brent Belzberg 24:13**

It happens every single day. So the benefit of age is you can use the Socratic method and send people back to try and prove things that are wrong. And you hope they come to the same conclusion as you do. And there's a level of respect for sure. So if they hear it coming from you, it makes them second guess it. I'll say it the opposite. If there's nobody in your place who desperately wants to do that transaction and believes in it, it'll never happen. Somebody has to want to do this and has to believe in it and it's generally not because okay, well, I want to do it because I'm that makes me a big boy or big girl. It's generally because they truly believe that you're missing something and they aren't. Often they prove you wrong. Awesome.

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Steve Divitkos 25:14

I want to stay on this topic of growth, because presumably, when you started, the actual investment decision making process, I suspect was quite informal, quite organic. Maybe it was just you maybe it was just you and Eric. And as your farm has grown, and as any GP grows, the investment decision making process understandably becomes more formalized. So involves more people, more committees, more steps, etcetera. That's a totally understandable consequence of growth. But what I asked you about is about the quality of decisions. So as a firm grows, all of the steps and committees and people to those increase the quality of the decisions being made relative to when it was just you and Eric sitting over a beer making a decision?

B

Brent Belzberg 26:05

Well, actually, the returns on our first fund, which was Eric and I just sitting in a room making decisions ended up being the best of all of our funds. That's a very small sample, and you can't draw conclusions from it. It's not possible to do that at this level. It doesn't allow you to grow and it doesn't allow your investors to grow with you and doesn't allow your investors to get the benefit. There's no doubt that people who who start these businesses on their, own one person in a room or two people in a room hate process. It's an anathema to them. They hate committees, they hate 60 page EOI memos, and 60 page LOI memos and 60 Page bring down memos. They hate spending hundreds of 1000s of dollars on consultants, if not many millions of dollars on due diligence every single time when they think they have the answer before you're a fiduciary. And you have to do things in a way that a fiduciary does, because you can't have tail risk. If you miss something, you'll have a fraud. And if you miss something you're responsible. So going through these processes, perhaps protects your downside. Does it increase your upside significantly? You try and get some plans out of these things which help you make decisions on how you run the business after you own it. Generally, people are more important determinant of success than the numbers.

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Steve Divitkos 27:57

Let's talk a little bit about the business of private equity. And we'll go back to the timing point that we alluded to a little bit earlier. Let's say if I were to just randomly select, I don't know, 100 middle market private equity funds that have been raised over the past 30 years or so. Roughly what portion of their returns do you think might be attributable to the skills and abilities of the GP? And what portion might be attributable to just the vintage of the fund or the year in which it was raised?

B**Brent Belzberg 28:28**

So I can't give you a percentage of that. And I know it'd be a great question. I'm sure there is some information on it there. There's no doubt that if you do appropriate surveys and analysis, and that that funds raised in 2006, or 2007 or 2008 did better than funds raised in 2003, or 2004, there's no doubt about it. So it is a contributor. And that's why people are giving you money based on your percentile or quartile performance, which measures you against your peers. And there's lots of information on different vintages and what the median is and what the top quartile performances in each of those periods in. And they're very different depending on the time that the fund was raised. That doesn't take away from the fact that you have to have the best people and then you have to make good decisions.

S**Steve Divitkos 29:34**

How do you think about timing the market, if at all, with respect to a new fund? Is that something you pay attention to or attempt to do in any way?

B**Brent Belzberg 29:41**

On the margin, for sure you do. It's very interesting that right now, for the last six months, there haven't been as many transactions but prices have not reflect the fact that your cost of capital is way higher that your interest rates are. 600 700 basis points higher, prices have not reflected that, nor have they reflected that, you know, the investment alternative for an institution should require a higher return on equity in these times, then it does in in times when interest rates are way lower, or when volatility is less. So, you delay, you hope to take advantage of some pain that other people are going through. And you don't rush as quickly into the decisions because you believe you have time. And for sure you play it, but I say on the margin and the term of your investors is, you know, five years with realisations over five years after that. You can't just sit and do nothing for five years. And so, they're giving you money, they're making a decision that you can invest it now. And you have to invest it now.

