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Affirmation very grateful to Vault's entire staff for all their assistance in editorial, production and marketing processes. Vault also would like to acknowledge the support of our investors, customers, employees, family and friends. Thank you! Adapted from: Quan (miaoquan@gmail.com) 8. Table of contents INTRODUCTION 1 What is private capital? 1 Scoop 3. . 5 Role of private equity firm . 5 Modern private equity . 7 Big names . 8 See Kohlberg Kravis Roberts & Co. . Chapter 12: Short history of private equity 15 Beginnings . 15 Greed is good: modern private capital . 15, 2007. 17 Public going . 19 Looking ahead . Chapter 20: How private capital works 21 Fund creation . 21 Finding a goal . 22 Making a transaction . 24 Getting funding . .25 Opening the company value . 27Died: Quan (miaoquan@gmail.com) Exit strategy: Return on investment . 28 Private equity actors . 30 Best Players . 33 Famous big deals . 35 Visit vault finance career channel www.vault.com/finance-koos career insider profiles, bulletin boards, Vault Finance Job Board and more. LIBRARY IX 9. Vault Career Guide Private Equity Table of Contents HIRED 39 Chapter 4: What is a private equity firm looking for? 41 Education . 41 Experience . 4 2 Type of person . 42. Chapter 5: Finding Work 45 Getting In the Door. 46 Resume the sample . 52 A long way around . 55 Work and networking . Chapter 57: Interview with 59 sample expert questions . 60 Model knowledge issues . 60 Personality model questions . 61 Demonstration vision issues . 62 Your turn: Questions you should ask . Chapter 65: Living as a private equity specialist 67 Lifestyle . 67 Remuneration and allowances . 68 Development opportunities . 69 Day in the life: beginner . 70Sed: Quan (miaoquan@gmail.com) Day in the life: Scientist . 71 Day in the life: Fund raising and investor relations . 72 Day in the Life: Deal-Maker. 74 Day in the life: Portfolio Manager Manager . 75 CAREER x LIBRARY © 2008 Vault.com Inc. 10. Vault Career Guide to Private Equity Contents Contents Chapter 8: Private Equity Career Paths 77 Typical Career Paths. 77 In private equity firm . 78 Departure from private equity . 79 Further training and improvement . 81 FINAL ANALYSIS 83 APPENDIX 85 Useful websites . . . . 87 Specific websites . Recommended reading . 89 ABOUT AUTHOR 91S: Quan (miaoquan@gmail.com) Visit Vault Finance Career Channel www.vault.com/finance-koos CAREER INSIDER PROFILES, Message Boards, Vault Finance Job Board and more. Library xi 11. Introduction What is private capital? In the broadest sense, private equity is an investment from a public entity. Of course, by this definition, any person who owns one share is indeed a private equity investor. The private capital we are talking about is much higher; these individuals do not only invest in shares – they buy whole companies. In today's private equity, private investors generate capital, from university donations and pension funds to hedge funds, Wall Street investment banks and high net worth individuals. Managers of their private equity reserves, or funds, then try to put that capital to work, generally by buying private or state companies, setting them up so that they earn more income, money and income, and then flipping them by selling an advanced company to another buyer or taking it to public equity markets. However, private equity investments are not just the purchase and sale of companies. Many private equity firms invest in debt, helping the company save itself by lending it money in return for an equity position or other form of income. Some private equity funds for private equity direct funds in startup companies called venture capital firms, although a diversified private equity management company often involves venture capital activities with acquisitions and debt purchases. Venture capital investments are often made in exchange for equity in a private company that the company hopes will make a big profit when the startup goes public or get sold. However, today's private equity landscape is once dominated by the acquisition of public companies. Since 2001, 2,316 publicly traded companies have been purchased with the support of private equity firms, with a total value of $1.065 trillion, according to the National Venture Capital Association. During the same period, 384 companies were returned to the market through an initial public offer (although the initial is a little misleading because many of these companies were public once before), the rest were either sold to other companies, to the public or to the adjusted: Quan (miaoquan@gmail.com) private, or remain private equity. From 2006 onwards, it will be the first time that the Commission has been privately held companies to be swallowed up during this period. And even among the 30 stocks that comprise the Dow Jones industrial average, these blue-chip stocks were said to represent the American economy as a whole, with private equity takeover rumors swirling around such luminaries as Alcoa and Home Depot in early 2007. The record takeover deal is worth $44 billion in cash and debt, the 2007 acquisition of utility TXU Corp. For a while, Wall Street was gearing up for the first $100 billion takeover; In the second half of 2007, with market turmoil, it may have to wait... but it's coming. Visit Vault Finance Careers Channel www.vault.com/finance - insider career company