Crossing borders

Castle Harlan taps global relationships to nurture an Australian affiliate

by Vyvyan Tenorio

It wasn't the best of times. Australian mining toolsmaker Bradken Resources Pty. Ltd., a portfolio company of Sydney-based Castle Harlan Australian Mezzanine Partners Pty. Ltd., was due to go public in May, but the market was less than hot for it.

Not that the company itself wasn't up to snuff. It was performing very well, says Howard Morgan, a managing director in New York-based Castle Harlan Inc. and a board member at Champ, as the affiliate is known. The problem was in part that the Australian markets had become skeptical of private equity firms that were perceived as unloading stocks on unwary investors. So underwriters Goldman Sachs JBWere Pty. Ltd. and Credit Suisse First Boston pulled the offering.

Two months later, the IPO was back on. Goldman had just finished a successful IPO for a similar company, Bucyrus International Inc., a South Milwaukee, Wis.-based manufacturer of excavation equipment. Sensing a turn, the Goldman affiliate dusted off Bradken's filing.

This time, the head of Goldman's global equity capital markets, David Solomon, "gave it his global imprint, that they really thought they could get the deal done," Morgan recalls. Goldman fully underwrote the issue, which it rarely does on global offerings. The IPO was done in 10 days, overcoming the August lull, and raising about A$245 million ($178 million) for Bradken.

The company's successful IPO was icing on the cake for Champ and Castle Harlan, which owns 50% of the partnership. The company had posted a 38% rise in Ebitda, to $48 million, since its LBO in 2001, and investors had recouped most of their original investment in a A$50 million recapitalization in July. But the IPO, combined with retained stock, helped Champ lock in a 3 to 4 times return on its cost.

No doubt, having Solomon's—and Goldman's—full support was a big help. Like other Champ deals, Bradken was one whose successful outcome was ultimately driven by Castle Harlan's Champ partners and facilitated by close links with the financial community across borders.

Morgan has plenty to crow about. Bradken was a product of Castle Harlan's successful, 4-year-old partnership with Aussie private equity veterans William Ferris and Joseph Skrzynski, Champ's founding principals. Ferris created the country's first venture capital firm in 1970 and is regarded as one of the fathers of VC in Australia who quite literally wrote the book on it, entitled "Nothing Ventured, Nothing Gained."

Ferris (left) and Morgan: *buyout venture*

Ferris and Skrzynski were long-time partners at Australian Mezzanine Investment Trusts, the predecessor to Champ. In 2000, Castle Harlan acquired a 50% stake in their partnership, renamed Champ, which raised a $350 million fund.

At the time, Castle Harlan was looking to grow outside the U.S. Though Australia's population is only 20 million, Morgan and his colleagues were impressed by its resiliency amid Asia's devaluation crisis in 1997-98. They were also encouraged by it already having an institutional framework for buyouts. It so happened that Ferris and Skrzynski were also looking for a U.S. partner with middle-market experience because "we believed that the LBO business would build up in Australia," Ferris says.

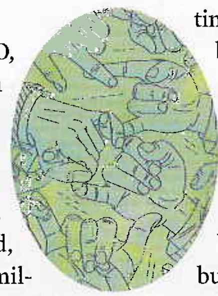
Their instincts proved right. In June, Champ scored its first realization when it sold Penrice Soda Products Pty. Ltd., an Adelaide-based maker of soda ash and baking soda, to two Australian private equity firms for A$110 million. That gave Champ's U.S. investors a 54% internal rate of return. A recapitalization of another company, Australian Pacific Paper Products Pty. Ltd., the country's second-largest maker of disposable diapers, allowed Champ to recoup its A$20 million equity.

For transactions, Champ managers have tapped investment bankers, such as J.P. Morgan Chase & Co.'s Steve Brimo and Mark Brown, and Goldman's local partners, to provide debt financing, brokerage and advice. Champ developed close ties with J.P. Morgan early on, when the bank brokered Champ's Penrice purchase. To finance the A$85 million deal, Brown offered 75% leverage, high for Australia at the time.

Bradken was an example of those relationships at work. Ferris, the project manager, worked closely with Morgan, who was living in Sydney to get Champ going, along with other key Castle Harlan staff. When Champ bought the company, Brown, who had also relocated from New York to head up financial sponsor coverage, came in with an "aggressive leverage that enabled us to make our financial models work at the required price," Morgan says.

