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Castle Harlan looks Down Under

Edited by John E. Morris

Those who see Australia as the remote outback of the leveraged-buyout world might want to take a look at the profits booked there recently by **Castle Harlan Inc.,** one of a few U.S. private equity firms with full-time operations Down Under.

After buying a 50% stake in the country's oldest private equity firm, Australian Mezzanine Investments Pty. Ltd., it formed Castle Harlan Australian Mezzanine Partners, known as Champ, and raised a $350 million fund in 2000. Now it's cashing in.

Champ recently sold portfol io company **Penrice Soda Products Pty. Ltd.** of Adelaide, the country's only producer of soda ash and baking soda, to two Australian private equity firms for A$110 million ($76.3 million). Champ acquired Pen-rice for A$80 million in November 2001 with only about A$22 million in equity— a deal notable at the time for its high leverage ratio.

Operational improvements and expansion have since boosted Ebitda to nearly A$24 million, from A$18 million in 2001, on revenue of A$125 million. It was auctioned off recently to Quadrant Capital, an affiliate of **Westpac Private Equity Pty. Ltd., and Colonial First State Private Equity Ltd.,** allowing Champ to chalk up a 54% internal rate of return for U.S. investors.

Penrice is the first realization from six investments by Champ. Soon a recapitalization of **Australian Pacific Paper Products Pty. Ltd.,** Australia's second-largest maker of disposable diapers, will allow Champ to recoup the A$20 million of equity it put into a A$55 million buyout in December 2002, according to Howard Morgan, a managing director of Castle Harlan who moved to Australia for two years to assist in setting up Champ and now helps oversee it from New York. Today, Champ has 30 employees, 12 of whom are investment professionals.

Perhaps its most promising stake so far is **Austar United Communications Ltd.,** the 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 acquired 81.3% of publicly traded Austar in partnership with Denver-based broadband services provider UnitedGlobalcom Inc., a unit of John Malone's **Liberty Media Corp.** Champ put up A$85 million in equity out of a A$120 million commitment.


Morgan

Ebitda more than doubled to A$56 million from 2002 to 2003 on revenue of $240 million, and Ebitda is forecast to hit A$86 million this year. The share price has thus soared. At the current share price of A$0.73, the deal has yielded an unrealized 4.9 times return on equity. (Only 18% of Austar is in free float.)

Not every investment has gone so swimmingly. A planned IPO of **Bradken Resources Pty. Ltd.,** a toolsmaker for the mining industry, had to be pulled. Part of the problem, Morgan says, was a longstanding perception in Australia that private equity firms took advantage of stock markets at the expense of investors.

"This criticism was a throwback to the historic skepticism over private equity firms as bottom fishers," says Morgan.

The problem was compounded by Champ's plan to sell all of its shares in the IPO. Champ wanted to keep a stake, Morgan says, but was advised by its bankers to sell them all to avoid a stock overhang—the possibility of block sales later that could depress the share price. It didn't help, either, that the issue was preceded by a wave of private equity-backed IPOs that have since declined in trading.

The first Champ fund is now 60% invested, and, Bradken notwithstanding, the results have validated Castle Harlan's original take back in 1998. Though Australia has a population of only 20 million, the Americans were struck by its resiliency amid Asia's devaluation crisis. Moreover, it already had the institutional framework for buyouts. A handful of the large U.S. players have set up Australian operations—including **Advent International Corp., GS Private Equity, Bain Capital LLC** and—but the country remains far off the radar of most global LBO shops.

Now Castle Harlan hopes its base there can serve as a stepping stone to Asian markets, particularly China.

"That's a story that's starting to unfold," says Morgan.

—*Vyvyan Tenorio*