profiles, message boards, Vault Consulting Job Board and more. Library 112. PRIVA EQUITE Scoop CARE Chapter 1: Private Equity Fundamentals Chapter 2: A Brief History of Private Equity Chapter 3: How Private Equity WorksCustomized for: Quan (miaoquan@gmail.com) Visit the Vault Consulting Career Channel at www.vault.com/Consulting-Insider Company Profiles, Message Boards Vault, Finance Job Board and more. 13th Adapted: Quan (miaoquan@gmail.com) 4 CAREER LIBRARY © 2008 Vault.com Inc. 14. Private equity fundamentals CHAPTER 1 Who are private equity investors? The institutions and people who invest in private equity funds are the most prosperous in the world. Larger pension funds, such as California's Public Employee Pension Systems (CalPERS), put some of their money into private equity funds to boost returns. Major Wall Street investment banks also put investments in private equity funds-if of course they create their own in-house private equity funds as did Goldman Sachs and Morgan Stanley. Hedge funds often invest in private equity funds, as these funds have gathered outstanding results over the years. Indeed, some hedge funds have blurred the line between their own and private equity firms by participating in the redemption of public companies, either independently or in cooperation with traditional private equity firms. Finally, companies themselves often invest heavily in their private equity funds. Private and, more recently, public companies that manage the private equity pool ensure that their interests are in line with the interests of investors by mixing much of their wealth. This, of course, is a breed of private equity dealmakers who have joined the billionaire club, most famously Henry Kravis in KKR or current industry poster boy Steve Schwarzman of Blackstone. Roll Private Equity Firm These investors do not want to manage these high-value, high-return investments themselves. Indeed, CalPERS is outstanding in managing money and making sure millions of California seniors get their control every month, no market conditions. But do they have the knowledge to find a good companycustomized for: Quan (miaoquan@gmail.com) to buy, run that company, and then bring it public or sell it? This is where private equity firms - and you, potentially - come in as a private equity firm playing multiple roles during a typical investment. For example: • Raising the fund. Private equity is the centre of private equity. The company raises capital from the different constituencies mentioned above and then manages that capital appropriately until the investment is identified. In addition to the same people who raise capital, visit the Vault Finance Career Channel at www.vault.com/finance-insider CAREER company profiles, bulletin boards, Vault Finance Job Board and more. Library 5 15. The Vault Career Guide for private equity fundamentals also helps to get credit for any leverage required for buyouts. Finally, they manage the payments to all concerned. • Find a target. Companies hire researchers to analyse the activities of thousands of companies in search of possible investments. Sometimes it's easy- many companies readily announce that they are looking at strategic options, business talk to put themselves up for sale. But there are many options in other companies, even those that seem to work just fine. Researchers know the strengths of the different management teams of a private equity firm and are able to identify possible goals based on the company's ability to make even more profit from its strengths. And yet in other cases, the fund may just see a very conservative company underuse its resource-chain casual dining restaurants, for example, that hasn't leveraged the real estate it owns to the extent it could expand. There are many ways to find a target that we will discuss later. • Termination of the transaction. The fund must then contact the company or, in some cases, manage the company's approach to it and try to make a transaction. This is very similar to the merger and acquisition dance two exchange-traded companies can do. The private equity firm hires a Wall Street investment bank for its advisory firm, although its own cadre of dealmakers and due diligence teams is often as talented as that of an advisory firm. The deal is hammered out, which usually gives the company's current shareholders a premium over the current price per share, giving the private equity firm enough room to make even more impressive profits along the way. • Company management. When a private equity firm buys a company, the deal generally disappears from the news, but the hard work is just beginning. The company, which represents new owners, has a plan to maximize profits ready to go-that was part of the targeted and acquisition The company will then bring in individuals who it believes can implement this plan. Adapted: Quan (miaoquan@gmail.com) Such plans often include a variety of cost-cutting measures, including new management and production processes and redundancies. This also usually involves borrowing quite a bit of money–generally much more than investors in an exchange-traded company would stand for. As a general rule, private equity firms are aggressive managers and leverage is immediately put to work. In recent years, this leverage has also helped to give early payout to investors in the fund – essentially using the company's good name to sell