Extended clan

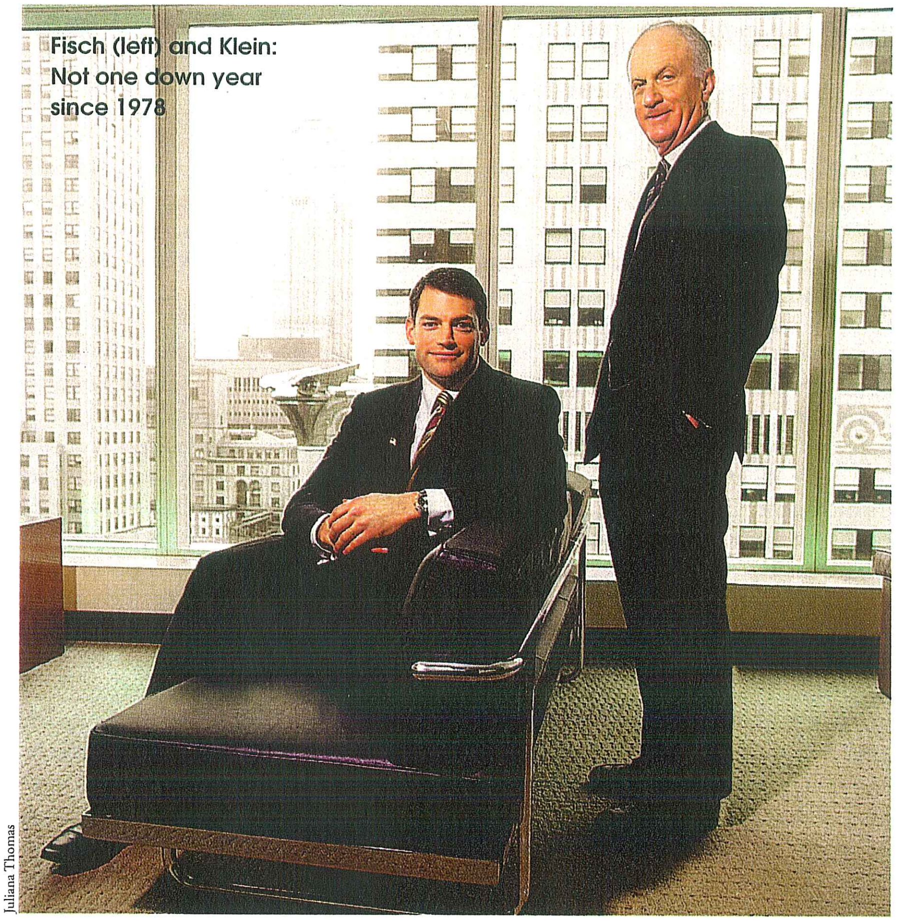
Many family offices try to crack the institutional market. American Securities, which runs money for heirs to a Sears Roebuck fortune, actually pulled it off. • **By Jill Andresky Fraser**

In 1978 Charles Klein walked away from Wall Street, leaving his job as a broadcasting analyst at Lehman Brothers for what seemed to be an industry backwater. He signed on as senior financial adviser to the head of a wealthy family eager to jump into the private equity market.

But Klein's new employer wasn't just any rich guy. He was William Rosenwald, the youngest son of Julius Rosenwald, who had built a great American fortune through his ownership stake in Sears, Roebuck and Co. By the time he recruited Klein to manage the family office, Bill Rosenwald already had 30 years' of experience as an active investor and deal maker, honing a strategy that aimed to combine consistent returns with minimum risk.

During Klein's nearly 25-year tenure, that small family office has grown into American Securities. Excluding Rosenwald family assets, which the clan refuses to quantify, American Securities manages over $3 billion, more than half of that for trusts, endowments and high-net-worth households. Its private equity arm, New York–based American Securities Capital Partners, which makes equity investments of $25 million to $150 million, has raised $1.1 billion in three separate funds — in 1994, 1998 and 2001. The third fund closed in July with $650 million, about $150 million more than the original target.

Many family offices try — and fail — to attract institutional clients, but American Securities is the rare success story. In 1994 the firm began pursuing institutional money with the launch of its first fund. It attracted three initial institutional investors: a college endowment, an insurance company that had invested with the Rosenwald family in the past and Chase Manhattan Bank.



Fisch (left) and Klein: Not one down year since 1978

Juliana Thomas

The key to success? Credit impressive portfolio performance (not one down year since 1978), a shrewd investing strategy and an effective marketing team that draws upon well-placed contacts in the pension and endowment world. American Securities targets an overlooked corner of the private equity marketplace, the so-called middle market, which features $100 million transactions, versus the $500 million deals that are the norm for private equity.

Among the institutional investors in the American Securities private equity funds are the DuPont Pension Trust, the University of Texas endowment and New York State Common Fund, the state's public employee pension fund.

Klein explains the firm's decision to target midsize investments: "Valuations were lower, financing terms tended to be better, and we believed that we could control our risks by capitalizing our deals conservatively. With middle-market companies, there's usually better opportunity than with larger companies to achieve internal improvements by upgrading management skills."

