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## Appetite for (Creative?) Destruction

By GREGORY ZUCKERMAN  
AND RYAN DEZEMBER

Private-equity firms have been called barbarians, locusts, flippers and asset-strippers. They also have been praised for improving weak businesses and delivering impressive returns to their investors, which include retiree pension funds.

These dueling images of the industry have come into stark relief, as the merits of private-equity investing have emerged as a hot-button issue in the presidential campaign. Some candidates have accused Republican presidential hopeful Mitt Romney of destroying jobs and companies at private-equity firm Bain Capital, which he helped found and later left in 1999.

Industry participants—and some critics—say there is truth to both perspectives.

Private equity specializes in leveraged buyouts, or deals funded by debt that is loaded on to the target company's balance sheet. The acquired companies often are restructured to reduce costs, improve efficiency and repay the debt, before being sold or listed on the public markets.

A few recent deals show how leveraged-buyout barons can fund innovation and growth, create jobs and sometimes rebuild companies in challenging industries. Other times, private-equity deals result in onerous debt loads, losses and deep layoffs.

In early 2010, Gloucester Engineering Co., which manufactures machines that make thin plastics like those used in trash bags, was saddled with debt and hurtling toward bankruptcy. The Massachusetts company's management informed union officials it planned layoffs and needed concessions from remaining workers. Word of

the company's distress reached customers, who began canceling orders.

A union representative, Mike Vartabedian, knew a lawyer who put him in touch with Blue Wolf Capital Partners, a New York private-equity firm with a reputation for teaming up with labor in its investments. He asked Blue Wolf to step in.

Blue Wolf, which manages a \$118 million fund, invested in Gloucester just as it went into Chapter 11 bankruptcy protection, and bought the entire company when it re-emerged from bankruptcy in late 2010. "If we could fix the operational issues, there was no reason we couldn't see this grow," said Blue Wolf managing partner Adam Blumenthal.

Blue Wolf brought in a new management team, installed a computer system that helped better manage inventory and estimate job costs, and built up a business to service Gloucester equipment around the world. It also struck a deal with union workers that Mr. Vartabedian says kept pay and pensions unchanged but mandated employees perform a wider range of tasks than their previous job descriptions allowed.

"The one goal we had was to make the company successful," said Joe Orlando, who took on multiple roles, including maintenance and truck driving under the new union agreement. "There were a lot of people that live in Gloucester and wanted to keep the jobs here."

Gloucester now employs about 100 workers, up from 30 at the time of the bankruptcy. Mr. Blumenthal said he expects substantial job growth over the next several years.

Other deals aren't as satisfying to all parties.

When KKR & Co. and TPG Holdings purchased TXU Corp., Texas' largest power generator, in a \$45 billion leveraged buyout in 2007—then the largest ever such deal—the private-equity firms left the utility with \$35 billion in debt, up from \$11 billion before the takeover.

All that debt has put pressure on the utility, since renamed Energy Future Holdings. At the same time, a plunge in natural-gas prices has eaten into revenues by reducing prices the utility charges for its power. Today, Energy Future's debt trades at less than 50 cents on the dollar, suggesting that investors anticipate a default.

Despite the difficulties, Energy Future has added jobs by adding three new coal units since the buyout, expanding its employee base by 25% to about 9,400, the company says.

One problem with assessing buyouts is that it is hard to tell what a company's fate would have been had a buyout not taken place. It is especially tough because buyout specialists often target troubled industries.

In 2006, Apollo Global Management and other leveraged-buyout specialists purchased Linens 'N Things for \$1.3 billion. They used \$260 million of cash and added more than \$1 billion of debt to the already-struggling company.

Apollo and the other buyers failed to improve operations quickly enough to turn the company around. The economic downturn compounded the problems, as did all the debt the firms piled onto the retailer.

In 2008, New Jersey-based Linens 'N Things filed for bankruptcy protection. Apollo, the other buyout firms and the firms' investors, together lost the \$260 million they had invested.

The failure didn't hurt Apollo

very much: Apollo had invested just 2% of its most-recent buyout fund in Linens 'N Things. The fund delivered profits topping the stock market's gains between its launch in 2001 and September of last year, according to the most recent data shared with investors.

As for the retailer, it closed 120 stores and let go 2,500 full-time and part-time employees. The company was liquidated and the estate sold the Linens 'N Things name. The price: \$1 million.

A spokesman for Apollo declined to comment.

It is also true that much of the debate over private equity is based on methods that are increasingly not practical, in part due to pressures from the 2008 financial crisis.

Unable to take on as much inexpensive debt as they did in previous years, some private-equity firms have been using less debt and searching for ways to expand companies, rather than strip and sell their assets.

But less debt can mean lower returns, which isn't great news for private-equity's investors, including public pension funds and university endowments. Data show the industry's performance has been declining, although it still has been beating the broad stock market.

As for jobs, there is no doubt that many buyouts result in job losses, as private-equity firms often try to streamline operations and trim expenses. What is less clear is whether, over time, those jobs are regained and new ones added as some companies emerge stronger.

A recent study found that initial job losses often are later recovered, with net job loss at private-equity-owned companies about 1% more than comparable companies.