bonds, the proceeds of which are then distributed to the new owners. One of the biggest discussions about private equity is whether THE CAREER 6 LIBRARY © 2008 Vault.com Inc. 16. The Vault Career Guide to Private Equity Fundamentals for such debt is legitimate or even ethical, but if a company goes into private hands, there are few regulators can do. • exit strategy. There are several ways to loosen up equity investments and raise profits. One of them is to sell the company to another entity, a company generally already established, which was identified as a potential buyer at the beginning of the due diligence procedure. The private equity sip company has done all the hard work, after all, making it more attractive for a big company to buy. Alternatively, some companies that have just purchased the shares-had speculation that Toys R Us would have been a much more profitable investment if its private equity buyers simply closed the struggling toy retail business and sold all their properties out. Finally, and in particular, the private equity company will reverse it by returning it to the public equity markets through an initial public offering. In general, a company needs to be stronger than it was when purchased private equity investors get good returns, although in some cases, especially hertz's IPO, companies may be overwhelmed with debt. Private investors generally receive IPO income, although in some cases at least part of the income goes to the company itself. Of course, a private equity firm needs a variety of talented employees to deal with billions of dollars and larger corporations. And that's where you come in. Private equity holds some of the most experienced talents of companies in America, and their personnel needs are as broad as deep. Whether you're fresh out of undergrad or an experienced corporate veteran, chances are you'll find a home for private equity firms. And in doing so, you are on hand to make billions for your investors, while directing the big companies, and the thousands of people they use, through major changes and improvements. Modern private equity firm for: Quan Currently, private equity firms are mainly aimed at purchasing companies or their shareholdings. However, some, including Bain Capital and The Blackstone Group in particular, have entered other businesses, including struggling debt and real estate. At the same time, hedge funds have also begun to dip into private equity, mainly through practice, but occasionally through their active efforts. However, the average private equity firm remains committed to the concept of buy-out. In the long term, the return on private equity has not yet consistently competed with any other asset class, including hedge funds. Visit the Vault Finance Career Channel at www.vault.com/finance-with insider career company profiles, message boards, Vault Finance Job Board and more. Library 7 17. Vault Career Guide private equity fundamentals There simply aren't any other investments where returns can reasonably be so high. And even issues arising from the current M& In A and LBO environments, private equity funds have proven their value to investors time and time again. Private equity in the US in the United States operates only about 200 private equity firms at a time, and this number can vary due to openings and closures at the small end of the scale. But the money they manage is impressive. According to the newly created Private Equity Council-formed companies in response to growing pressure from Washington for its operations and profit-to-private equity companies were responsible for $40.6 billion in transactions in 2006. They had already made this mark in 2007. Like their venture capital cousins, private equity firms generally find specialties in the industry. Some companies focus on mid-market, mid-caps, while others are focused on foreign purchases. Others, however, look at small public undertakings or companies in a particular sector. And then there's the big ones. They have the money and the clout to go after the biggest deals in different sectors. Here's a look at the biggest and most notable companies in private equity today: Big Names Blackstone Group Arguably one of the top two companies in the world, Blackstone, started in 1985 with $400,000 and recently raised $230 billion in its buyout money. Ceo Steve Schwarzman is a well-known sharp tactician. The company, which went into the Adjusted for: Quan (miaoquan@gmail.com) public in 2007, recently diversified its holdings beyond private equity and hedge funds, struggling with debt and real estate holdings. This has led to Blackstone being perhaps the most aggressive talent recruitment effort by private equity firms today. Kohlberg Kravis Roberts & Co. (KKR) One of the oldest and most successful companies, KKR is considered Blackstone's main rival for the king of the private equity mountain. Founded in 1976, the company today CAREER LIBRARY © 2008 Vault.com Inc. 18. The Vault Career Guide for private equity fundamentals can boast an average annual return of 27 per cent. It is also one of the most rigid corporate structures in the industry, with 11 industry group companies focusing on 100-day business plans and transaction-making of portfolio companies. And the Investment Committee will meet every Monday to thoroughly investigate the company's activities. KKR is perhaps also the purest private equity company