March 17, 2007

PAGE ONE

Big Buyout Firm Prepares to Sell Stake to Public

Blackstone Would Add To Its Financial Clout; A Sign of Market Peak?

By DENNIS K. BERMAN and HENNY SENDER
March 17, 2007; Page A1

NEW YORK -- The king of private equity is expected to go public.

Blackstone Group, the lucrative partnership that has grown rich taking public companies private, is in advanced stages of planning an initial public offering of roughly 10% of its management company, according to people familiar with the matter. An offering of that size would conservatively value the entire enterprise at $40 billion.

Such a move would give Blackstone even greater financial clout, including more money of its own to invest in deals. But it also may signal that Blackstone partners think the financial market has hit a peak.

VIDEO
1

WSJ Reporter Henny Sender[2] and others discuss the wisdom of a Blackstone IPO

and the potential impact on other private-equity firms.
GOING PUBLIC

- **Graphic:** Private Equity Profiles[3]
- **Q&A:** Opening the Hedges[4]
- Fees, Management Companies Keys to IPOs[5]
- For Fortress, Perfect Time to Go Public[6]
- Hedge Funds Eye Riches After Fortress IPO[7]
- Private-Equity Firms Delay IPOs[8]
- KKR's $5 Billion IPO Experiment[9]

An IPO would offer everyday investors the benefits -- and risks -- of sharing in a business that historically has been the sole preserve of sophisticated institutions and wealthy individuals. The largest private-equity firms have had massive, 100%-plus annual returns in recent years, bringing one household name after another -- from Hertz to Burger King -- under private ownership.

Private-equity firms either buy companies or divisions of companies on behalf of their own investors, take them private, and then sell them off within a few years. A Blackstone IPO might well be followed by other well-heeled private partnerships -- whether hedge funds or buyout firms. Should that occur, it would signal a significant shift in the capital markets, which have become dominated by these firms that have prospered because they have access to cheap credit, aren't subject to the regulations governing public companies and pay the executives at companies they acquire handsomely.

Blackstone and several rivals have been exploring IPOs in the wake of the successful stock-market listing of hedge fund Fortress Group in January. The speed of Blackstone's decision is surprising and may reflect the belief of Stephen Schwarzman, Blackstone's co-founder and chief executive officer, that market conditions are worsening. Both Mr. Schwarzman and Blackstone President Tony James have in recent weeks been privately and publicly warning about a turn in financial conditions, especially in terms of their own firm's ability to finance acquisitions via cheap and ever-plentiful financing offered by Wall Street banks.

"They're monetizing the reputation that they've built," said Colin C. Blaydon, director of the Center for Private Equity and Entrepreneurship at Dartmouth University's Tuck business school. "That often means you're at the top."

By going public, Blackstone would gain a source of permanent capital, since money raised from on the open market never has to be returned. Blackstone then wouldn't need to depend on endless rounds of time-consuming fundraising from its usual investors: public and corporate pension funds, endowments and wealthy families. It also would get a powerful advantage over rival bidders since once it has listed, it could offer its stock as well as cash to finance acquisitions. That could

Stephen Schwarzman

enable it to outbid competitors, whether other private equity firms armed with cash or industrial firms that often use stock to partly pay for acquisitions. Blackstone already boasts the largest private-equity fund at $20.6 billion. It has $55 billion of capital under management.

"They can use this to further institutionalize their business and make sure Blackstone is around 100 years from now, versus relying on any one personality," says Christopher Bower, chairman of Pacific Corporate Group.

Blackstone's plans were reported earlier by CNBC.

Blackstone's management company, a partnership of about 60 investors, has been on a buying spree and owns everything from Madame Tussauds wax museums and Mrs. Paul's fish sticks to the country's largest office landlord, Equity Office Properties Trust. Blackstone has separate arms that invest in hedge funds and advise corporate clients on mergers and restructurings.

The personal wealth created for Blackstone partners by a public offering could be staggering. Much of the proceeds of any initial offer will likely go to the Blackstone's two founders, Pete Peterson, a former commerce secretary under President Nixon, and Mr. Schwarzman, with the bulk going to Mr. Schwarzman. Mr. Schwarzman, who is said to be worth upward of $10 billion now, could double that.

Around Blackstone, the joke for years has been that the firm is like a pool table with one leg shorter than the others -- so all the balls gravitated to that corner. That leg was said to be Mr. Schwarzman, who often keeps half of a given fund's returns since he holds the biggest stake and is its biggest rainmaker.

