PRIVATE ANSWERS

500

Equity Private is the online moniker of an unidentified woman working in a mid-sized Manhattan private equity firm who, through her blog, Going Private, at equityprivate.typepad.com, has faithfully and wittily documented the private equity boom since February 2006. She took a few minutes out of her deal-making recently to participate in a rare e-mail interview with *Canadian Business* staff writer **JEFF SANFORD**.

CB: What is the mood on Wall Street around private equity these days?

EP: Wall Street tends to like private equity. After all, the sector generates a *ton* of fees for everyone. Lawyers. Bankers. Brokers. Accountants. Consultants.

Where is the private equity market at right now? Are we at a peak?

The massive "club deals" are, of course, on the wane. A combination of regulatory scrutiny and a lack of promising targets has pruned down those quite a bit. Any crusading Securities and Exchange Commission attorney who thinks that [Stephen] Schwarzman and [Henry] Kravis are conspiring to keep bids low by doing club deals hasn't seen the two of them in a room together. Kravis didn't even get invited to Schwarzman's birthday party, for crying out loud. What, wasn't the list big enough? He only invited [a reported] 1,500 people.

Moving down the size-sorted list, the larger buyouts are seeing pretty big multiples. A lot of the low-hanging fruit was picked long ago and firms are starting to do strange things to keep returns up. Things like private investment in public equity deals or Blackstone taking a stake in Deutsche Telekom, for instance. This is worrying. All of this sort of plays into the theme I replay often that leveraged buyouts are, or should be, about turnarounds or operational excellence, not leverage. That presupposes your targets are undervalued and fixable.

Of course, there is still a lot of stuff going on in mid-market and even small buyouts. Debt is still reasonably cheap. You don't have as many "covenant lite" deals happening, but remember that during the last big LBO boom, interest rates were at double-digit levels in the United States. That was back when you made money with significant operational improvements. You had to.

So, is there a pause? A downturn? Depends what you're talking about. If you are talking about the massive deals at double-digit EBITDA multiples, probably. But those weren't what I would consider "pure" LBO's anyhow. The middle-market transactions of the sort that my firm does are pretty strong and will probably continue at a reasonable pace for quite a while.

And, of course, there is distressed investing. I am interested to see what happens during the upcoming downturn, which I expect, because of the amount of liquidity around that could easily pour into distressed debt. LBOs that have blown up might very well be recapped by LBO firms and hedge funds, if regulators get off their anti-business agenda in the United States.

What other trends have caught your eye?

The sudden move of both hedge funds and private equity into

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public relations. I suppose it is telling that boom-bust cycles have their equivalents in public opinion, but the zeal with which Americans punish capitalists still fascinates me. In some ways the arbitrariness of it frightens me. I mean what does it tell you when in the land of free markets the ultimate capitalists need public relations firms like they were a married presidential candidate that just got caught sleeping with a 17-year-old?

Are we going to see a flood of IPOs in the years ahead as LBO firms refloat many of the companies they took private? Are we going to hear complaints about that?

There is this interesting dynamic afoot. The market punishes a firm for not making short-term decisions. That presses firms to make short-term decisions. The firm then stagnates because it hasn't invested in growth. How can it? The stock price will get pounded. I call it the tyranny of quarterly numbers.

Then, a bunch of astute investors with a lot of capital and good financing take the firm private and make the sort of changes that are required to position the firm for the long term. Mind you, when they do that they do it at a premium to the market. But no one really complains much when they get a 15% jump in stock price in a few days. So the company goes private.

Then, a year later there's a new CEO, the balance sheet has been appropriately dealt with, earnings are up and the IPO market is booming. Of *course* the private equity gals are going to float it. And the public eats it up at twice the price, even after the private equity gals pay themselves a special dividend and use debt to finance it.

But then right after the transaction the whining starts. First, people whine that the public shareholders who were in the company when it went private have been cheated. No one was complaining when they got a 15% premium. Hell, those shareholders probably thought they had gotten a gift. I mean really, why do you think the stock price was languishing for months or years, because the original shareholders were convinced it was worth twice that?

So really what you have when you hear this argument is a defence of idiot, short-term-focused shareholders. Forget that they themselves have depressed the stock price to half of what the firm could be. Forget that the incentives of the public markets have destroyed the value here. Let's insist that shareholders who sell out at 15% premiums and share in *none* of the risk of holding what is now a highly illiquid investment privately and making the changes required to boost its value after it's taken private share in the "windfall" of the IPO. Greedy LBO bastards. Why should we let them keep all the value they've created?

Then you hear the argument, how could that much change have been undertaken in 12 months? Never mind that it is one of the most liquid and efficient markets in the world, the United States capital markets system, that repriced just the firm at 200% of its original "going private" figure. Never mind that it was the same capital markets that took a 15% premium when the firm went private in the first place and counted themselves lucky. America is very conflicted in this, I think. They love a winner. Unless the winner is rich.

This discussion, that somehow it is hypocritical to buy from the public markets low and sell to the public markets high, is just nonsense to me. We might as well ban anyone who makes money in the stock market. God forbid we would find capitalists in the capital markets, right?

What's the next hot sector or region for private equity?

Distressed investing. Europe. There is a lot of inefficiency in Europe. Labour still rules many companies. You have lots of family-owned businesses that have been in the same hands for generations but now the youngsters are far more interested in enjoying life than being capitalists. Lots of those firms will have to sell in the next 10 years.

What are the big players in the industry really like? Are there any defining characteristics for those who run private equity firms?

Oh, ego, certainly.

What has been your favourite new deal term this year?

Well, it was from last year, and it's my favourite because I invented it. "LIPO Suction." LIPO is the "Leveraged Initial Public Offering" that I used to describe debt-laden IPOs coming out of private equity shops. "Suction" to refer to the special dividend that sucked out hundreds of millions right before the LIPO.

What has the private equity industry taught you?

Trust no one. CB