INSIGHT

VIEW FROM: The US

HOWARD MORGAN, CO-PRESIDENT OF CASTLE HARLAN, SAYS THAT WHEN IT COMES TO CROSS-BORDER PRIVATE EQUITY, THE REWARDS ARE STILL THERE – BUT IT'S NOT FOR THE FAINT OF HEART

"PE firms that expand globally may get the added reward of better access to a global investor base"

The world of business and finance has been massively disrupted in the past two years. While G7 economies are mending, markets remain volatile and the regulation around private equity remains uncertain. For some PE groups, this is probably the wrong time to venture outside of their home regions.

For a typical US fund to do deals outside of its local geography, basic investment criteria – such as valuation, industry and capital structure – need to be followed more closely to compensate for the greater deal complexity, such as cultural differences, properly dealing with multiple currencies, and cross-border tax and debt issues. In the mid-market, simple things like travel costs and time can be prohibitive over the course of a five-year investment.

Many institutional investors in PE funds are wary of "style drift" and do not want to see their funds venturing outside of their core competencies. In a difficult fundraising environment, this has added pressure on funds to de-emphasise more adventurous activities, such as investing abroad. Further, many funds have been spending unusually large amounts of time on existing portfolio company issues, making it even harder to venture abroad.

However, industry specialisation brings real benefits, which has driven some US funds to look globally to increase deal flow within the industries they focus on. The riskiest proposition is investing in an unknown industry in a new territory.

Castle Harlan remains a North American-centred firm, yet has built a global brand and gained international experience. Over the past decade, some of our best deals have been done in Europe and the UK – notably Polypipe, with Livingstone. We have also nurtured a partnership with CHAMP Private Equity in Australasia.

Increasingly, mid-market businesses are becoming global – or they should be. PE firms that have cross-border experience and are networked well can bring significant added value to management teams by helping them expand their businesses globally in a faster and smarter way, with better-managed risk. Getting access to good deals means offering management teams more than just capital; namely creativity and added value that help them grow. The ideal European deal for us is one in which we can use our experience to grow a business faster and/or make it more profitable than it could be on its own.

Several of our best deals have combined the North American and Australasian cores of Castle Harlan and CHAMP with our European experience and networks. United Malt, which has operations in the US, Canada, England, Scotland and Australia, and which Castle Harlan identified via its US-based parent, Cargill, is a good example. Working with CHAMP, we spearheaded Asian growth and ran the investment exit process in the Aussie markets. In another example, CHAMP purchased a global education business, Study Group, from UK-based DMGT Information in 2006 and sold the business last summer for a significant gain.

Institutional investors are increasingly intrigued with the idea of diversifying by increasing their international PE exposure – recently, this has mostly meant Asia. Our strategy has been to focus on regions where we have at least a beachhead of relationships and can bring local partners into our deals – critical issues of caution to those that follow the 'région du jour'. PE firms that successfully expand globally may get the added reward of better access to a global investor base when raising funds in the future. However, the emphasis needs to be on successful investments, not just on getting deals done.

One of the first investment rules I learned decades ago is to pay for what you get, not what you bring to the table. That is where the real upside in deals should be. Bringing a global perspective to mid-market businesses can be key to creating value, and we believe that great equity returns are available for those who are confident in the long-term success of free and open global markets.

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