S**Steve Divitkos 31:15**

If 40 year old Brent Belzberg was magically transported into September of 2023. At that stage in your career, would he still start a middle market private equity firm? And why or why not?

B**Brent Belzberg 31:31**

Well, there's a whole bunch of new products today that are taking institutional investors money that didn't exist when I did it, when I started the secondary market, is a big part of that. Yet funds are a big part of that, neither of which existed when I started. Both of those are very interesting alternatives to what we've done. Probably the secondary market is taking an increasing amount of institutional money right now then, you know, just traditional private equity, money. But our expertise is in navy and middle market. And so you can't go into things you're not as good at. So you have to do what you're best at. And we're best at that. So the answer is yes, we would go into the same thing, because that's where we can create true outsized returns.

S**Steve Divitkos 32:44**

How about the source of your capital, which is to say your limited partners, what have you learned over the years about both selecting and managing and communicating with your limited partners? And how much should an emerging fund manager care about specifically where their money is coming from? Or should they think that capital is a commodity and your money is as green as the next person's?

B**Brent Belzberg 33:07**

Well, you know, if you taken only European funds, European LPs 10 years ago, it would be very complicated for you to do your fun today, because the regulatory environment changed around that alarm, because the economic environment in which they operate, it changed. Lots of people are trying to take lots of that lease money today, because they believe that's where the opportunity is to raise significant amounts of money. We've had the luxury and I say it's a luxury of being able to balance our portfolio amongst all of those groups and Americans and Canadians and Europeans. And so we purposely try to not only have Canadians and move beyond Canada, so if there ever was a change of view, we would have investors from around the world. But you know, these are limited partner structures. So the amount of involvement that your institutional investors is very different than what you do see. And so yes, they they teach us how things work. They're a great source of us reaching out and finding out how other GPs are doing. But they're very limited in their ability to not because they're not capable, but because they have dozens and hundreds of funds that look like us of getting seriously involved. They do get involved when we do some co investment work where they co underwrite with us on occasion, and that's valuable. We try and balance the number of people who want co investment from those who don't. So you do purposely try and find investors that ensure that you have significant capital. So you can do larger deals if you need extra money. And we look for a geographic diversification, we also look for diversification around foundations versus pension funds versus high net worth family offices. Because the factors in the economy that affect each of those are different. And so as a result, we want to ensure that if those things change, we're still not left out there by ourselves.

S**Steve Divitkos 35:39**

That makes a lot of sense. I mean, given the theme of diversification, I suspect I know your answer to this next question, but I'll ask it anyways, if you were raising a, you know, hypothetical \$100 fund, would you rather have five LPs at \$20 each, or 20, LPs at \$5 each?

B**Brent Belzberg 35:56**

I mean, you want diversification, so you're not dependent. You don't want too much diversification because some of the best investors and the most loyal investors and the ones who are best recognized do very few funds and want to give you significant amounts of body. So we have some \$200 million investors because they are a brand name and because they're really smart, and really good people. And so we love having them there.

S**Steve Divitkos 36:39**

So it sounds like there's a delicate balance between not too concentrated on one hand, but not too diversified on the other. It sounds like they're both imperfect. So managing the pros and cons of each likely is a bit of an art in itself.

B**Brent Belzberg 36:55**

It is for sure. I mean, it's a very complicated business in the sense that, you know, maybe this is too much information, but you have to understand who your investor base is, you have to understand what your banking relationships are. Because that's a very, very big strategic differentiator for you. And the Canadian banks have built many of us and are hugely responsible for our success.

S**Steve Divitkos 37:25**

Let's move on to the investment decision making process. I mean, you've had so many reps at this, and I'm sure have learned so many lessons over the years. I'm curious if you've developed any like generalizable rules or heuristics about investing, that you now lean on when making investment opportunities? And it's kind of a vague question. So I'll give you two examples that I have, you know, kind of gathered over the past couple of years, I recognize my experience is not even in the same stratosphere as yours. But just to give you a sense, as with respect to what I'm saying, so one of my rules is, if I have to make a list of pros and cons, then the answer is no. And my other rule is, if I have to make a decision more quickly than I'm comfortable making it I just say, so do you have any, like, anything like that, that you still lean on?