with little presence in other forms of investment. Under Carlyle Group's $5.5 billion management, Carlyle operates 48 different funds in four key investment areas: buyouts, venture capital, real estate and leverage financing. The latter has given the company's struggling late-Carlyle management had to lend its Carlyle Capital hedge fund subsidiary a $200 million bailout brought about by the 2007 market crisis, as many hedge fund investments with structured credit issues collapsed. Carlyle is one of the largest private equity firms in the world, with 750 people in 27 offices worldwide. The company has averaged a 31 percent return rate since its founding in 1987. Texas Pacific Group This company vaulted to the top echelon of private equity in its 1993 purchase of twice bankrupt Continental Airlines-which it eventually deducted more than 10 times the purchase price. It boosted its airline's expertise with an $8.7 billion purchase of Australian airline Qantas in 2006. It's building a greater presence on the Pacific rim than most private equity firms. Bain Capital Bain is perhaps best known for producing Republican presidential candidates: Quan (miaoquan@gmail.com) Mitt Romney, who was ceo of the company until he left in 1999 to run for governor of Massachusetts. The company has been without a CEO since instead relying on its 26 partners in committee-style management, which has been surprisingly effective. The company specializes in club deals, and recently started a $1 billion Asian fund. Many of the Boston-based company's investors are university donations. Visit the Vault Finance Career Channel at www.vault.com/finance-with insider career company profiles, message boards, Vault Finance Job Board and more. Library 9 19. Vault Career Guide to Private Equity Fundamentals Providence Equity Partners This quiet, private equity firm cut its chops on a $63 million investment in VoiceStream Wireless in 1992, which renamed T-Mobile and flipped Deutsche Telekom in 2000 to 19 times the initial purchase price. Its reported return is now around 70 percent, though even the company admits that is likely unsustainable. Given his noting, this small company remains small enough for CEO Jonathan Nelson to take the entire company to Alta, Utah, every year to ski Apollo Advisors' prototypical turnaround company, Apollo, can boast that 90 percent of its investments since its founding in the 1990s have produced a positive return, and it has maintained a 40 percent average return each year. Founder and chairman Leon Black has said that the master of arranging creative loan financing thanks to his days spent as a manager at M&; Drexel Burnham Lambert in 1980. He needs all his skills to navigate the new credit environment brought by the conditions in the summer of 2007. Warburg Pincus Warburg Pincus is unusual among private equity firms because it tends to hinder the blockbuster deal. Instead, the company focuses on fast-growing companies with price tags below $1 billion, which it holds, develops and sells years later for big profits. It is also one of the oldest private equity firms on Wall Street, with roots dating back to 1939. Another major Asian player, the company closed a $1.2 billion real estate fund in 2006-of which 60 percent is slated for purchases in Asia. Cerberus Capital Managementled: Quan (miaoquan@gmail.com) Is this a hedge fund or a private equity company? It doesn't really matter how you call it, because Cerberus is exactly one of the top 10 private equity players in the world. Its strong armed acquisition of food chain Albertson's and GMAC-which were both targeted by KKR turned out to be just a stepping stone for its epic $7.4 billion acquisition of Chrysler Group from Daimler AG in 2007. However, the company struggled to get that deal funded amid a credit crunch-and-some wonder whether the two-way dog myth will bite more than even two mouths can chew on the Chrysler deal. CAREER 10 LIBRARY © 2008 Vault.com Inc. 20. Vault Career Guide to private equity principal Thomas H. Lee Partners Another venerable company, Thomas Lee, started his company in 1974 for $150,000. Today, the company is sans Lee, who left in 2005- specializing in consumer, media and business services companies, and has participated in club purchases at Dunkin' Donuts and Clear Channel Communications. If you're a Harvard Business School graduate, you may have an edge here-30 out of 38 investment professionals as alumni. Other private equity sources In recent years, private equity firms have seen more competition from hedge funds and investment banks, even as both entities have given private equity firms more and more work. Investment banks tend to follow trends in order to continue to be a single point of contact for institutional banking needs. Thus, major Wall Street companies-Goldman Sachs, Lehman Brothers, Bear Stearns, Morgan Stanley, Merrill Lynch, JPMorgan Chase and Citigroup-all started private equity stalks over the past decade. (To be fair, they all started or acquired hedge funds.) Some, like Morgan Stanley, had a long interesting and unusual private equity investment works are used, while others launched private equity funds from scratch and financed them through other activities. The results have been different; banks have exceptional players for employees, but their expertise in turnarounds is not so pronounced. Indeed, the jury is still out on whether