



Little leverage.
Technology investments.
TA Associates is not your average
private equity house

by David Carey

Playing the cycles

The episode exemplified these hand-wringing times. This summer, **TA Associates'** partners spent weeks trying to craft a winning bid for **Phoenix Scientific**, a marketer of generic drugs for livestock, only to see **Leonard Green & Partners**, a larger private equity player, swoop down and snatch the prize.

"Auctions can give you nightmares," muses Kevin Landry, 58, the firm's CEO. "We liked Phoenix a lot. But trying to get deals done without overpaying is tough. The biggest challenge facing the industry now is the huge capital overhang," he says, referring to the roughly \$150 billion of capital that private equity firms amassed in headier days that they are now hard-pressed to invest.

Being stymied has become a common annoyance in private equity. But TA, a 34-year-old,

Landry, Tadler, McLane, Conway (left to right):
wide-ranging niche

Boston-based middle-market firm, has been thwarted less often than many peers. The fund's unusual strategy—investing in high-growth companies that are profitable but not capital intensive—has been honed through several economic cycles.

"We get our best returns investing in growth," Landry explains. "Others get theirs from paying down leverage. That kind of investing doesn't excite us. Leverage enhances our returns—it doesn't create them."

While many rivals find themselves hamstrung by a weak economy, a dearth of debt financing and hordes of bidders chasing too few deals, TA has managed to plant stakes in 10 portfolio companies over two years, committing about \$520 million from the \$2 billion equity fund it raised in 2000. "I'd have liked to do twice the deals we've done lately, but we've been more active than most," Landry says.

Moreover, during a span when plunging asset valuations have put the kibosh on exits, the firm has cashed out of a handful of holdings, most notably **MedQuest Associates**, a diagnostic imaging concern, in which TA quadrupled its \$38 million investment, and **International Microcircuits Inc.**, a supplier of specialized semiconductor chips, on which it reaped six times its money.

What keeps the engine humming? For starters, an investment niche, shaped by trial and error, that's at once exclusive and wide-ranging. Having been burned early on by early-stage, venture-style deals, TA since the late 1970s has largely confined itself to backing cash-flow-positive, fast-growing businesses that don't guzzle capital. "Our target market has gotten smaller," Landry says. "In this economy, there are fewer profitable companies than there were and fewer still with momentum."

Furthermore, TA, unlike many LBO players, frequently takes minority stakes where existing owners want to keep control. Indeed, the portfolio is dominated by minority investments, with an average stake of 35%. That flexibility helps to compensate for the fact that TA's profitable-but-growing criterion sharply limits the number of companies it will invest in.

A trendsetter in technology LBOs, TA often adds a splash of debt to the capital mix. But the ratio of debt-to-equity, especially in tech deals, often is less than for a standard LBO. After all, cash-flow growth drives TA's returns and debt can impede that growth. At times like these when debt financing is scarce, TA may swear off debt al-

together, as it did in this year's purchase of U.K. antivirus-software company **Sophos plc** for \$60 million. Currently, only half TA's 56 portfolio companies shoulder debt.

Crucially, TA tries to play the ebb and flow of industry cycles for all they're worth. It has to. Because the growth companies it targets are in cyclical sectors such as technology, financial services and healthcare, TA's performance hinges on its skill at timing the swings.

The firm's instincts sometimes fail it. TA blew \$47 million on a mid-1990s buyout of cable-TV operator **Galaxy Telecom**—exactly the sort of cash-hungry business TA usually avoids. It also took a big hit on a \$66 million investment in **Altamira Investment Services Inc.**, a Canadian money manager it didn't exit until this year, when financial services were in a tailspin.

But such flops are rare. Fixated on positive cash flow, it largely managed to steer clear of the dot-com and telecom craze that laid waste to billions of private equity dollars since 2000. Despite a tough past couple of years, during which TA's marked-to-market returns have been slightly negative, the firm puts its net average yearly return since 1997, after subtracting fees and carried interest, at 32.9%. Its 10-year average: a dazzling 47.7%, well above the 10% overall average for buyouts and the 26.1% for venture capital investments, says **Venture Economics**, which monitors industry performance.