B**Brent Belzberg 38:16**

The second one is a certainty for us. We're not setting up to throw a bid into an auction with everybody else and fit into the timeframe imposed by investment banker, what we find is most of those are artificial anyway. And we have a lot more time than we think. And so we worked our way through those. The second one we agree with you 100%. And as far as the pros and cons. I think the first page in our, in every one of our industry memos should be opportunities and risks. And analyzing the transaction against the risks. You know, our job is not to have no risk. Because if that was the case, we'd be buying government bonds, and even that, today might not be perfect, and we'd be diversifying that. So we always know we have risks. And the question is, what's the tail risk? And can we manage our way around risk? Most of our big mistakes are because we underestimated the tail risk. And underestimated. So in one that we did, we analyze the regulatory environment around the business and it proved to be significantly worse than what we estimated it could be. And another one that we made a mistake and we knew we had to spend a lot of capital on this business which is the reason that the entrepreneur was selling it to us because he just didn't want to work couldn't make the capital investments. And we underestimated the complexity in that capital investment, so, you know, if we don't identify the risk at all, that would be terrible. But if we saw the risk, and we underestimated the risk, that's okay, because it's curable, and in most cases. And at least we saw the issues that that existed, you know, people to us are way more important than they are to the average private equity fund, we either reach into our Bevy and have someone we're going back to do this transaction, or we don't, or we are backing the existing management, or we're not. And when people underestimate that, they always make a mistake. And so I always say, a great business with the wrong person can screw up an average business with a great person. It'll always it'll do well. And so you know, the difficulty with today's generation is that is they believe everything can go into a model. But the EQ is the thing that distinguishes us from a lot of people in our field. And we think it's extremely important to our investment decisions.

S**Steve Divitkos 41:24**

So when making investment decisions over the years, I'm curious, what has been the greater source of mistakes for you. And when I say mistakes, maybe we can call that doing an investment that you probably shouldn't have done, or maybe not doing an investment that you should have done. So what's been the greatest source of mistakes, overthinking it or under thinking it?

B**Brent Belzberg 41:45**

That's a hard one. You know, it's very hard to grow your business and do everything on gut. So initially, we could do lots of stuff on gut, it's a lot harder to do it today, because you're trying to convince seven of your partners that are at the Investment Committee or long before that, that your gut is sufficient. So you know, we overanalyze everything. And that is the nature of being a fiduciary. And you got to make sure that in the end, the person really looks at his, into his heart, our heart, and and says, I really believe in this one. So yeah, you have to have some gut, or it just doesn't work.

S**Steve Divitkos 42:48**

Let's move on to hiring, you know, a combination of you and your team have likely evaluated and hired a large number and a wide range of CEOs for your portfolio companies. I want to learn a bit more but the broad generalizable lessons that you've learned related to experienced CEOs running your portfolio companies versus first time CEOs running your portfolio companies, how do you think about that? How much weight do you put on experience, and are there any industries or a business model that maybe lend itself to one type of leader but not the other?

B**Brent Belzberg 43:24**

So because we have a relatively short whole period of things we do, three to five years, where we know what value we bring, we leave room on the table for the subsequent buyer to create value for them as well. We have historically hired experienced people in the field that the company is in. And is generally stood us in good stead. The interesting thing is, we decided to take a risk on a first time CEO who came out of our business. And it's been a gigantic success for us. So we're learning even at our stage on this topic. And I don't want to generalize from one experience, but it's proved to be excellent for us.

S**Steve Divitkos 44:34**

Do you think that I mean, again, we're talking with a single data point here but as best as you can tell, is it the person him or herself it's just an absolute superstar? Or is there something about the day to day nature of that particular business or that particular industry or that particular company that might lend itself more suitably to being run by a first time CEO?

