FORTUNE ARTICLE – "WOULD YOU GIVE THIS MAN YOUR COMPANY?"

Mattel did, handing him its Learning Co., Micron paid him to take its PC unit. So who is Alec Gores, and why are the FORTUNE 500 unloading their tech divisions on him?

May 28, 2001
by JULIE CRESWELL

HUDDLED AROUND THE DESK, THE THREE men with their shirtsleeves rolled up and brows furrowed stare intently at the phone. Colleagues scattered around the country are weighing in on a troubled division of a large tech company that buyout firm Gores Technology Group wants to take over. The deal is hitting snags. There are vendor contract and real estate issues; more critical, the company is in a free fall, argues one employee. The call's focus is quickly shifting from how much money Gores can make to how much it could lose. On one side of the desk sits Alec Gores, the firm's 48-yearold founder. His eyes keep wandering to the window where the Los Angeles afternoon sun seeps through slatted blinds. He asks some questions during the call, listens halfheartedly to the answers, and for the most part stays quiet. As the call goes on, Gores pushes up from the desk and heads to the back of the room. "This is a very complicated deal," he says, smiling as his small, wiry frame sinks into an oversized black-leather chair. "I give it about a fifty-fifty chance. But that's okay. I don't need this deal. There are a lot out there." The melt down continues. FORTUNE 500 companies— pressured by Wall Street and disillusioned with tech—is trying to unload noncore or money-losing divisions at fire-sale prices. Venture capitalists stuck with cash-starved tech startups and a looted IPO market is hoping to sell or partner up. All these factors mean one thing: glory days for Gores. Never heard of Alec Gores? You will. Until recently, Gores was known more for having a name reminiscent of the guy who didn't invent the Internet than for the 35 tech companies his firm has acquired since 1990. Most of his targets have been small, with revenues between $5 million and $50 million. But that changed last October when Mattel rid itself of the Learning Co., the educational and entertainment software group that the toymaker bought for $3.8 billion in 1998. The Learning Co. was supposed to lead Mattel into the Digital Age. Instead it wrecked CEO Jill Barad's career, scarred Mattel, and racked up losses of $1 million a day. Barad's successor was so desperate to get rid of the bad-luck charm that he gave it to Gores free. Just over two months later, TLC turned an operating profit. And with that Gores earned his own name in the tech world. In late April, Micron Electronics paid Gores $70 million to take over its money-losing PC business. In mid-May he bought Hewlett-Packard's VeriFone division, best known for its ubiquitous credit card readers. And by the end of this year, Gores predicts, he'll sift through hundreds of deals, acquire about ten companies with revenues above $100 million apiece, turn around half, and gain some sort of boost in the rest. The secret to Gores' sudden popularity is more than just timing. He has earned a reputation as someone who can not only repair broken companies but also come up with creative deals. are in disrepair or being managed poorly and that can be righted quickly. Generally the tech firms he acquires share three criteria: They have strong cash flow (the key to Gores' making money from the deal); they are small divisions of large companies (offering plenty of opportunities to cut fat); and the seller wants to move quickly (eliminating bidding wars). Then Gores takes a back seat, turning loose his financial and operations managers. His financial wizards—culled mostly from the legal world and Big Five accounting firms—comb through financials, real estate agreements, and supplier contracts, looking for hidden bombs in the numbers. The operations group meets with management and employees, looking for ways to restructure and cut. On the occasions when Gores needs to pay for a deal, he fronts much of his own money and also taps into his tight relationship with Foothill Capital, an asset-based lender owned by Wells Fargo. After a company is acquired, Gores sends in his so-called SWAT team, a fast-moving 20-person group based in Boulder, Colo. The team quickly takes over top management positions at the company. All bases are covered—from the in lieu of cash for the Learning Co., Gores agreed to give Mattel 50% of any profits and part of any sale of TLC. "That was a unique structure," says Jeff Raich, an investment banker with UBS Warburg who has worked with Gores on deals. "By taking no money up-front and a part of future profits, Mattel was saying it had a high level of confidence that the Gores team could fix the business." Despite his work, Gores is no Excel-loving, HP-17B calculator-wielding ex-Wall Streeter. He is a big-picture guy who loves strategizing but gets lost in the details. On a recent evening Gores picked up a reporter in a new car—a midnight blue Mercedes-Benz. Cruising Rodeo Drive, Gores points out the car's features, lingering on the five-inch color LCD screen used for phone calls and GPS navigation. But ask him the model type, and he pauses, bumbles it, and finally gives up, laughing. He doesn't know. (It's a Mercedes Class CL55 AMG that retails for $99,500.) "Alec is definitely not a details guy," says Dave McGovern, a former mergers and acquisitions lawyer and Wall Street banker who heads up M&A for Gores. "That's what he's got us for." "Us" is a group of 40 or so people who work for Gores. (Yes, he's not really sure how many employees he has.) Like some financial version of the Dirty Dozen, each team member plays a specific role. Gores sets the guidelines, targeting companies that executive level to accounting to real estate and human resources. "As well as having people who know how to do financial transactions, his team can parachute into a company and figure out what needs to be fixed," says Raich. "There's not a lot of companies on the planet with that kind of financial and operational expertise." Once in, the goal is to get out. Gores claims that of the 35 companies he's bought, 12 have been sold for a profit, two have broken even, and the others he either still runs or has shuttered. With the Learning Co., Gores sold