

# PERSPECTIVES

*Insights on Healthy Living & Aging*

## Healthy Living and Aging: The Power of Focus

### North Castle's Focus Provides Unique Investment Advantages

*North Castle Partners is a focused mid-market private equity fund investing exclusively in consumer businesses that address Healthy Living and Aging trends. North Castle was founded on the principle that focus would provide specialized knowledge and capabilities that would bring competitive advantages to all aspects of private equity investing.*

*In the private equity world, focused funds are somewhat unique. In 2003, the total private equity industry comprised an estimated 600 firms managing more than \$700 billion. Mid-market private equity funds concentrate their investments on companies with revenues of \$50-\$500 million. Most mid-market funds do not specialize although a few concentrate on companies within a certain geographic area or within a given industry. More often mid-market funds span a broad range of industries from technology to consumer to industrials.*

*Since its founding in 1997, North Castle has maintained its focus on the Healthy Living and Aging market. In this issue of Perspectives, we will discuss the attractiveness of this market as well as the benefits of our focused approach.*

### The Healthy Living and Aging Market

The Healthy Living and Aging market refers to a growing number of consumer businesses that are emerging as a result of the convergence of two long-term trends:

- Science and research are broadening our understanding of the many factors that contribute to healthy living. These discoveries are generating a steady stream of new products and services that enhance well being and promote lifelong health.
- The population is aging. Every day ten thousand baby boomers turn fifty. These consumers are actively seeking products and services that address their concerns about aging well, maintaining or improving all



aspects of their health and appearance and leading richer, more balanced lives.

North Castle's focus is on five consumer verticals where the two key trends above are strongly impacting business models and creating many new product and service opportunities:

- *Aesthetics and Personal Care*
- *Fitness and Weight Loss*
- *Leisure and Recreation*
- *Nutritional Products*
- *Specialty Consumer Health*

Within these broad consumer verticals, North Castle combines its Healthy Living and

Aging "filter" with its investment analytics to identify the specific industry segments with the greatest growth potential.

### The Right Time for Investment

The Healthy Living and Aging market has several characteristics which make it highly attractive for private equity investing:

- Most companies in this space are experiencing strong revenue growth, which is projected to continue. In addition, they operate in highly fragmented industries and are often undercapitalized presenting excellent opportunities to build market-leading companies and to create significant shareholder value.
- Many large corporations recognize these trends and the emerging business opportunities in their industries. However, they may prefer not to build internally for a number of reasons – they are not effective developers of subscale businesses, some aspects of the economic models may not

yet be proven, or there are more pressing uses for their human and financial resources. In a few years, after these new companies have successfully increased revenue and earnings and achieved suitable scale, they will be attractive strategic acquisitions for corporations searching for growth opportunities.

While the companies in the Healthy Living and Aging market are diverse, many are at the same stage of development, with similar consumers and retail customers. North Castle has built a wealth of experience and expertise in evaluating these companies and addressing the challenges and issues that are common to most of them.

# The Benefits of Focus

There are a number of ways our focus benefits our fund, its investors and our portfolio companies. These benefits range from deal identification/sourcing and more effective due diligence to company synergies and opportunities for other value-added activities.

## Industry Insights and Proactive Deal Sourcing

A North Castle team often researches and analyzes a business segment within one of the five consumer verticals long before there is a targeted opportunity. When a potential acquisition does appear, much of the homework has already been done and we are often in a position to move more quickly, ask better questions, and make more informed investments.

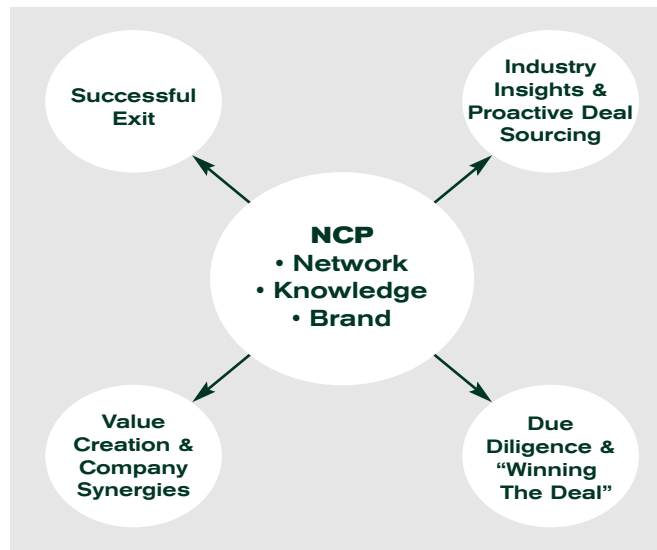
One good example of this approach is our investment in the fitness industry. Ben James, a North Castle Managing Director, and his team researched the industry in 1999.

“After looking at a number of companies and business models” says Ben, “we decided that our best opportunity to create value would be by investing in a high-end club chain with a strong brand name. A business that had an economic model based on attracting and keeping affluent, demanding customers. Customers with sufficient discretionary income to pay for quality services and to sign up for additional programs.”

