

HUNGRY LIKE THE WOLF

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Blue Wolf Capital Management LLC stalks deals in a forest most mid-market buyout firms avoid — a patch where the activities of private companies and public agencies intertwine.

Created in April 2005 by two financial veterans who also spent time in government, Blue Wolf invests in businesses that have “unconventional constituents” that are critical to success. Those include government in the form of customer, regulator, subsidy contributor, or all three. They also can include tough labor unions in situations involving financial distress.

“We think we’re able to see value where many of our competitors get a little distracted or confused by a situation,” says Adam Blumenthal, Blue Wolf’s co-founder and managing partner.

Blumenthal and co-founding partner Josh Wolf-Powers have both worked for the city of New York. Blumenthal was first deputy comptroller for the metropolis from 2002 to 2005, and Wolf-Powers served as managing director of private markets for the New York comptroller’s office from 2003 to 2005.

This is not the first time Blumenthal has set out to build an investment firm. Prior to his stint in city government, he was president of publicly traded buyout and mezzanine fund

American Capital Strategies Ltd., which he joined in 1989 when it had yet to raise institutional capital.

As for **Wolf-Powers**, he was previously at KPS Special Situations Funds, joining the firm in 1998 after working at an investment banking job at **Goldman, Sachs & Co.**

The pair’s private-sector experience is Blue Wolf’s bedrock, even though their public-sector background is a key attribute.

“We’re not betting on our skill as policy analysts,” says Blumenthal. “We think we’re good at assessing business risk, especially in complex situations.”

So far, Blue Wolf has made one control investment: In January, it closed its purchase of **Montauk Energy Capital LLC** from a subsidiary of **Duquesne Light Holdings Inc.** for \$101.8 million.

Montauk is a Pittsburgh-based gas developer that operates eight landfill-gas-to-energy operations in the U.S. and has investments in an additional 13.

The company has multiple levels of government involvement and “that makes it very appealing to us,” says Blumenthal.

Gases that come out of landfills — mainly methane and carbon dioxide — are highly regulated substances,

he notes, and working effectively with regulatory agencies is critical to thriving in the business.

“Many people wouldn’t touch anything in the space,” Blumenthal says, because they don’t want to deal with the Environmental Protection Agency, which regulates the emissions.

However, “we think that air quality regulations are here to stay, and that [Montauk] can be analyzed and underwritten,” he says.

Montauk is also a joint venture partner in a commercial landfill-gas-to-liquefied-natural-gas project in Irvine, Calif., where gas is taken from the Bowerman landfill and used to fuel the local bus system in Orange County.

It’s the first-ever commercial landfill-gas-to-LNG project, according to Blumenthal, and Blue Wolf is working closely with the company to make sure it’s getting the greatest possible advantage from federal, state and local policies promoting renewable energy.

While Montauk does benefit from tax credits, “we did not value them,” Blumenthal is quick to add. Blue Wolf only invests in deals that are economically viable without subsidy, he says.

Blue Wolf currently has backing from one major institution, **Johnnic Holdings Ltd.**, a South African in-

vestment company.

Johnnic's parent is Hosken Consolidated Investments Ltd. Both trade on the Johannesburg stock exchange.

The chairmen of the two South African companies also invested in American Capital Strategies' initial public offering in 1997, so when Blumenthal and Wolf-Powers set out to create Blue Wolf, it was "quite natural that we went back to them," says Blumenthal.

Generally, Blue Wolf looks at companies generating \$5 million to \$25 million of Ebitda and posting revenue of \$25 million to \$250 million a year.

The firm used co-investments to help back the Montauk deal, in which it injected \$57 million of equity. "That would be at the upper end" of what the firm plans to invest, Blumenthal says.

Blue Wolf is now looking at deals involving energy conservation strategies — specifically, energy service companies, ESCOs for short.

ESCOs help businesses save money by upgrading their buildings to improve energy efficiency. Extracting savings might be as simple as replacing a 100-watt light bulb with a 60-watt light bulb, or replacing a boiler, says Wolf-Powers. Or it could involve computerizing a control system to keep temperatures in a particular heating zone accurate to within a half

a degree.

Energy service companies are particularly popular with hospital, school and government facilities that don't have the benefit of a large commercial property management company, says Blumenthal.

While Blue Wolf views the growing field as promising for potential transactions, many investment firms might shy from businesses that contract with the government because they believe the government is an unreliable customer, he says.

However, based on his experience working for the city of New York, Blumenthal sees government as a loyal customer. Despite delays and payment systems that are often seen as erratic and cumbersome, there's security in the revenue, he says.

"We know it can take a long time for a city to pay a bill," he adds. "We also know the city is going to pay the bill."

Blue Wolf has also taken a close look at a fair number of unionized companies where stable labor relations are critical to maintaining the value of the business, says Blumenthal. Both co-founders have long track records with heavily unionized environments, he says.

When Blumenthal was at **American Capital Strategies**, for instance,

one of the transactions he says he enjoyed most involved a California bakery business called Four S Baking Co. that had "a long history of extraordinarily contentious labor management relations." Indeed, its parent company, **Interstate Bakeries Corp.**, was prepared to shut the side-business down.

American Capital stepped in with a new management team and a new labor agreement, which included profit sharing. The firm took a company with hostile labor-management problems and turned the situation into something positive, Blumenthal says.

Including senior debt and equity, the sponsor realized a 39% annual compound return on its investment, he adds.

Complex situations and the sometimes opaque world of government can scare off investors, if only because they are unfamiliar with the sector's dynamic.

Not Blue Wolf and its team of four investment professionals. The firm's experience in that realm gives it an ability to see clearly beyond what might initially meet the eye — and to act accordingly.

"We find very limited competition for most of the transactions we think are really exciting," says Blumenthal.

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