B**Brent Belzberg 44:57**

So it's an amazing question. perfect question. Business had fantastic operating people. It was owned by a family who weren't willing to stay. So they had always had a boss buy on a day to day basis, they could do a great job. Business was a bit of a roll up, done five little acquisitions into it, for sure the management team couldn't have done that. And this young man could do that. And he's done a great job of it. So a lot depends on the nature of the business.

S**Steve Divitkos 45:52**

Let's talk about private equity playbooks. And I'll try to define that for folks who don't necessarily know what I'm talking about. So there are some private equity firms that are somewhat notorious for executing on a very prescriptive playbook after the acquiring companies. So financial or operational changes that they execute on pretty shortly after they acquire so Vista in the software space, Riverside constellation software, you know, these are three firms were pretty notorious for their playbooks. I'm curious, does TorQuest have a playbook, whether it's a formal one or an informal one that you tend to execute on? And if so, what are some other more common changes or additions within that that that playbook, quote unquote?

B**Brent Belzberg 46:35**

For sure we do, because we tend to buy businesses from entrepreneurs in transition. So the first thing we do is is make sure we have 100 day plan, generally not something that the entrepreneur has had. Second of all, he's usually not spent enough money on systems, ERP, etcetera. So we generally have to spend that on almost every business we've done. Data Analytics is something that he or she generally has not done a lot of, because they have relied on gut, and we can't. So we do a lot of that as well. We help educate them on the M&A platform for that business, which is generally something they haven't done before. Because they tend to always grow organically, we always put a board of directors in place that has mostly outside directors from the industry. And that's turned out to be very successful for us historically, it gives a third party look at our transactions and allows us to learn from them as well. So that's just some of it. We do lots more than that, but but we do those things almost every time.

S**Steve Divitkos 48:09**

I'm curious to know about your experience with these 100 Day plans, because in my world, what is most frequent is that 100 Day plans are written during due diligence when the entrepreneur is outside of the business. And I often kind of joke that you'll learn more about your business and the first month running it, then you will have learned in the 12 months of due diligence that preceded it. So when people ask me about 100 day plan, admittedly, this is in a different context and yours. You know, I use that line from Mike Tyson. He says every boxer has a plan till he gets punched in the face. Which is to say that a lot of 100 Day plans kind of end up in the garbage on day two. I'm so curious, what is your experience with 100 Day plans? How often do you actually execute on them versus not executing on them for any number of reasons?

B**Brent Belzberg 48:55**

So I didn't say that we put in place the same plan that we had during due diligence, we learned a lot during due diligence. And in the first month that we own the business, we sit with the guy who's running the business or the woman who's running the business. And we sit with the new board of directors and we amend everything that we thought made sense and set priorities against them with the management team. Sometimes those changes take years, sometimes they're thrown in the garbage and they never made any sense whatsoever. We now have a team of three value added people who educate themselves on the earnings that we have in our due diligence, and discuss those and give copies of all those reports to the management team once we close the transaction. And then between the value added people the management team and our deal guys, we come up with a new 100 day plan that's not always even similar or the same as the one that we came up with during our due diligence.

S**Steve Divitkos 50:05**

Now, every 100 day plan is going to be different across companies, of course. But if you were to zoom out, what role does pricing of the product or service play in that 100 day plan? And the reason why I asked that question is because, in my very limited experience, both as a CEO as an investor, I've noticed that pricing is a lever that is often pulled quite early, it's a low friction, high margin way to make a change. And it pricing is a discipline that often isn't done terribly well. Speaking very, very broadly. I'm curious, if you were to zoom out, what role does pricing tend to play in your, in your 100 Day plans or your value creation plans more broadly?

B**Brent Belzberg 50:46**

So often, it's very difficult to answer in recent days, because everyone's increasing pricing due to inflation, it's really more interesting is how much margin expansion there is in the businesses afterwards, of which pricing is a part of it. You know, we're good listeners. And obviously, the people, if they stay there who ran the business before, have their own preconceived ideas about how much pricing power you have in your transaction. Our value added people spend a lot of time on that Friday provide data to give confidence to new CEOs that they can affect exercise that lever. It's work sometimes. And, you know, in some of our companies, we're seeing gigantic growth in that. In these times, when you see volume slowed down, you never really know if it's because of pricing are you've lost market share? Or are you overdid it, so it's gonna be interesting to watch over the next little while how much effect that has.