American Securities looks to buy stakes in firms with strong market shares in stable or growing industries. Companies must have annual revenues of no less than $50 million and usually no more than $300 million, with operating profits of at least $10 million and preferably in excess of $20 million. Its portfolio is limited — at the moment just nine companies. "Because we've got a small portfolio, we've got the time to be involved in our companies," says Michael Fisch, president of ASCP since 1994.

"We buy stakes in high-quality companies, and then we give those companies all the attention they need."

"We buy stakes in high-quality companies, and then we give those companies all the attention they need," Klein says. He adds that American Securities, with about 30 professionals on staff, carefully controls the debt structure. Leverage on a deal is typically about 65 percent, roughly the industry average, but it never includes any type of subordinated debt. Typically American Securities becomes a controlling shareholder, takes a majority of board seats and holds on to its ownership stake for a fairly long time — usually five to ten years.

Its cautious approach kept American Securities away from any dot-com or telecommunications deals in the late 1990s. "Our investors have bought into our strategy and don't push us to do the kind of deals we don't believe in — even when that means we don't do deals for a while," Klein says.

Investors can't quarrel with the results. The annual total returns on ASCP's first two funds (which raised about $120 million in 1994 and $350 million in 1998, respectively) are in the "very high 40 percent range," says Fisch. Among the portfolios' stars: Caribbean Restaurants, the exclusive franchisee of Burger King Corp. in Puerto Rico. In October 1996 American Securities paid $34.1 million for a 91 percent stake in the company. Since then, its investment has returned 86 percent a year. Significantly, too, none of the firms American Securities has invested in have gone bankrupt.

With those kinds of payoffs, John Wolak, portfolio manager for venture investments at DuPont Capital Management, felt comfortable investing in ASCP's third fund. "With about $3 billion under management, we see virtually every private equity fund, and we're very selective — maybe we'll look at 350 to 400 and select ten. We decided to invest in American Securities because they're in an investment space that we really believe in, the middle market, and they have accumulated an outstanding record of acquiring companies, helping those companies get to the next level and earning impressive returns."

Julius Rosenwald certainly delivered returns for investors in Sears Roebuck. A Chicago clothing manufacturer, he bought an equity stake in the company in 1895 and became president in 1910. (Rosenwalds were significant Sears Roebuck shareholders through the 1960s.) Under his leadership, Sears became the world's largest retailer. As a philanthropist, he financed the construction of more than 5,000 school buildings to help serve black communities across the South.

Bill Rosenwald, who separated his assets from those of the rest of the family in the 1930s in an effort to boost his returns, went on to buy large and profitable stakes in Western Union Corp. and Ametek. He also sustained the family's philanthropic largesse, co-founding the United Jewish Appeal and serving on the boards of the New York Philharmonic and the Tuskegee Institute. Rosenwald died in 1996.

Few family offices boast such a pedigree, and American Securities has used its illustrious history to attract a high-caliber staff, which began to pursue the institutional business in the mid-1990s. "The critical issue for a family office looking to make the kind of major transition that American Securities did is the quality of people who are involved," says Kevin Penn, a managing director of ACI Capital Co., a New York–based money manager.

"Nobody would have given them a chance," Penn emphasizes, "if this had been an operation run by the family's accountant or a son-in-law with plenty of time on his hands. What you see in American Securities is a best-of-breed team. They've hired people with superb educational backgrounds and real knowledge. And yet they've continued to retain what's best about a family office: a strong, close-knit culture."

Indeed, Klein and Fisch go out of their way to stress their ties to the family-office culture. "This company is all about trustworthiness, long-term support for each other — as well as our investors and our portfolio companies — friendship, collegiality," says Klein.

American Securities Capital Partners invests in market leaders with a strong product and customer base. But, explains Fisch, "they're not being run by Jack Welch. What we've found is that if we get the chemistry right — and keep the valuations on these deals at a reasonable level — we'll never make these companies worse, and the chances are very, very good that we'll make them better."

"It's clear that plenty of the CEOs at the portfolio companies find [ASCP's] background appealing. It enhances the quality of their deal flow," says Erik Hirsch, managing director at Hamilton Lane, an investment management firm with several clients, including New York State Common Fund, that have signed up for ASCP's third fund.

J. Christopher Chocola, chairman of CTB International Corp., a $250 million-in-revenues manufacturer of agricultural equipment, strongly agrees. His family-owned business had about $140 million in sales in the mid-1990s, when ASCP was one of several possible investors with an eye to jump-starting growth and helping the company go public. "We chose them because we really liked those family office roots. We sensed that they would be good board members and good partners for us. And that's the way it's turned out."

What's next for ASCP? With valuations lower than they have been in years and $650 million in place at its third fund, Klein and Fisch are gearing up for more activity. "We've just hired four new people to help us analyze prospective deals," says Fisch. As Julius and Bill Rosenwald well knew, in business timing can be everything. ii