"You hear a lot of B.S. about performance in this business," says one of TA's institutional investors, who asked not to be identified. "But these guys are for real. The bottom line is that TA is a great firm with a great investment track record."

TA won points from its investors this fall when it opted to return \$38 million of profits its partners had taken from earlier exits in case the fund fails to achieve the returns investors and the fund's managers anticipated.

The key propellants for TA's success have been technology and financial services. Technology had been a big moneymaker for TA for decades, but it produced particularly lush profits in the 1990s. Of the 42 businesses backed by TA's seventh fund starting in 1992, 20 were tech businesses, which were sold for 4.5 times TA's aggregate investment, producing a fat 95% average yearly return.

Two standouts were buyouts of telecom-oriented concerns that TA escaped before the tech boom flamed out: **Finisar Corp.**, a supplier of fiber-optic components that TA sold out of in 2000, earning 35 times its \$20.7 million investment, and **SBA Communications Corp.**, a wireless-telecom tower operator that TA exited in 2000 with a 10-fold gain. (SBA is now flirting with default.)

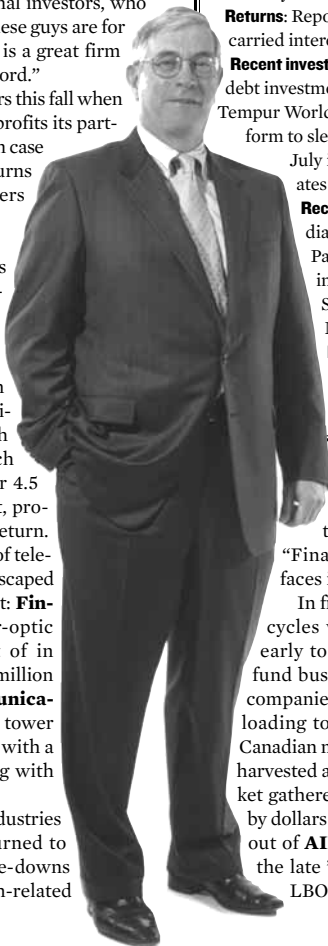
Today, with the technology industries in a stubborn slump, TA has turned to bargain hunting. In spite of write-downs of TA's three dozen current tech-related

holdings, the sector is bound to revive, predicts Brian Conway, one of two TA partners in charge of technology. TA retains particularly high hopes for **Ameritrade Holding Corp.**, the world's biggest online securities brokerage, and for **Instinet Group Inc.**, a major electronic trading network. TA sank a combined \$214 million into predecessor companies of each in 1999 and 2000, including \$196 million into Datek Online Holdings Inc., which Ameritrade absorbed in a stock-swap merger this year. Datek represented TA's largest capital commitment ever to a single company. Still, the modest, unrealized gains TA had been showing in each deal have evaporated for now as the stock

markets have fallen.

"In the late '90s," Conway says, "it was an easy environment in which to sell [technology] assets and a difficult one in which to invest at reasonable prices. Now it is going the other way." An encouraging sign, he says, is a steady rise in the quality of the tech busi-

“BECAUSE OF OUR EXPERIENCE AND OUR STRATEGY, I DEFINITELY THINK WE WILL REMAIN A TOP-QUARTILE PRIVATE EQUITY FIRM”
P. Andrews McLane



Capital under management: \$5 billion
Web site: www.ta.com

CEO: C. Kevin Landry
Founded: 1968

Professionals: 30, including 12 managing director/partners
Offices: Boston (headquarters), Pittsburgh and Menlo Park, Calif.

