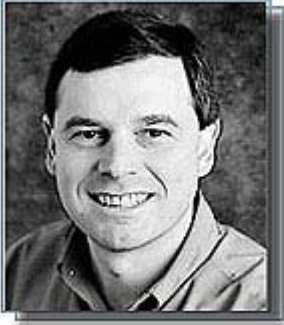


Meet The Manager

James Farrell, Fremont Partners - Middle-Market Veterans

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San Francisco-based Fremont Partners believes its middle-market strategy will work in all types of economic conditions. The firm seeks out companies that are large enough to have proven themselves but small enough to represent a sizeable opportunity for growth. Investors seem to like this approach – Fremont, affiliated with the Fremont Group and the Bechtel family, recently closed its third fund, Fremont Partners III, on \$920 million. James Farrell, a managing director with the San Francisco-based firm, recently spoke to PrivateEquityCentral.net about the firm’s middle-market strategy, the current environment, and what makes a solid management team.

PrivateEquityCentral.net: To what do you attribute the current popularity of middle-market funds?

James Farrell: I believe the oversubscription of our fund was due in large part to the [firm’s] middle-market focus and the attractiveness of the middle market today, as well as the consistency with which we’ve participated in the middle market. The investment strategy has been implemented very consistently over the past 11 years and the results have been very consistent, as well. Today we have a portfolio of seven middle-market companies and last year all of those companies grew cash flow EBITDA by more than 15% and they grew in income by more than 30%. I think it’s that consistency of results in the middle-market that has been very attractive to the investors.

PEC: The firm’s portfolio ranges over a wide variety of sectors. Are the partners at Fremont sector-specific or generalists?

JF: We’re a team of generalists. There are certain individuals who have greater experience in certain industries but everyone here is a generalist. In terms of our approach to investing or the deals that we look at, we are opportunistic, as well. We’re really looking for businesses that meet our investment criteria and they can almost be in any industry, as opposed to saying, “These are the three industries we want to invest in.”

PEC: In terms of sourcing deals, how large a role does the firm’s parent company, the Fremont Group, play?

JF: The deal sourcing is done primarily by the investment professionals at Fremont Partners. In deal sourcing, we do receive a major benefit from the sponsorship by the Fremont Group, which is the private Bechtel family investment company. The benefit the Bechtel Group provides is that it has a more than 100-year history of private ownership of operating businesses.

About two-thirds of the investments we've made were outside of the auction environment, and many of our management teams have actually invested all of their equity in the company, or the majority of the equity that they own in the business. In our typical deal, management owns more than 20% of the equity outright, excluding stock options they have as part of the options program. We like to say for every two dollars we invest from Fremont Partners, one dollar is invested by the management team.

PEC: How does the firm pick the management teams it chooses to invest in?

JF: We largely back a management team that's already in place at the company. In those situations, we're looking for a management team that's looking to raise capital in order to successfully execute the business plan that it's pursuing over the next three years.

We look for No. 1 or No. 2 market-share positions and good growth characteristics. We define that as the opportunity to double the business every four to six years. We also look for good margins – on average we have about 25% cash flow margins – good returns on tangible capital, generally north of 35% or 40%. We also look for that large management insider investment that we already talked about, and we look for very good unlevered rates of return, as well as good levered rates of return.

PEC: What does the leverage market look like for firms that are trying to do middle-market deals?

JF: Leverage is less available, and leverage multiples frequently come down more quickly than purchase price multiples. But we actually believe this lending environment is a better environment in which to be making investments than the more aggressive lending environment of a couple years ago. So while the lending markets are difficult today, we think today is an opportune time to be making investments and the higher-quality businesses will continue to have access to capital.

PEC: So you believe the lending market for winning companies remains open?

JF: That's correct. We like to say good management teams and good businesses always have a need for capital – or an opportunity to deploy the capital – and we have really built a reputation and relationships with financing sources. Fremont Partners has had the good fortune to meet all of its interest and principal obligations. We've never had a default or delinquency, and we've never filed a Chapter 11 with our portfolio companies so that our senior and senior-subordinated lenders have received all of their interest on all of the investments that they made with us.

We also generally look to build the business plan first with the management team and then determine what the appropriate leverage is, not the other way around. Sometimes people may think, "How much can we borrow, ok, let's use that amount of leverage." We would rather build a plan, and determine what's really appropriate for that plan. Because management has a large investment alongside of us, the management is frequently a buyer and a seller, not just a seller. When it's their largest personal asset, management does not want to see the business over-levered. Throughout the past 10 years, our average equity investment has been about 40%. So today's more conservative leverage markets creates a good opportunity for middle-market investing.

PEC: One of the sectors your firm focuses on is financial services. What types of financial services companies look attractive now and which are you avoiding?

JF: We bring the same discipline to financial services that we look to bring to any industry we're considering. We look at the underlying unit economics and the returns on capital and the defensibility of the competitive position. So that causes us to tend to look more at specialty finance companies, like a recent deal we did involving the modular assets serving the education and commercial marketplaces. Those type of businesses, where the market segment might be a little bit smaller than a large consumer marketplace, and there are some competitive dynamics that allow you to earn a reasonable rate of return on your capital.

PEC: Has the firm made any exits recently? How does the exit market look now for middle-market companies?

JF: Our typical hold, or investment time period, is four to five years. In our Fremont Partners II fund, we only have two investments that are now four years old, so those investments are beginning to enter the time period where the exit is occurring or should be occurring. Thus, we haven't sold anything in the last 12 or 18 months. That being said, our strategy is always to invest in companies where the primary sale will be to a strategic buyer. The reason why these businesses are not sold to the strategic buyer when we invest is because the owners of the business continue to see the opportunity to build and grow the business and they're looking to leave all of, or the most of, their money in the company alongside of us. In those situations, the owners are not interested in selling to the strategic buyer because they don't want to become a small part of a much larger company and lose control in terms of the day-to-day management operations of the business.

For all of the companies we invest in we continue to see strong interest even in today's marketplace from strategic buyers within the industry of the companies that we're involved with – healthcare, packaging, specialty finance, to name a few. The strategic interest continues to be very strong and I think that it's driven by the fact that these companies that we've been involved with have good revenue growth, good profit growth, and they represent high-margin, high-return on capital segments of their industry, and that is attractive. The larger corporations are finding it harder to maintain their internal revenue growth and income growth. The types of companies we've invested in represent avenues through which those larger corporations can continue to achieve their long-term price-per-share goals.