

SPECIAL REPORT

Eye on water

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Timothy Dugan

Water Street Capital derives its name from Chicago's oldest commercial thoroughfare, South Water Street, where the Chicago River divides. But the private equity boutique reflects the city's legacies in more ways than one.

The firm was founded by Timothy Dugan, who started out with First Chicago Venture Capital in 1989. When that unit spun out to create **Madison Dearborn Partners LLC**, Dugan set up First Chicago Equity Capital with two others, Larry Fox, since retired, and Eric Larson, now head of **Linden LLC**. Later, after First Chicago merged with Bank One Corp., Dugan and colleagues were absorbed into One Equity Partners in 2001.

Dugan, a product of the University of Chicago Graduate School of Business, helped launch FCEC's healthcare investment practice in 1998. It was one of three areas of concentration that included industrial technology and infrastructure, and business services. Their strategy: to develop healthcare companies into dominant players in their niches.

The unit made several midmarket buyouts out of One Equity's \$2 billion capital commitment from the parent, resulting in successful realizations and one notable failure. But as the bank geared up to deploy a larger pool, Dugan and his colleagues felt that the fund may be too large for the size of healthcare transactions that had worked out in the past.

"The team has had about 20 years of experience but we were concerned there would be a mismatch between the strategy and fund growth," says Dugan, now 40 years old.

By the time his healthcare team spun out to form Water Street last year, its strategy was well-honed and firmly in place. It's what sets it apart, says Dugan, from the city's few midmarket healthcare buyout shops that include **RoundTable Healthcare Partners** and Linden. Roundtable boasts operating talent and is very focused on applying it to maximize growth, while Linden, besides being smaller, buys underperforming, noncore businesses, he says.

"Everything that we've done has involved transformational acquisitions," Dugan says. "We identify a sector, buy a base business, expand its customer set, product offerings and geography, and strategically reposition it as a market leader."

As examples, Dugan points to previous FCEC holdings: **Medex Corp.**, **AbilityOne Products Corp.**, **Kendro Laboratory Products LP**, and Lifestream International Inc. The Woodlands, Texas-based Lifestream, a products supplier in cardiopulmonary bypass, tried to integrate three small players in 1999, but it didn't hold together. Its assets were sold three years later, resulting in a \$25 million loss.

The three others prevailed. San Diego-based Medex manufactures fluid and drug delivery products used in critical care. The \$100-million business had a diverse product line but was not equipped for major purchasing or global marketing. Dugan's team partnered with management, which wanted to step up growth.

In 2003, Medex carved out Jelco, a \$195 million business in the peripheral catheter segment of critical care, from **Johnson & Johnson**. The business grew 10% annually, Dugan says. Sales rose to \$330 million and operating profit reached \$100 million in less than two years, from \$100 million and \$12 million, respectively, in 2002.

Not long after, London's **Smiths Group plc** acquired Medex, yielding a 5 times return multiple on a \$120 million outlay.

Ability One, a Bolingbrook, Ill., rehabilitation supplies distributor that the team, along with Chicago healthcare buyout firm **Beecken Petty & Co. LP**, bought in 2000, went a similar way. It was a fully independent supplier by the time **Patterson Dental Corp.** bought it in 2003 for \$575 million, generating a 7 times return for One Equity and other backers.

An earlier deal, Kendro, a Newtown, Conn., provider of laboratory products and services, produced a 10 times return when **SPX Corp.** acquired it in 2001.

The year-old Water Street, brandishing a freshly minted \$370 million fund, has taken a page from FCEC. In May, it bought **Lakewood Pathology Associates**, a Lakewood, N.J.-based supplier of pathology services, for \$50 million. Last month the firm agreed to buy diabetes products maker Facet Technologies, a unit of **Matria Healthcare Inc.** for \$122 million. The firm relies on its 11-strong investment professionals to identify acquisition targets to complement or build out these businesses.

Coming in handy are insider connections with the medical communities, of which Water Street probably has plenty. Partner Jim Connelly emerged from **Baxter International Inc.** and before that, American Hospital Supply Corp. Operating partner Al Heller was a former president and CEO of **American Pharmaceuticals Partners Inc.**, and also hailed from Baxter, as did fellow operating partner Kevin Swan.

"It's nice to have a shared heritage of executives," says Dugan.