these funds will last longer than the current boom. Hedge funds have also dipped a toe into the private equity space, as much as they have entered any market or asset class that promises no return. Some, such as Fortress Investment Group, have done well in managing their investments. Others are simply content to put money together with an established private equity firm and allow the company to make most of the heavy lifting. Adapted from: Quan (miaoquan@gmail.com) Visit the Vault Finance Career Channel at www.vault.com/finance-insider career company profiles, bulletin boards, Vault Finance Job Board and more. Library 11 21. Vault Career Guide to Private Equity Equity Fundamentals Look Inside Kohlberg Kravis Roberts & Co. Let's take a look at perhaps the most iconic private equity firm running today-Kohlberg Kravis Roberts & Co. to which many credits invented modern private equity investment. The company was founded in 1976 by Jerome K. Kohlberg Jr. and cousins Henry Kravis and George R. Roberts. The three founders had worked together at Bear Stearns Cos. In the 1970s, Inc. Like many private equity firms, KKR started simple by buying in 1977. Instead, KKR used about 25 per cent of its capital in the transaction, financing the rest through bank loans and the issuance of high-yield bonds. Thus, this financing theoretical transaction may seem something like this: Cost: $1 billion bank loan: $250 million, 8 percent a year Bonds: $500 million, 10 percent a year Let's then say, that the company's turnaround takes three years, after which it will be sold to a larger company (or goes public) worth $3 billion. Siin on küll lihtsustatud jaotus: Müügihind: $ 3000000000 Laenu põhisumma: $ 250.000.000 Laenuintress: $ 60.000.000 Bond põhisumma: $ 500.000.000 Bond intress: $ 150.000.000 Capital: $ 250,000,000 Kasum: $ 1,79 miljarditKohandatud jaoks: Quan (miaoquan@gmail.com) Muidugi, KKR oleks lihtsalt fronted kogu $ 1 0000000000000 0000 0000 000 000 000 000 000 000 000 000 0000 000 000 000 000 000 000 000 0000 0000 000 000 000 000 000 000 000 000 000 000 000 000 000 000 000 000 0000 000 000 000 000 000 000 000 000 000 000 000 000 000 000 000 000 000 0 Ja 1960. KKR oli oma finantsvõimenduse kasutamisel oma kapitali suunamiseks mitme investeeringu suunas. So it could have gotten $2 billion. from one $10 billion investment over three years–or could have made another three $250 million investments at the same time and within three years, could theoretically have made $71.6 billion. CAREER 12 LIBRARY © 2008 Vault.com Inc. 22. Vault Career Guide to private equity fundamentals as you can imagine, with such a return, KKR quickly ramped up its transactions. In 1981, he closed six different transactions, and by 1985 Kohlberg resigned at the age of 61, leaving Kravis as a senior partner. KKR then started looking for a new deal and found a big deal. KKR and Henry Kravis in particular came to symbolize a private takeover of their $31.4 billion acquisition of RJR Nabisco in 1988. The takeover was a brutal process in which KKR faced competing offers from the opposition and RJR's own management. But the lack of guaranteed price management and word from then-CEO F. Ross Johnson's lucrative golden parachute deal in the event of a buyout eventually tipped the board to vote on KKR's offer. The back and forth between KKR, the board and the board were finally the subject of the bestselling book, Barbarians at the Gate, and even an HBO movie starring James Garner and Jonathan Pryce. Surprisingly, though, the deal made KKR a poster child for private equity and some say the corporate greed-deal itself was not great. Many say that in the 1980s, the European Commission was the first country in the world to have a And KKR was also a victim of bad timing. The increase in tobacco disputes and intense competition between cigarette makers sent RJR's profits in that division. The recession and recession of 1990-1991 made it difficult for RJR to raise money for debt markets, prompting KKR to throw another $1.7 billion of its own money to support RJR's operations. Finally, in 1995, KKR left. With its total $3.1 billion investment in RJR Nabisco, KKR was said to have barely broken even the deal-than-this. And RJR Nabisco himself was dilapidated and sold to others. But the eventual failure of the investment pulled out over at least TheCustomized for: Quan (miaoquan@gmail.com) for seven years, and the sheer audacity of the deal made Kravis and Roberts wall street the equivalent of rock stars. Banks were perfectly happy to lend KKR increased amounts of leverage because no matter how the investments did, fees were worth it-in-the-investment banks and lenders walked away from RJR Nabisco's deal with $1 billion in payments after all. KKR's success prompted other private equity firms such as Blackstone Bain Capital and Carlyle Group become even more aggressive. Visit the Vault Finance Career Channel at www.vault.com/finance-with insider career company profiles, message boards, Vault Finance Job Board and more. Library 13 23. Vault Career Guide to Private Equity Private Equity Fundamentals Leveraged Buyouts took a back seat to the technology boom of the 1990s, but KKR remained busy buying up such names as Spalding Holdings Corp. and Law III Cinemas Inc. and regaining its stride. Investment in takeover funds slowed between 2000 and 2002. That means KKR doesn't run the barbaric hordes at