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Blackstone Plan Could Reshape Private Equity

Listing Would Require Public Disclosures Likely To Intensify Scrutiny

By HENNY SENDER
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Blackstone Group's expected decision to seek money from public shareholders will place under scrutiny -- and possibly lead to changes in -- the highly lucrative private-equity business model that has transformed Wall Street in recent years.

Blackstone, which has grown rich taking public companies private, is in the advanced stages of planning an initial public offering of roughly 10% of the firm's core partnership, according to people familiar with the matter.

That prospect worries other private-equity firms. The hefty fees the partnership charges the big investors who supply its buyout funds make it potentially attractive to public shareholders. Taking the partnership at its heart public might oblige Blackstone to disclose how much of those fees it keeps for itself, and other private-equity firms aren't eager for that to happen. Any such disclosures, while they could be good for investors, might expose Blackstone and its rivals to criticism from their investors -- and from lawmakers.

Stephen Schwarzman

All told, Blackstone, which has been involved in some of the biggest corporate buyouts in recent years, has about $55 billion in funds under management. It charges its investors a 1.5% management fee and charges the companies in its investment portfolio a host of other fees it splits with investors. The firm also takes a 20% cut of profits made by its funds when they invest in or sell companies.

Private-equity firms use a combination of funds they raise from big investors and a lot of debt to buy companies, reshape them outside of the limelight, and then cash out later, hopefully at a profit. The profits from Blackstone's private-equity business aren't known, but the firm has told investors that its returns from the business both last year and the previous year exceeded 100%.

Blackstone has a portfolio of companies as large and diverse as any conglomerate, including German chemical company Celanese Corp., which it took private and then relisted in New York, and Madame Tussauds waxwork museums.

VIDEO
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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

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It recently bought Equity Office Properties, the largest office landlord in the U.S., in a $23 billion deal. Last year, as part of a partnership, it bought Danish telecommunications firm TDS AS for $12 billion, in one of Europe's largest buyout deals.

Like many such firms, Blackstone's biggest investors include many of the same endowments and public pension funds that are demanding better corporate governance from publicly traded companies. These investors, known as limited partners, may not know in detail how much of Blackstone's fees go toward expenses and how much to the firm's bottom line.

Private Property

Some of Blackstone's investments

Property	Sector
Celanese	Chemicals & pharm.
Vanguard Health	Health care
Nielsen	Media & publishing
SunGard	Technology
Michaels Stores	Consumer & retail
TRW Automotive	Automotive
Travelport	Transportation
Nalco	Chemicals & pharm.

Source: the company

More familiarity with the firm's practices could lead investors in Blackstone's funds to call for lower fees or a greater share of other sets of fees that Blackstone charges the companies it acquires or the individual funds it manages. Eventually, the demands of its pension-fund investors -- or their public overseers -- could lead to a spate of similar demands on other private-equity firms that could reduce those firms' profits.

"This will force limited partners to say 'We are paying you all too much,'" says a founder of another major private-equity firm.

Their demands could conflict with pressure from the potential public shareholders in Blackstone's core management partnership to extract as much money as it can from its buyout-fund investors and the companies it owns.

"If you're investing in the manager that's getting fees, those higher fees are in your interest," says Barry Barbash, a former Securities and Exchange Commission official who now heads the asset-management group at Willkie Farr & Gallagher, a law firm.

In addition, a public listing could alter Blackstone's standing on Wall Street. Traditional Wall Street firms have increasingly regarded Blackstone as a rival, given that some of them are aggressively building up their own private-equity arms. At the same time, Blackstone is treading on their turf by building up advisory and money-management businesses.

A public listing would emphasize Blackstone's growing power against Wall Street. Moreover, Blackstone could use its new stock to acquire Wall Street firms.

Should Blackstone list at a valuation of some $40 billion, as some have predicted, that would make it worth more than **Lehman Brothers Holdings** Inc. and nearly twice the value of **Charles Schwab** Corp.