When several mid-market clubs based on “churning” rather than keeping customers began looking for investors, Ben and his team passed. However, in late 2000, when Equinox, a high end fitness club, which had facilities only in New York City began looking for a buyer to help fund and guide its expansion, Ben and his team knew they had found the right investment.

North Castle’s analysis of industry trends often leads to identification of companies that are not officially for sale. In 1999, North Castle Managing Directors Chip Baird and Brent

Knudsen decided to study the spa market, a Healthy Living and Aging industry which perfectly addressed a number of consumer trends. After reviewing a number of spa businesses, they concluded that the leading brand — Elizabeth Arden Red Door — was ripe for further expansion in this growing market. The North Castle team flew to Phoenix, Red Door headquarters, to meet management and to present their ideas for building the company. This began a year-long courtship that ended in an acquisition, the first step in creating the biggest spa business in the country.



*The NCP Advantage*

Some companies that North Castle identifies are at too early a stage for a North Castle investment. North Castle’s understanding of the industries in which these companies compete often leads to the development of long-term relationships with company owners. When the owners decide to bring in new capital, one of their first calls is to North Castle.

North Castle first met Joe Contorno, the CEO of HDS Labs (producers of the DDF line of cosmeceuticals) when the company’s revenue was well under \$10 million. HDS was too small for North Castle but, given North Castle’s interest in personal care, NCP Managing Director Rich Gersten kept in touch with Joe. In early 2004, after HDS had increased its revenues several times over and Joe was

searching for new capital, North Capital assumed control of the company in a proprietary transaction.

## Due Diligence and “Winning The Deal”

Once North Castle has identified a company to pursue, the firm’s basic knowledge of the industry and the external trends impacting it often results in more thorough and effective due diligence.

Harvey Spevak, the CEO of Equinox remembers “North Castle came to the conversation with greater knowledge than most firms because of their focus on Healthy Living and Aging. That knowledge and their contacts were important to me.”

In early 2003, Barry Karlin, the founder and CEO of CRC, a network of substance abuse treatment centers, had begun to seek private equity funding. Barry’s contacts suggested he meet Doug Lehrman, a North Castle Managing Director, who was exploring investment opportunities in the treatment market. Doug’s knowledge of the market and his vision for CRC quickly led to his gaining Barry’s confidence and to North Castle’s investment.

North Castle’s knowledge and focus also led to its purchase of EAS, the lifestyle nutrition company that has just been sold to Ross Labs, a division of Abbott (NYSE:ABT). In 1999, Bill Phillips, the CEO and founder met with Chip Baird and Brent Knudsen. Bill, the author of the bestselling book “Body for Life” was impressed by North Castle’s knowledge of the market and by their transformational plan to take EAS from a specialty business to a mass market player. Although he was about to start an auction process, he decided to call it off and sell his company to North Castle.

Bill Phillips response was not unusual. Many entrepreneurs in the Healthy Living and Aging space, for example in the natural prod-

ucts industry, have started their businesses not only to realize returns but because of their commitment to consumers and to providing a better quality of life. “North Castle has strong credibility in this industry and appreciates the values that are inherent in these businesses” says Ellen Marram, a North Castle Managing Director. “When we talk to owners of natural products businesses, they view us as part of the family. We understand a little more about the DNA of their brands and how to grow them without losing the company’s values.”

That credibility also counts when it comes to recruiting management teams. Gil Pritchard, a veteran of private equity-sponsored natural product companies who became the CEO of Avalon Natural Products earlier this year after serving on the board, says “I knew that North Castle, with its focus on health and wellness, would be a strong strategic partner, a group that would really add value. For me, that was a huge reason to sign on to lead a North Castle portfolio company.”

### **Value Creation and Company Synergies**

Prior to investing in a business, North Castle has already developed a clear vision for that company’s profitable growth. North Castle and the management team align around the key financial and operational initiatives that must be implemented to realize a successful exit.

All of North Castle’s companies are consumer businesses and many are at a similar stage of development. They often share common challenges — filling out management teams, professionalizing systems and infrastructure, expanding the number of retail units or selling channels, and building strong well recognized brands. The North Castle team draws on their own expertise and the North Castle network, staying actively involved with management as the growth plan is executed.

North Castle’s focus on Healthy Living and Aging results in many opportunities for individual businesses to share learnings and resources with their sister companies.

For example, many product companies in the portfolio have common retail customers. If one company wants to introduce its products to a new account, a sister company can offer advice or make an initial introduction.

Most North Castle companies also serve similar consumers, i.e. relatively affluent people who are searching for ways to live longer, healthier lives. “The opportunity to talk with smart people whose businesses are focused on consumers similar to mine is a large plus” say John Richards, the CEO of Red Door Salons. “Proven marketing techniques to reach consumers may be applicable to sister companies. Promotional opportunities between companies may make sense given the similarity of our target audiences. Sometimes people just want to know whether I can recommend an outside agency or vendor.”