S**Steve Divitkos 51:43**

In speaking of unanticipated things happening, I mean, in my little corner of the universe, where we're buying very, very small companies, from their founders, who often have been running them for 20 or 30 years, the investment base case, by the entrepreneur buying the business, of course shows margins in the first year acquisition going up by like 100, or 200 basis points. But what actually happens in almost all instances is they realize that the business has under invested in tools and software and system and people and infrastructure. And they have to make those investments. So more often than not the margins go down in the first year, because they're making the investments that are ultimately going to pay off in years, three, four, and five, what is your experience been with respect to having to make those like infrastructure type investments early on, and what that does to margins in the first year post close?

B**Brent Belzberg 51:59**

That's true 100% of the time in our businesses 100% of the time, we tell our investors, we're going to have a Jaykar. In fact, if we paid seven times EBITDA for a business, we tell people, we've paid eight or nine because of the amount of investment we need to make, to ensure that that that we can achieve the strategic plans that we put in place. The interesting part is that for the last 20 years, there's been nothing but growth. So every investment you make looks good, because the world has gone in one direction. Over the last year or so, it's interesting, it'll be very interesting to see what the effects of all that expenditure of those expenditures are, when you have a market where unit volume as opposed to row sales are going down, as opposed to up.

S**Steve Divitkos 53:45**

We've talked about pursuing inorganic growth strategies, naturally through acquiring smaller firms. You mentioned in your first fund, I think it was maybe your second fund, you attempted a roll up, but it didn't really work out. And I know since then you've pursued some inorganic growth across your more recent funds. Again, if you were to zoom out across all of your funds, what are some of the more generalizable lessons that you've learned over the years about both the merits and the risks of pursuing a primarily M&A based growth strategy?

B**Brent Belzberg 54:19**

So the only way it really works if you are a true strategic buyer, and the only way it really works is if you have strong management in your first acquisition or near the beginning of your plan. If you think that one dental clinic added to a second dental clinic, added to the third Dental Clinic is worth twice the multiples. That has been the history over the last 10 years and we don't believe it. So have we missed a whole bunch of opportunities? Yeah, we've missed a whole bunch of opportunities, and we've given them to others. We gave another fund in Canada, veterinary roll up, we gave another fund in Canada a dental roll up where the strategy really is that if you buy these things at four and five times and you put enough of them together, they're worth 12 to 15 times. You know, maybe that's true, but there's a lot of operational stuff that needs to be done, be able to achieve it. And we historically haven't felt like we have the ability to do that. So we have not pursued that what we have pursued is more major acquisitions of a true strategic nature where we have a product that is selling well in Ontario, and that if we had an Alberta base and a PC base, we have national customers, and that has worked for us way better, but only where we have strong management in the first place. The mistake we made was we did more of the ladder, where we put a bunch of people together really where there was almost no synergies, and that was a problem. Everyone claims that there are lots of synergies, usually, those are, you know, financial reporting, centralized buying, things like that, they almost never happen.

S**Steve Divitkos 56:39**

Your emphasis on day to day management and execution is, you know, reminds me of something that a friend and mentor of mine said that he was a CEO that pursued an inorganic growth strategy. And he said, they should be called integrations, not acquisitions, because everyone is so focused on like the, you know, the glittery acquisition, but at the end of the day, he said, you should only do a roll up strategy. If you like merging payroll systems and consolidating banking relationships, and figuring out what CRM system to use, I thought that line has stuck with me for a long time.

B**Brent Belzberg 57:16**

He or she is so right. When getting more and more size means that you're tripling your multiple on ACC on exit, very hard to concentrate on the things that really matter.

S**Steve Divitkos 57:35**

So strategically, I was going through TorQuest's website, even though I'm familiar with you guys, I wanted to kind of refresh my knowledge. And I noticed that your portfolio doesn't contain many software or technology investments. And I'm wondering if you can explain why is this a deliberate decision? Has it just kind of worked out that way? And is it becoming harder given that software and technology companies are now representing a greater and greater percentage of North American GDP?