The idea of public listing has been pushed by Stephen Schwarzman, Blackstone's chief and co-founder, according to people familiar with the firm. Mr. Schwarzman first had to persuade his own top lieutenants, including co-founder Pete Peterson; Tony James, a veteran Wall Street executive brought in five years ago as president and Mr. Schwarzman's eventual successor; and J. Tomlinson Hill, who runs the lucrative business that invests in hedge funds on behalf of Blackstone's partners and outside investors. They are still considering the idea, according to people familiar with the matter.

The other top partners were initially reluctant, but Mr. Schwarzman, who may own about 40% of the firm, has come up with a structure that he believes will insulate them from undue interference from the outside world, allowing Blackstone to "maintain its privacy and autonomy" while reaping the advantages of a public valuation, one person familiar with the firm said.

One possibility is that Blackstone could adopt a structure similar to a so-called master limited partnership or a real-estate investment trust, in which investors get a cut of the fees and profits but a private entity administers them. That way, such sensitive matters as how the money gets distributed within Blackstone might not have to be disclosed.

Another possibility, though less likely, is that Blackstone would adopt a structure with two classes of stock, allowing the partners to exercise significant control with supervoting shares. That option, however, wouldn't exempt Blackstone from various stock-listing rules, such as having to have independent directors and complying with the Sarbanes-Oxley corporate-accountability law.

A spokesman for Blackstone declined to comment.

Blackstone is nearly done raising a planned $20 billion private-equity fund and is in the process of raising a $10 billion real-estate fund. Securities rules prohibit firms from saying anything that could be viewed as marketing a fund.

Despite his well-known antipathy toward the restrictions on public companies, Blackstone's Mr. Schwarzman has worried about one of his rivals beating him into the public market, according to people who know him. Last year, Kohlberg Kravis Roberts & Co. listed one of its funds in Europe, scooping up all demand, to Mr. Schwarzman's displeasure. "Steve is a street fighter and a genius," says his longtime friend Tom Barrack, head of Colony Capital, a Los Angeles-based private-equity firm specializing in real estate.

Mr. Schwarzman has imbued the firm with his determination that any rival "feel the pain," as he puts it. Recently, he has been obsessed with communicating a single message to the market: Nobody wins something that Blackstone wants. "I want war, not a series of skirmishes," Mr. Schwarzman said recently about his philosophy. "I always think about what will kill off the other person."

The wealth he has accumulated from his deal making is estimated at about $10 billion. That kind of money makes him and other private-equity executives a lightning rod for controversy amid Washington's growing scrutiny of executive compensation and the widening income gap between rich and poor.

New SEC disclosure rules require extensive disclosure of executive pay, giving shareholders much more knowledge of the perks and benefits enjoyed by top executives. Top partners at private-equity firms are among the best-compensated executives in the world.

On Capitol Hill, some Senate staffers are evaluating whether to change tax rules for private-equity firms and hedge funds. One issue being discussed is the tax treatment of "carried interest," a cut of profits -- typically 20% -- that fund managers often are entitled to. Currently, the interest is taxed at 15%, the capital-gains rate.

Senate aides have raised the question of whether those sums should be subject to regular income-tax rates of as much as 35%. Such a move would be a big blow to the private-equity industry since a vast chunk of its profits comes from this carried interest.

Many existing investors in Blackstone are likely to balk at a public listing of the firm, primarily because it would reduce their clout with the powerful firm. Limited partners have already received hints that they are no longer indispensable, particularly when times are good.

That message was delivered with special force last year, when KKR, a Blackstone rival, listed a fund in Amsterdam, which gave it permanent capital on more favorable terms than its traditional investors gave it for the life of a single fund. KKR's traditional investors objected to the fact that the new fund got chunks of some juicy deals, reducing their own share. They also feared that their own interests were no longer necessarily in line with those of KKR itself.

Blackstone's plan, according to people familiar with the matter, is to continue to try to court traditional investors and raise money through its usual fund structure, even though the listed management company could supplement or supplant these investors with the money it raises from the public.

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