Companies can also leverage each other’s assets. Avalon has benefited by coordinating their orders for a scarce ingredient with Leiner which, as a large vitamins and supplements company, has more leverage with suppliers. Enzymatic Therapy, a natural medicine company with production facilities, has manufactured some products for EAS which out-sources all of its production.

The North Castle deal teams keep each other updated on portfolio company activities to uncover areas of common ground. Several North Castle CEOs serve on the board of another North Castle company. There are two formal CEO meetings each year and there are councils for the North Castle CFOs and senior marketing people. Additional councils, including human resources, are planned. These meetings provide the people in the portfolio companies an initial opportunity to become familiar with each other and their business objectives, identify areas of common interest and discuss shared challenges.

“North Castle firmly believes that each company’s management, working with their North Castle team, must make their own decisions about how best to optimize that individual business,” says Chip Baird. “But there is no doubt that each of our companies has benefited as our portfolio company CEOs have gotten to know each other better.”

# NCP’s Targeted Consumer Verticals

North Castle’s focus is on five key consumer verticals where Healthy Living and Aging trends are strongly impacting business models and creating many new product and service opportunities.



## **Aesthetics & Personal care**

*Selected Examples:*

- Anti-aging Cosmeceuticals, Treatments & Services
- Spas
- Natural Personal Care



## **Fitness & Weight Loss**

*Selected Examples:*

- Health Clubs
- Weight Management
- Fitness Equipment



## **Leisure & Recreation**

*Selected Examples:*

- Hobbies & Crafts
- Adventure Travel
- Sporting Equipment



## **Nutritional Products**

*Selected Examples:*

- Functional Food & Beverages
- Natural Foods
- Vitamins & Supplements



## **Specialty Consumer Health**

*Selected Examples:*

- Behavioral Health
- Rehabilitation
- Home Healthcare Services/Products

# The North Castle Network

Because of its focus, North Castle has developed a powerful network of knowledgeable people in the Healthy Living and Aging arena. At each stage of the investment process, North Castle's capabilities are further enhanced by this asset.

A key part of the network is the North Castle advisors who are actively involved in a broad range of North Castle's activities. Our advisors are well known in various segments of the Healthy Living and Aging space.

Peter Roy, the former President of Whole Foods markets, is very knowledgeable about the natural products space, still active in the industry and highly regarded by those operating in it. Peter builds North Castle's credibility with many of the small companies in this arena and has been a resource in all aspects of North Castle's business from helping us identify possible acquisitions and adding his input during due diligence to recommending prospective portfolio management team members who bring natural products experience. Peter is also an active value-added member of the boards of Avalon Natural Products and Naked Juice.

Another advisor is Augie Nieto, a legend in the world of fitness and exercise. Augie founded Lifecycle, Inc., an exercise equipment company he successfully sold to Bally. He was also the President of Life Fitness, cur-

rently the largest commercial manufacturer of fitness equipment in the world. Augie has been active in deal sourcing, due diligence and recruitment for a number of North Castle companies. He serves on the board of Grand Expeditions and, prior to its sale by North Castle, served on the board of EAS. Augie has also been a helpful informal advisor to the Equinox management team.

In addition to advisors with operating experience in Healthy Living and Aging businesses, the North Castle advisory board includes experts in issues affecting the Healthy Living and Aging market. They include Dr. Ken Dychtwald, who is recognized as the nation's leading authority on the "age wave" – the impact that the aging baby boomer generation will have on our businesses and institutions, and Dr.

Pam Peeke, an internationally recognized expert in the fields of nutrition and fitness. Both Ken and Pam are actively involved in many aspects of North Castle's activities. They both have introduced us to companies, have participated in due diligence and are actively involved with our operating companies as board members or informal consultants.

Our advisors themselves are also invaluable in introducing us to others and further broadening our network, which currently includes literally hundreds of individuals knowledgeable about Healthy Living and Aging issues. When North Castle identifies an area or company of interest, we can quickly draw on this extensive network for advice to evaluate opportunities and, after acquisition, to ensure that we have the necessary expertise on our portfolio company boards.

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## North Castle's Brand

North Castle's focus on Healthy Living and Aging is already well known throughout the private equity chain from financial institutions to small business owners. As North Castle builds its brand awareness and reputation, the benefits of its focus continue to grow. Entrepreneurs, investment banks, industry experts, potential management team members, etc. increasingly turn to North Castle when they have an interest in

selling or working in the Healthy Living and Aging market.

"The breadth of deals and businesses that North Castle is analyzing in Healthy Living and Aging is creating a body of knowledge and understanding that I've never seen in any other group," says Dr. Ken Dychtwald. "Their knowledge base, network and value-added investing capabilities keep getting both broader and more refined."



Our mission is to partner with accomplished, entrepreneurial management teams who share our vision: building "great companies" that contribute to healthy living and quality of life. We strive to accomplish our mission with integrity in our process and balance in our lives. If we achieve our mission, we will create extraordinary value for these companies, their employees, investors, communities, and the North Castle team.

*Perspectives is published by North Castle Partners, the leading private equity firm focused exclusively on consumer businesses that address Healthy Living & Aging trends.*

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