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North Castle Plans to Sell Three Companies Amid Buyout ‘Bubble’

By Brett Cole

Oct. 20, 2005 (Bloomberg) — Charles F. Baird, founder of North Castle Partners LLC, told investors today that the U.S. buyout firm is preparing to sell at least three portfolio companies because he expects a slump in the private-equity market.

“We’re beginning to redline,” he said at a North Castle conference in New York. “The bubble will burst again. In the 1980s, there were 10 years of growth and then bust. In the 1990s, there were nine years of growth and then bust.”

The Greenwich, Connecticut-based firm is in negotiations to sell three undisclosed companies, Baird said. Earlier this month, North Castle divested CRC Health Group for \$720 million. Rising interest rates, a softening market for initial public offerings and increased leverage to make acquisitions are signs the private-equity market already has peaked and is in decline, he said.

North Castle, founded in 1997, buys companies that promote healthy living and aging well among baby boomers, an estimated \$400 billion industry. It has invested \$1.2 billion together with investors in 40 companies including Red Door Spa Holdings, which offers beauty services including those at Elizabeth Arden Spas, and

Equinox Holdings Inc., an owner of fitness centers.

Baird, a former banker at First Boston Corp. and consultant at Bain & Co., said buyout firms are flush with cash and eager to make acquisitions.

Private-equity funds may raise as much as \$200 billion globally this year, up from less than \$30 billion in 2002 and 2003, Baird said. There have been \$222 billion in announced takeovers by buyout firms this year, a gain from \$151 billion for the same period in 2004, data compiled by Bloomberg show.

Hedge-Fund Threat

Baird said the \$1 trillion hedge-fund industry is increasingly competing for private-equity deals to improve returns, which were 7.5 percent on average from 2000 to 2005. Hedge funds will use as much as \$200 billion for private-equity deals, topping private-equity firms’ unused capital of about \$150 billion, he said.

“Unrestricted hedge funds with little experience, lower return requirements and outlandish incentive structures will inexorably allocate capi-

tal to private-equity opportunities and drive significant changes in supply and demand,” Baird said.

Meanwhile, higher interest rates will dampen acquisitions and prompt higher prices, he said. The U.S. Federal Reserve has raised its overnight lending rate 11 times since June 2004.

High-yield bond sales may slide this year to about \$134 billion from \$174 billion last year, and the volume of U.S. IPOs may fall to \$35 billion from \$43 billion, Baird said.

Some buyout firms are using more leverage, or borrowing against the annual amount of earnings before interest, tax, depreciation and amortization generated by the company, to make acquisitions. Leverage levels are more than seven times on some deals, compared with 4.6 times in 2001, Baird said.

“My mother told me when they start leveraging businesses seven times, start selling the children,” he told investors.