Mr. Schwarzman, along with Henry Kravis of Kohlberg Kravis Roberts & Co., has become a poster child of the private equity world. But while Mr. Kravis is associated with the early, raw days of private equity in the 1980s, Mr. Schwarzman is considered the new "King of Wall Street," as he was dubbed on a recent Fortune magazine cover. His recent 60th birthday celebration, which featured singer Rod Stewart and was emceed by actor Martin Short, was the talk of New York society.

Such a high profile, though, could cause a public backlash in an environment when anger is rising over what is seen as excessive compensation for top executives and a widening income gap in the U.S. In addition, should small shareholders buy into Blackstone's IPO, it would expose them to some of the risks of private-equity funds. That could attract more attention in a Congress controlled by Democrats. Lawmakers are already discussing ways to potentially limit how much money pension funds can invest in hedge funds, thereby limiting the risk a fund blow-up could indirectly have on its retirees.

More important, some Senate staffers are examining whether to change tax rules in such a way that would force hedge funds and private-equity firms to pay higher taxes on their massive profits. Every time a private-equity firm sells one of its companies, whether to a single buyer or through the public markets, 20% of the profits go to the management company. Investors in private-equity firms also pay management fees of about 1.5% of the money under control. So when Blackstone recently raised $20 billion, it pocketed about $300 million in fees.

In addition, private-equity firms pocket an array of fees from the companies they buy. Just for sealing the deal to buy Equity Office Properties last month, for example, Blackstone got to share a success fee of $400 million with its investors. It gets additional fees for arranging financing for its portfolio companies and for monitoring them.

There would be plenty of irony in a Blackstone public offering. Mr. Schwarzman has for years evangelized against the failings of public-market ownership to companies he hoped to acquire. In a series of recent public appearances, Mr. Schwarzman has been unsparing, calling public stockholding "a broken system" and criticizing the 2002 Sarbanes-Oxley corporate-accountability law as having "taken a lot of the entrepreneurial zeal out of a lot of corporate managers." Quarterly earnings reports for public companies, he has said, create a "tyranny."

Blackstone's plans may point to a much deeper shift in the financial markets. The lines between public firms and private concerns are continuing to blur. The next few years, a number of Wall Street denizens say, might see the creation of hybrid companies that exist simultaneously in the public and private spheres.

Indeed, Blackstone's decision is likely to lead to a race by others to follow suit. Carlyle, KKR and TPG -- the former Texas Pacific Group -- have all been considering a similar step and may be forced to imitate a Blackstone IPO if only to have equal firepower in competing for attractive targets.

The frenzied demand for the Fortress listing showed investors are willing to pay up to tap into the magic of alternative investment firms. At the same time, though, when markets are volatile, the advantage of going first may be considerable. Blackstone, Carlyle and TPG learned this lesson last year when Blackstone's arch rival, KKR, listed a fund in Europe that would invest in its deals. Demand was so strong that KKR expanded the offer from $1.5 billion to $5 billion. That left little demand for anything that followed, to the frustration of rivals which then abandoned plans to launch similar units.

So far, Boston-based Bain Capital has been about the only large private-equity firm to show little enthusiasm for going public. But senior people at Bain concede they may be forced to consider such a move if all their competitors do so, according to people familiar with the matter.

The Fortress experience also offers a cautionary tale, however. Just one month ago, Fortress stock was listed at $18.50 and soared to $35 on its first day. Its now trading at $25.83, so investors who entered the stock at the high point have lost a third of their money.

--Tennille Tracy and Kara Scannell contributed to this article.

Write to Dennis K. Berman at dennis.berman@wsj.com[10] and Henny Sender at henny.sender@wsj.com[11]

URL for this article:
http://online.wsj.com/article/SB117405731529839461.html

Hyperlinks in this Article:
(1)
http://release.theplatform.com/content.select?pid=9NUKCW69ncGZTKB46QfboXJf_W_T5LOW
(2)
http://release.theplatform.com/content.select?pid=9NUKCW69ncGZTKB46QfboXJf_W_T5LOW
(3) OpenWin('/public/resources/documents/info-pequity0607.html','pequity0607','736','590','off','true',20,0);void('');return false;
(4) http://online.wsj.com/article/SB116611696223650358.html
(5) http://online.wsj.com/article/SB117407438663039708.html
(6) http://online.wsj.com/article/SB117098515181903162.html
(7) http://online.wsj.com/article/SB117103622648403759.html
(8) http://online.wsj.com/article/SB115016833117578658.html
(9) http://online.wsj.com/article/SB114652945050641009.html
(10) mailto:dennis.berman@wsj.com
(11) mailto:henny.sender@wsj.com