the gate these days. Unlike its 1980s boom, KKR is a much more willing team with competing private equity companies in so-called club deals, where the risk and rewards of acquisitions are shared with several private equity funds. And the hot-shot role that Kravis enjoyed in the late 1980s has been taken by Blackstone Group's Stephen Schwarzman. Nonetheless, KKR remains one of the leading private equity firms on Wall Street and is certainly an industry elder statesman. As of October 2007, the company has completed approximately 318 transactions with a total corporate value of $318 billion. Currently, there is a portfolio of companies and investments worth $780 billion -invested capital of $31 billion, 2.5 times the multiple. Adapted from: Quan (miaoquan@gmail.com) CAREER 14 LIBRARY © 2008 Vault.com Inc. 24. A brief history of Private Equity CHAPTER 2 The beginning of the history of private equity can be traced back to 1901, when J.P. Morgan-man, not the institution-bought Carnegie Steel Co. from Andrew Carnegie and Henry Phipps, for $480 million. Phipps took his share and essentially set up a private equity fund called the Bessemer Trust. Today, Bessemer Trust is more of a private bank than a private equity firm, but Phipps and his children started the trend of buying exclusives from up-and-coming companies-or buying them directly. Although the turn of the century and 1950, when President Dwight D. Eisenhower signed the Treaty of 1958, he was a member of the European Parliament. This provided government loans to private risk capital firms, allowing them to leverage their holdings to provide larger loans to start-ups – the first actual leveraged purchases. Soon other companies began to play with the idea of leverage. Lewis B. Cullman made the first modern leveraged buyout in 1964 by buying Orkin Destructive Co. Other but this trend quickly passed in the early 1970s. First, the government raised capital gains taxes, which makes it difficult for KKR and other emerging companies to attract capital. In 1974, Congress limited pension funds to risky investments that included private equity funds. Greed is good: Modern Private EquityCustomized for: Quan (miaoquan@gmail.com) These trends began reversing themselves in the 1980s, when Congress relaxed both pension fund restrictions and capital gains taxes. The money flowed back to private equity funds, and some of the best-known companies were founded by Bain Capital in 1984, Blackstone Group in 1985 and Carlyle Group in 1987. Carl Icahn made a name for himself as a corporate raider for his LBO TWA Airlines in 1985 and KKR raised private equity visibility to a new high with the $31.4 billion acquisition of RJR Nabisco in 1988. Visit Vault Finance Career Channel www.vault.com/finance - Insider Career Company Profiles, Message Boards, Vault Finance Job Board and more. Library 15 25. Vault Career Guide private equity with a brief history of Private Equity It was a time of growing pains in private equity as well as intense success. Many companies realized that they could not operate in a bubble, as KKR became aware of a ton of negative advertising surrounding the RJR Nabisco deal. Tom Wolfe's Bonfire of The Vanities gave everyone on Wall Street a black eye and Gordon Gecko's Greed is a good mantra since Wall Street was endorsed by private equity firms as a whole. By the time the recession of 1990-1991 took place, the gaps in private equity continued to be low, expecting another boom. Technology boom in the 1990s Share prices rose even for companies that didn't have a business in public, let alone a share price increase. The private equity firm was completely difficult to create value through the traditional buy-out method. At the same time, however, venture capital was on the rise, prompting the addition of new businesses. As one venture capitalist said, Look, I throw in $1 million for 10 different companies. If one company succeeds, it will bring me $50 million. So it's worth it in the end. So larger private equity limped and participated in the boom through starting funding. LBOs are still taking place, but at a much less impressive level than in the 1980s. The maturing industry dot-com bust from 2000 to 2001 brought markets back into reality and unearthed new opportunities for private equity firms. Some companies swept in to buy good businesses cheap, waiting for the bust mentality to pass before returning them to the market. Others simply enjoyed the sale of fire and bought technology and patents for resale, dismantling failed companies in the process. By 2003, the market had returned cycle, but for some notableCustomized: Quan (miaoquan@gmail.com) changes. Congress had enacted the Sarbanes-Oxley Act, which tightened the rules for public companies and what they could say and do. The new bull market focused very much on companies that are hitting their numbers in a new business instead of long-term investments. These pressures together make private buyouts attractive to potential target companies. In addition, the rise of hedge funds generated a great deal of wealth that required new homes and expanded the number of potential investors to private equity. Soon, newly wealthy individuals, hedge funds and major Wall Street institutions were all piling up on private equity, and the companies enjoyed career 16 LIBRARY © 2008 Vault.com Inc. 26. Vault Career Guide private equity's brief history