Investment hallmarks: High-growth, profitable businesses with low capital requirements, weighted toward technology, financial services, healthcare and consumer sectors. Often uses relatively little leverage. Frequently takes minority stakes

Returns: Reports 32.9% net average annual return after fees and carried interest since 1997 and a 10-year average of 47.7%

Recent investments: A \$130 million equity and subordinated debt investment in \$350 million recapitalization in October of Tempur World Inc., a fast-growing maker of mattresses that conform to sleeper's shape. A \$20 million minority investment in July in National Imaging Associates Inc., which evaluates diagnostic-test requests for HMOs

Recent exits: Sold MedQuest Associates Inc., a diagnostic imaging company, to J.P. Morgan Partners in July; TA quadrupled its \$38 million investment. Made several times its money in September selling AmeriChoice Corp., an HMO for Medicaid recipients, to **UnitedHealth Group**

Primary advisers: Law firm: **Goodwin Procter**, Boston; tax advisers and due diligence on deals: **KPMG** and **Ernst & Young** Boston offices

nesses that are being sold. But lenders' persistent leanness toward tech puts a damper on deal activity. "Financing deals is the biggest issue" TA faces in tech he says.

In financial services, TA has navigated the cycles with comparable success. From the early to mid-1990s it stocked up on mutual fund businesses, which banks and insurance companies with ailing balance sheets were unloading to raise cash. Although Altamira, the Canadian mutual fund group, was a bust, the firm harvested a bounty in other deals as the bull market gathered momentum. TA's biggest gain ever by dollars was the \$775 million it scored cashing out of **AIM Management Group Inc.** during the late '90s. It invested just \$34 million in a LBO of AIM in 1993.

P. Andrews McLane, a senior managing director and partner who leads TA's financial services effort, observes that, as their balance sheets mended in the mid-'90s, banks and insurers switched from dumping mutual funds to buying them. Now, McLane says, "the music has stopped" once again; banks' balance sheets are hurting, and they're starting to rationalize. Even though McLane expects that a bumper crop of mutual fund units and money managers eventually will be divested, few have come to market. TA's only recent financial services investment was \$110 million in paid for a minority stake in **Clinton Group Inc.**, a hedge-fund manager, in January.

TA, meanwhile, has increased its efforts in consumer products, a sector it had pursued less zealously than technology, financial services and healthcare.

"Consumer has always been a focus, but it's becoming even more of a focus now," says McLane, who also oversees TA's consumer products deals. "In the face of a poor economy, you can still find companies with exciting products and good sales growth. Our task is to find which brands will be enduring."

A case in point: **Tempur World Inc.** In October, TA bought the fast-growing mattress maker in a \$350 million leveraged recapitalization, investing \$95 million in equity and \$35 million in subordinated debt. Sales of the company's Tempur-Pedic-brand mattresses, which are made of heat-sensitive foam that conforms to a sleeper's body, have been soaring, far outpacing average growth for the mattress industry, McLane says.

The fourth mainstay of TA's portfolio, healthcare, exhibits a cyclicity uniquely its own. The industry's well-being is tied directly to government reimbursements for Medicare and Medicaid and also to the tightfistedness or liberality of health maintenance organizations, which set revenue levels for healthcare providers. While 1997 to 1999 were rocky years, providers have thrived of late. Richard Tadler, who heads TA's healthcare team, thinks the industry is in midcycle.

"The trends are very good right now for both buyers and sellers of [healthcare] assets. But we're concerned it might start going the other way," Tadler says. "We've sold into that trend, with MedQuest. In our investing, we're trying to avoid companies we think will be the first to fall when the cycle turns down."

National Imaging Associates, in which TA invested \$20 million for a minority stake in July, clearly fits the bill. The company is built upon the notion of saving HMOs money, for it advises them on whether to sign off on CAT scans, MRIs and other costly diagnostic tests.

Landry and McLane, the senior members of its brain trust, are getting on in years. Once they're gone, can TA keep its winning streak alive?

It appears that Landry and McLane, who is 55, have built a deep talent pool—the other 10 managing directors are in their late 30s and 40s—so that TA should not face the succession issues that so many competing firms of similar vintage do.

"We know what we're doing," McLane says. "Because of our experience and our strategy, I definitely think we will remain a top-quartile private equity firm." ■