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## From bootstraps to big time

In order to keep control of their company, the founders of Valerus Compression Services have opted for debt rather than equity financing

Houston Business Journal - by [Casey Wooten](#) Houston Business Journal

For the most successful businesspeople, compromise isn't part of their vocabulary.

So when Mike McGhan and Charles "Chet" Erwin, along with four other co-founders, started **Valerus Compression Services LP**, they knew that, in order to be the best, they couldn't hand over control to someone else -- even if it meant taking a few risks along the way.

In the past four years Valerus has experienced massive growth. The natural gas services company boasts figures anyone would be proud of. From 2004 to 2005 revenue grew 445 percent to \$78 million. A year later, growth was another 120 percent to \$173 million. And to make room for an expanding work force, the company recently moved its corporate offices into a posh downtown building.

But the explosive growth is only half the story. Taking advantage of a favorable climate to obtain debt financing, Valerus' co-CEOs, industry veterans McGhan and Erwin, fueled the company's expansion without giving up much equity and created an environment of co-ownership within their company, an atmosphere they say was a driving force in their success.

Valerus got its start in 2002 after Erwin, McGhan and four other senior officers left what was then the leading provider in full-service natural gas compression, Hanover Compressor Co.

McGhan and Erwin -- who had helped start Hanover in 1990 -- were bound by a two-year, non-compete clause that expired in August 2004. The day after it expired, both signed on to Valerus with the rest of the founders, who had begun building the company.

"We felt like our story wasn't completed -- what we had set forth to do with Hanover was not completed," McGhan says. "We wanted to go ahead and finish what we thought we could do, and we chose to do it with Valerus."



Craig Hartley/HBJ

Mike McGhan, left, and Chet Erwin, Valerus Compression Services: Used their past fortunes and misfortunes to chart a successful course for Valerus.

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Both McGhan and Erwin say that the timing couldn't have been better for starting up a new company within the natural gas compression industry. Both executives had kept a close eye on the industry for more than 20 years and knew its ins and outs better than most. Both say that the climate in the industry was ripe for a new competitor and, with their combined years of experience, felt they were in the best position to succeed.

But, as with any new startup, the pursuit of reward meant taking a few risks.

To get Valerus on its feet, the founders needed cash, but McGhan, Erwin and the rest of management didn't want to surrender their equity to a venture capitalist or similar investor. Instead, Valerus' management made the decision to grow by its bootstraps, securing capital any way it could without sacrificing ownership.

"We chose to form Valerus a little differently than we formed Hanover," McGhan says. "At Hanover we had a venture capital player step in early and own the majority of the company. With Valerus we wanted to make it a management/employee-owned company."

Valerus' founders decided to risk everything they had to get Valerus where it needed to be. McGhan, Erwin and most of the others signed personal guarantees for the majority of their net worth to secure Valerus' initial funding.

"I think the war cry was, 'Failure is not an option,' " Erwin says.

Valerus also received financing from another source -- family and friends of the company's management. Through a convertible debt feature, the company was able to raise about \$6 million. A second round produced an additional \$5 million.

Thanks to their success starting and running Hanover, McGhan and Erwin didn't have any trouble convincing those around them to show a little faith.

"They watched the success that we had in our prior career and all of them wanted to be part of this," McGhan says. "There was no strong-arming at all. In fact, we were oversubscribed both times."

Throughout Valerus' short life, McGhan, Erwin and the rest of the team have made it a priority to maintain ownership. Management has retained a 70 percent share in the company. McGhan and Erwin say their experience at Hanover taught them the value of keeping a meaningful stake in the company and, in starting Valerus, the two set out to create a cooperative environment.

"When you're an owner in a company, you wake up and you get up with a little different attitude in the morning," Erwin says. "You are not there for a paycheck, you're there to build a company and provide the best service in the industry and to work together amongst the management team and the employees. It really and truly creates a family atmosphere."

McGhan and Erwin have used their past fortunes and misfortunes to chart a successful course for Valerus. With more than 50 years' experience in the industry between them, they have seen just

about everything. When forming Valerus, both decided some things would be different than when they created Hanover and, in their opinion, things couldn't have worked out better.

Among the lessons learned at Hanover, they say, was the need to establish a quality accounting system. McGhan and Erwin spent time and resources implementing the industry-leading software to help them keep the books. Both say they have more timely information than they ever did at their previous company.

Valerus' ability to expand without giving up much equity is rare in such a capital-intensive industry, Erwin says.

McGhan and Erwin both agree that avoiding the temptation to give up equity when getting the company started was hard. That was how they had done it at Hanover, but both say that maintaining ownership -- even if it meant being short on capital for the first few years -- was best for employees and management alike.

As Valerus grew, though, management realized that, of its three primary businesses, compression equipment rental, production equipment processing and after-market parts and service sales, the rental business was by far the most profitable -- and the most capital intensive.

Financing from within had run its course, and if Valerus was going to grow, McGhan and Erwin knew it was going to need some outside help.

Through long-time acquaintances, McGhan and Erwin found the help of Sanders Morris Harris Capital, an asset management, wealth management and capital markets services group. The team at SMH shopped Valerus to a number of different investors, gaining the interest of several.

Valerus and SMH eventually secured a \$165 million credit facility, based on the value of Valerus' rental fleet, with Guggenheim Partners LLC. Quentin Hicks, an associate at SMH who participated in the transaction, believes that management's track record of success in the industry, combined with Valerus' solid asset base, motivated Guggenheim Partners' competitive offer.

"When they first came into this deal the company already had a year to two years of solid growth -- exponential growth -- and there was nothing on the horizon that was going to show that it was going to stop. And it hasn't stopped," Hicks says.

As McGhan and Erwin had wanted all along, the deal avoided giving up much equity, opting for debt instead. It was a win for the company. Valerus could expand and still maintain its independence.

### **Maintaining independence**

Valerus' ease in finding the right debt financing package came largely from being in the right economic climate. Hicks says the capital market is becoming more efficient. The trend is more fluidity in the market and transactions are becoming more transparent, which leads to a more vibrant investment atmosphere.

Investors today, Hicks says, are more enlightened, which he credits to the explosion of hedge funds and alternative investors.

"You're just seeing a lot more money splashing around on the market looking for returns." Hicks says.

Hicks adds that, unlike Valerus, companies looking for their first source of capital often go directly to private equity while overlooking the availability of private lenders. Hicks believes the investing world is changing. With the increasing liquidity of the private capital market, some early-stage companies that would not traditionally have access to debt capital now do, primarily through alternative lenders.

With cash in hand, Valerus has a bold plan for the future.

McGhan and Erwin plan to drive Valerus' rental fleet, its most profitable section, to the point where it is the primary source of revenue for the company. They want to add 150,000 new horsepower every year going forward, as well as processing and treating facilities to continue to expand the company. In addition, Valerus is expanding internationally into Southeast Asia, South America and the Middle East.

For McGhan and Erwin, Valerus' future looks bright. By drawing on their past experience, not giving into short-term temptations and timing Valerus' growth just right, management has seen the company boom in the past three years.

"We chose to use the bootstrap approach," Erwin says. "And I think a lot of people in the industry watched what we were doing and scratched their heads and couldn't figure it out.

"But we felt like we had a plan, and we stuck with it. And it appears to have worked."

### **Valerus Compression Services LP**

Founded: 2004

Top executives: Mike McGhan, Charles "Chet" Erwin, co-CEOs

Employees: 700

Revenue:

- 2004: \$14.48 million
- 2005: \$78.95 million
- 2006: \$173 million

Business: Natural gas services

Web site: [www.valerus-co.com](http://www.valerus-co.com)

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