of Private Equity further success, leveraging its newfound capital in large multibillion-dollar deals. The record RJR Nabisco buyout was eclipsed twice in 2007 alone. At the beginning of summer 2007, the Private investors in LBO'ed the state's largest utility, TXU Corp., a record $44.3 billion private buyout that had heads Blackstone and KKR gladhanding members of the Texas legislature, which many saw as a symbol of private equity growing clout. Then in the summer, the whole wave of private equity collapsed. And it wasn't even the companies' fault. LBOs became the last victim of the housing and mortgage crisis. When it began the dot-com crash and the subsequent recession of 2000-2002, investors frustrated by high-flying stocks began investing in tangible assets, mostly real estate. By 2004, the flat-flipping craze was in full swing. Prices had soared significantly in just three to four-year-triple locations like Los Angeles, Las Vegas and Miami. The national banking system helped fuel the madness with mortgages, supported by historically low interest rates and relatively simple conditions. But in June 2004, the Federal Reserve began raising interest rates, which went from 1 percent in early 2004 to 5.25 percent in July 2006, where they remained. However, house prices continued to rise as speculators jumped in and out of house purchases. That left the average homeowner fighting for a home. In response, mortgage lenders began pushing unusual mortgage products-everything from 50-year mortgages to interest-only, Adjusted: Quan (miaoquan@gmail.com) adjustable-rate loans. And because home prices were on such a strong trajectory, many banks relaxed their lending claims on subprime mortgages-loans for high-risk, bad credit borrowers. The rationale was that even these borrowers could refinance if their home prices were significantly priced. Visit the Vault Finance Career Channel at insider CAREER company profiles, message boards, Vault Finance Job Board and more. Library 17 27. The Vault Career Guide to private equity's brief history of Private Equity's fall in irrational exuberance in housing began to fall apart in spring and summer 2006, when prices leveled off and luxury homebuilders, which are responsible for half-full communities of McMansions across the country, began lowering profit forecasts. House prices flat, then began to fall in most cities across the country. And all those adjustable interest rate mortgages started to make higher adjustments. Without waiting to jump in home value, many borrowers, especially those with subprime mortgages, could not refinance and were stuck with payments they could no longer afford. The impact of all late payments, defaults and home closures was not limited to mortgage brokers and banks. Many mortgage lenders wrapped up their loans with mortgage-backed securities-bonds backed by an expected inflow of payments from borrowers as well as the value of homes on the mortgage. But with borrowers defaulting and home prices falling, the value of their bonds dried up. And the big banks and hedge funds that keep this paper got hit hard. Bear Stearns had to close two billion dollars of hedge funds in June because of the hit those bonds took, and Goldman Sachs spent $2 billion of its own money in August to support another fund. And of course, both hedge funds and major banks were hit not only by the depreciation of mortgage-backed securities, but also by a serious correction in stock markets and bond yields, which eventually returned to normal after almost two years of reversal. Squeeze down The result of all this was the overall tightening of credit. Almost all major investment banks had mortgage-backed investments, and those with consumer weapons also felt a pinch of default. Hedge funds, another major source of leverage, faced bond and equity problems and increased buybacks from worried investors. Adjusted: Quan 's (miaoquan@gmail.com) impact was seen as early as June, when Cerberus Capital Partners had a heavy loan of $12 billion needed to buy Chrysler Group. It received funding, but on less useful terms than it thought. And it's unlikely that new property will find insurers to help leverage Chrysler's dwindling property in investor payoffs, let alone the capital the struggling automaker needs to keep making cars. The lack of credit buyouts has hurt other transactions. Home Depot Inc., once considered the main buyout candidate himself, ended up accepting $8.5 billion in 18 LIBRARY © 2008 Vault.com Inc. on May 28, 2008. Vault Career Guide private equity's brief history of Private Equity billion selling its HD Supply wholesale/contractor chain to private equity buyers-initial offer was $10.5 billion. This is less Home Depot can use share buybacks and dividends, further pressurizing stocks and potentially prompting banks and hedge funds to reduce cash output. At the end of August 2007, 51 private equity deals were under way, including TXU and other notables: a consortium's $27.3 billion deal with Alltel Corp., KKR's $2.7 billion bid for First Data Corp. and Blackstone's $267 billion bid for Hilton Hotels. Of course, these transactions cannot be done without a loan. And if private equity firms don't get money to their liking, they're going to walk away. We can't borrow at unreasonable interest rates, but at the same time we don't want to see too many deals fail, says one insider at a top-three firm who