"Mark had the support of J.P. Morgan

globally and was able to get its Australian office to bid aggressively for the debt financing," he adds. While the bank is a small investor in Champ, Morgan maintains that "there are no guarantees, no strings attached" to that investment.



When it came time for an IPO, however, Goldman and CSFB won the mandate. Bradken's offering in May seemed to be going well until the last week, when the underwriters suddenly faced a tepid response.

A few days after the IPO died, Morgan ran into Solomon at a Hamilton College reunion in upstate New York. Solomon didn't know that Bradken was Champ's deal and was surprised when Morgan complained.

Buoyed by Bucyrus, Goldman JBWere pushed Bradken out again, promising to do the IPO in 10 days. "Even David was a little skeptical at first," Morgan says. (Goldman doesn't have full control over the Aussie affiliate, the only global unit that doesn't report to Solomon.) Still, Solomon gave his blessing, and the IPO sailed through.

One of Champ's most promising investments so far, Austar United Communications Ltd., also benefited from those relationships. Austar is the country's second-largest pay-TV company, with exclusive rights in all but the major Australian cities and the sparsely populated Western Australia. In April 2003, Champ bought 81.3% of the listed company, along with Denver-based broadband services provider United-GlobalCom Inc., a unit of John Malone's Liberty Media Corp.

How Champ engineered the complex, cross-border deal is a tale unto itself. Austar was restructuring, a consequence of its diversion into Internet content, away from its core business of delivering satellite TV to rural areas. But to gain the controlling stake, several events had to happen at the same time: Champ had to deal with bankrupt bonds, defaulted bank debt and a strict takeover law.

The odyssey began early 2002, when Morgan brought in former Austar CFO Jonathan Morphett, then Morgan's neighbor and a member of his church, to do a study of the buyout opportunity. In May, Ferris and company proposed a restructuring plan to Austar CEO John Porter.

In 2001, UnitedGlobalCom, which had issued about $500 million in high-yield bonds to fund Austar's growth, had gone into Chapter 11 in the U.S. Two U.S. vulture funds held about 75% of the holding company junk. Morgan and Ferris flew to Denver to meet with UGC management while separately negotiating with recalcitrant vulture funds, which eventually agreed to the plan to buy them out in late 2002.

Meanwhile, Champ had to resolve a regulatory conundrum. By agreeing to buy the high-yield bond interest, Champ ran the risk of triggering the takeover law, in which a 20% acquisition bid forces the purchase of the rest of the stock at the highest price paid for the 20%. Without a guarantee from bondholders, though, Champ found itself in a chicken-and-egg situation. Regulators eventually granted Champ a private ruling that it would commit to buy all the equity only if it were successful in getting bondholders to agree.

At the same time, Champ set out to renegotiate the bank debt. J.P. Morgan's Brimo acted as the lead agent for the 16 banks involved. As luck would have it, Brimo was no stranger to the Champ crowd. Morgan had met him on one of his very first meetings in Sydney.

As Morgan puts it, "It was a difficult time—like herding cats—but Steve was enormously helpful in dealing with a very challenging group of bankers."

Since the deal was completed a year ago, the company's stock has soared. Ebitda more than doubled last year to A$56 million from 2002 on $240 million in revenue. So far, Champ has booked a 3.5 times unrealized gain on its A$85 million outlay.

On the strength of its performance, Austar is currently refinancing the legacy debt, with J.P. Morgan and Deutsche Bank AG as joint managers. The effort involves new debt of up to A$290 million and the issue of a retail-placed convertible debt dubbed Stars, or subordinated transferable adjustable redeemable securities, a hybrid security unique to Austar.

For Castle Harlan, having Aussie ties has proved invaluable in other respects. When the firm acquired a company called Ion Track Instruments, a maker of trace detection equipment in airports, in 2000, it flew in experts in ion spectrometry from Australia. Castle Harlan later sold the business to a General Electric Co. unit for 7.5 times cost.

"Our relationship [with Champ] is a two-way street," says Morgan, who still travels to Australia about four times a year. "We've learned a lot from each other and benefited from each other's relationships to the point where they're now collective relationships." ■

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