B**Brent Belzberg 58:00**

So we haven't done a healthcare transactions to speak of either. We don't do a lot of resource transactions, either. There are a whole bunch of sectors that we just don't have the expertise on. We met a guy last week who was a software guy, and, and we would have hired him and, and put him in our shop, to do software. acquisitions. Technology generally is very different, the principles around buying it and the principles around growth, and the size of the transactions that are very different than what we've historically done, takes a very different talent pool. Actually, it comes from knowing who the funders are, and being able to do subsequent rounds at higher and higher prices. And working in minority positions, none of which we're comfortable with. I know that we have the expertise in any of those areas. And there's been so much capital provided to those spaces, that the opportunity to buy things that needs some work, even though constellation that was their original thesis has tended not to exist for the last five years. And so maybe it will exist again, and maybe now is the time to actually look at some of those spaces. But we would only do it if we had the right person in our shop with the experience in that space.

S**Steve Divitkos 59:54**

What role does valuation play in that decision? Because I have to imagine that someone or a firm who is used to paying, let's say, mid single digit EBITDA multiples, it might just feel flat out wrong to pay mid single digit revenue multiples, even though you know, you can intellectually explain why a software company is more deserving of a revenue multiple than a widget company would be of an EBITDA multiple. I'm just curious, like, what role does valuation play, if any, in your decision making process to be lighter touch on software and technology investments?

B**Brent Belzberg 1:00:33**

So again, it's an amazing question. And the person we were talking to, didn't believe we would be able to make that transition from paying mid mid to high single digit EBITDA multiples to the same numbers on the revenue side. And I think he'll end up going to a place that only does that part of the business. He might be right, I think he would have had more independence here and be happier here. But you know, the truth is, because of things we talked about earlier, which were Jay curves, and the amount of money you spend on transactions, once you own them, if they're not that sophisticated, and the amount of money you spend on M&A, you really are buying a platform and a lot of cases to do a lot of things too. So even though on its face, it looks silly, and looks usually different isn't actually that different when you come to me.

S**Steve Divitkos 1:01:45**

Even though I'm a software entrepreneur, and software investor myself, I still have a hard time paying revenue multiple for something. Whereas other parts of my portfolio, I'm paying a mid single digit EBITDA multiple. Again, it's explainable, but I don't know, I guess after years and years of training, something about it just feels very uncomfortable.

B**Brent Belzberg 1:02:06**

What I always say is that the value of a business is the present value of future cash flows. And the difficulty is the bill, the the predictability of cash flows in our businesses appears to be a lot clearer than it does in a business where you have to continue to get revenue growth, and you don't know when that's going to translate into cash flow. And so we have struggled with it. And I think that young man probably knows that. So that might be a risk that that he shouldn't take, and probably maybe we would never have got there with.

S**Steve Divitkos 1:02:53**

Brent, as we conclude here, I'm gonna end off with a bit of an odd question, but I'm so curious to hear your response. So all of the following terms will describe you in some way. But I'm wondering which of the following do you think best describes you, I should say, so, founder, entrepreneur, investor, operator, or business builder, I know you're kind of all of them. But if you had to pick one that best describes you which one feels right?

B**Brent Belzberg 1:03:25**

So our business has translated it to asset management, right. And we do not see ourselves an asset manager, we see ourselves as investors. And sure, not every investor could have started something on their own and gone and committed to a lease when they had no commitments, and picked a name and hammered it on the wall. So we think we're founders and entrepreneurs. But the only way we have long term success is being a good investor. And so that's how we've at least transitioned to that. And I think that's the only thing that will protect us for the long term.

S**Steve Divitkos 1:04:17**

I mean, individually. I mean, like I said, you're all of those things, right? So I'm wondering, as the builder of this business, of course, you know, you've been helped by your team in a very real way over the years. But as the founder, I mean, you are very much an operator. In this case, you're not running a widget business, you're running an investment business. Do you ever find a personal connection with the sellers that you're dealing with on hiring and firing and incentives and organizational design and culture, all of the stuff that you know, business builders need to deal with? Do you ever find that you kind of use your shared experience with them as a source of personal connection? Because in my experience, like I often say, the only one way to know how to be a CEO is to be one. Similarly, the only way to know what it's like to be a founder is to be one, do you ever find that that's like a shared personal connection of sorts with the sellers that you're buying these businesses from?