the entertainment division— home to cult computer games like Myst and Riven—to a French software company in March. "He spends time with management and tries to figure out what areas can show growth and be profitable," says James Marasco, a managing director at Foothill. "Alec isn't a pirate." IT'S NOT SURPRISING THAT GORES operates differently from most Wall Street buyout artists. His background is entrepreneurial, not financial. Upon arriving in the U.S. from Israel, Gores' father opened a grocery store, and Alec, the oldest of six kids, bagged groceries. In 1978, a few years after graduating from Western Michigan University, Gores borrowed $10,000 from his father and started a distributor business for CADO, a mini computer maker. E-CORP Headquartered in his parents' basement, Gores spent years traveling the state, selling systems. In the early '80s he sold his operation to Contel Corp. (a telecom company long since bought) for $10 million. That might have been the end of the story, says Gores, if Contel hadn't screwed up the business. It cut commissions to salespeople and let a profitable sideline software business slide. Gores was so enraged that he tried to buy his company back but was outbid. Bored and looking for something else to do, Gores hooked up with Art Pronovost, an older man who had also been a CADO distributor. Gores had a plan: The two would buy broken companies and try to fix them. Getting started proved difficult. "We had experience in starting and operating companies, but we didn't know how to buy them," laughs Pronovost, 74, from his Florida home. For two small players, getting any attention was hard. Gores was determined to be noticed. In the mid-'80s, Gores set his sights on word-processor maker CPT but needed cash. He and Pronovost visited the Drexel Burnham offices in L. A. to wait for a meeting with a friend of a friend. And they waited. "We sat in the lobby through the morning, and then through lunchtime. You couldn't get Alec to leave. We even saw the guy we were supposed to have the meeting with walk right by us," says Pronovost. Nothing ever came of the day, but Pronovost had seen firsthand Gores' dogged ambition and single-mindedness— something that would come in useful as Gores started negotiating with larger and larger sellers. "My ego got hurt, but it just didn't bother Alec one bit," says Pronovost. Over the next few years Gores continued to buy smaller companies, selling off some, staying in others. The big score came with TLC. Gores heard plenty of warnings when he sent his team in to look at the Learning Co. "I told him to run, not walk, away from this deal," recalls Jim Bailey, group president at Gores. "The numbers just didn't add up," adds CFO Cathy Scanlon. Yet Gores was frustrated at losing out in another deal he had wanted— Silicon Graphic's 2000 sale of Cray Research—so he pushed his team on TLC. "I really loved Cray. We had the management team to fix it, but we got too caught up in the company's financial problems," says Gores. "Losing that deal made me really step up to TLC." Why was at first unclear. The company was a total mess. The software firm's revenues were slumping, and it was losing crucial CD-ROM market share. "It was like we were fighting a brushfire that couldn't be contained," recalls Vance Diggins, president of Gores Technology, who headed up the Learning Co. team. Spending had gone out of control at the unit; Gores knew there was fat to be cut. That became readily apparent on his first trip to the company, when the elevator doors opened on an empty reception area. Empty, that is, except for four guards standing around looking bored. The further Diggins and his group dug in, the more problems they found. The company had been operating as seven fairly autonomous units that didn't share resources. "We knew things were bad when we organized an executive staff meeting, and three of the unit's general managers had never met one another," says Bailey. "And they had been working in the same complex." The Learning Co. was supposed to be the digital savior for Mattel; it was, in fact, a disaster. The Gores team had no higher view of the company. In a matter of weeks Gores figured out and executed what Mattel couldn't see over a period of months. The team restructured TLC's seven units into three, set strong controls on spending, sifted through 467 software titles to focus on the key brands, and repaired relationships with distributors. "This wasn't all that different from what we've seen in other turnarounds," says Gores, shrugging his shoulders. "Nobody [at Mattel] was facing the facts and trying to figure out how to fix the bleeding." The endgame for the Learning Co. is now in play. Gores has sold the entertainment division and has small plans for the rest of the company. Software sales across the industry are expected to be flat this year, but Gores thinks that by concentrating on a few titles like Carmen Sandiego, Reader Rabbit, and PrintShop, it can win market share. Gores is also revamping one of the company's Websites, allowing customers to purchase or download products or get free upgrades. Over the next few months Gores' team will transition out of TLC. One or two members will stay on its board, but day-to-day operations will be run by insiders. Which frees the SWAT team for its next mission impossible: Micron's PC group. In late April, Gores took over the ailing PC unit from giant Micron Electronics. It has all the ingredients of a classic Gores turn around. Micron wanted to focus on its Web-hosting business, not its money-losing PC group—a second-tier PC producer that has struggled to compete with rivals like Gateway and Dell. Micron tried to sell the unit but got no buyers. It could have shuttered the division, but that would have cost more than just giving it away. Micron's CFO and Gores started talking. About two months later the company agreed to pay $70 million for Gores to take over the business. In return Micron gets a piece of any sale of the group for the next three years. If there is any sale. The economy's slowing, big companies aren't buying, and tech has lost its allure. That doesn't bode well for the unit. But the longer things stay this way, the more deals there will be. And Gores has that big picture in mind.