didn't want to use his name. When you see us drop these mega-ideas, the people who have given us the money are very disappointed, and they won't give us any more. So even fewer deals can be made. This is probably the most tender situation we have faced as an industry. Going Public Fortress Investment Group Inc. (FIG) was the first large company with a private equity component that went public. The fortress is very much a hybrid of hedge fund and private equity, and it is widely regarded as larger than the last. Nonetheless, Fortress raised $643 million in its February 12, 2007 initial public offering. But the troubles that plagued the financial sector have taken its toll on Fortress stocks-as of late October 2007, it was down 35 percent from its April 19, 2007, high of $33.07. However, Fortress did not get nearly as much attention for its IPO as did blackstone group. The hottest private equity firm on Wall Street went public: Quan (miaoquan@gmail.com) on June 25, 2007, trading as ticker BX. Unfortunately, the timing couldn't have been worse as the market hit its peak on July 19 before falling on credit concerns. Given Blackstone's reliance on easy credit, it hurt stock-it was down 27 percent on its first day of trading at the end of October. The troubled trading environment led KKR to postpone its public offering plans. Visit the Vault Finance Career Channel at www.vault.com/finance-with insider career company profiles, message boards, Vault Finance Job Board and more. Library 19 29. Vault Career Guide private equity with a brief history of Private Equity Public Trading means the public's attention The public learned a lot about how private equity firms operate through Blackstone's prospectus. For example, the company's profits are due to the increasingly common 2- and 20-fee structures, albeit some surprisingly investor-friendly twists and turns. Blackstone will charge an administrative fee of anywhere from 1 to 2 per cent of the money if they are invested. But after the money is placed, that fee drops to 0.75 percent. Also takes 20 percent of any return on investments it makes in a performance fee–but only after the fund's other investors reach their benchmark rates of return, usually at least 7-9 percent. If they don't get to the benchmark, Blackstone won't get anything. And Blackstone will have to pay the fees back if the returns fall below that threshold later along the way. Blackstone is not shy about the nature of its business, noting that quarterly profit can be very choppy, and relies heavily on attracting new money and its cash performance. Both the castle and Blackstone's intellectual property organisations were, of course, well-marked, given the private equity madness of the first half of the year. Their fall from that time is also surprising. Looking ahead, it may be difficult for companies currently privately held to be too bullied. But even during the worst market cycles of the last three decades, private equity firms remained busy, buying companies and generally doing business. Like most things on Wall Street, private equity experiences boom and bust cycles. The boom since 2003 has been a year of economic development. If the boom ends in the near future, private equity firms will likely do what acquisition they can, and then scale back fund raising and operations for a few years until things are fixed for: Quan (miaoquan@gmail.com) to improve again. They're not leaving... Just retreating. CAREER 20 LIBRARY © 2008 Vault.com Inc. 30. How private equity works 3. As private equity or divisions, they must set up and fund a fund, find possible investments, line up additional funds, enter into a transaction, improve the business and determine an exit strategy. Here's a look at how it works. When setting up a fund, private equity funds may have several funds that work at the same time. Some are specialized in, say, distressed debt or venture capital, while others are just giant pools of money a company can use for any investment it considers appropriate. To create a fund, of course, the company has to find cash. Show me the money, a well-established private equity company is a reasonably reliable source of capital for its funds. The major banks, pension funds, hedge funds and other Wall Street think-backs are generally willing to give funds a million dollars to start with. Major universities and charities are also good sources of funding because their endowments are generally not used for operational purposes. Finally, private wealth management organizations sometimes combine money with some of their own clients – and generally only those who can measure their value in the hundreds of millions – to make private equity investments. And of course, CEOs and equity private equity: Quan (miaoquan@gmail.com) company also puts capital into any fund. For successful private equity investors, it can be valued at several hundred million dollars. Together, all these sources of capital constitute a private equity fund. Larger private equity firms can have more than $10 billion in assets, although outside of a handful of these top companies, such funds tend to be in the $2 billion to $5 billion range. Visit Vault Finance Career Channel www.vault.com/finance - Insider Career Company Profiles, Message Boards, Vault Finance Job Board and more. BICYCLE RENTAL (ADDITIONAL CHARGE) 21 21

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