B**Brent Belzberg 1:05:13**

It's no wonder people invest with you, Steve, because your questions are better than anybody I've ever met. But you know, it is my value added today to this firm. And in that I can sit with founders and understand exactly what they're going through. You know, most of them have kids who could be in their business and generally aren't, most of them have a love for their business from because they've been there since there was nothing there until they have where they are today. Most of them are having a hard time giving up authority or control. You know, we do have lots in common with those, I do have lots in common with many of those people. And even though the write ups often say, the guy is in Florida, or the woman's in Florida all the time, and she's not really there on a day to day basis in her business. I never believe that. Yeah, me neither. And so I always giggle it's become the joke around here, because they say at a time, I know what you're going to say. And I always say it at every investment committee meeting. So yes, that that was our the people I feel most common with. And as I've told you, when I talked to my kids, I say you want to be them. Because it's them that you should honor, it's not one more person in Bay Street. And I've said that to you a lot of times too. So I truly believe it. And so I say it's easy for me, because this is my business. I'm not just an investor. But I, you know, the common skill that you have to have, you know, I could never be in a business where I sat behind a desk all day ran models, I couldn't do it being close to people who have actually built their business and understand how they did it and understand what risks they weren't willing to take, and maybe we can take those risks today for them. And they could share in the upside with us. That's what we try to achieve around here.

S**Steve Divitkos 1:07:45**

So I said that was gonna be my last question. I promise. This next one will be my last question, because I know we're coming up on time here. And I was reminded of this, because we're talking about the things that only founders and only entrepreneurs can relate to. And the first thing that came to my mind when we're talking about that, is this idea of kind of having your identity wrapped up in your business. So for me, this would manifest as a bad day at work became a bad day at home. And if I was experiencing challenges at work, inevitably bleed into my personal life, and I really never mastered the art of compartmentalization. And this is a reason why when a lot of people sell businesses, which I know you've seen this, they struggle, right, they feel like they've lost a part of themselves, they feel like they've lost a big part of their identity, as a founder and as an entrepreneur yourself. How have you thought about this? Because you know, we're all going to exit from our business in one way, shape, or form one day. How have you thought about what does Brent look and feel like no longer with TorQuest?

B**Brent Belzberg 1:08:45**

It's what I think about 100% of my day. I wish I had the answer to it. I don't have the answer to it. Rationally, I know what has to happen or this place to have a future way beyond me. And rationally I'm constantly looking for the person my organization that's going to say if you started with no brand, you now have a brand. You've started with no people, you know people. You started with no investor relations, you now have investor relations. You started with no deal flow, you now have deal flow. If I could take all that. Here's what this place could look like 20 years from now and that's what you're waiting for. And if somebody does that, [inaudible] over quickly, which is what I've always done around here, that person. And so that would make it easy. And and so you're hoping that amongst your organization, not in one person but in in all of them together that you in fact have that and I think we've done a great job in that and there will be a time when you know, I want to be Warren Buffett, not that I ever would be it, I don't want to be Jimmy Patterson. Not that I ever could be. I want this place. I want this place to grow way beyond me and be way more successful a bunch of years after I'm gone. And so that today has become more important to me then what it will do to me personally if I'm not here.

S**Steve Divitkos 1:10:30**

Yeah. Well, I have to thank you for being so generous with your time and your insights today. I mean, you mentioned earlier the fact that torquest didn't have any turnover, which is ridiculous in the best possible way. And it's no surprise to hear that given the leader that they have at the helm. So thank you for your time and your insights today. We really appreciate it.

B**Brent Belzberg 1:10:53**

Thank you, my friend. Nice to talk to you and your brilliance in your questions is unmatched, and I'm making me uncomfortable at moments you prove exactly what you're so good at. So thank you