Taking Stock: Nothing equitable about private equity firms

by Malcolm_Berko

Dear Mr. Berko: My broker wants me to buy 600 shares of the Blackstone Group and 600 shares of the Fortress Investment Group because they are trading some 30 percent lower than their initial public offering price. Please tell me if this is a good idea to buy these stocks that have fallen so much. If you think that 600 shares each is too much would you recommend that I buy 300 shares each? I can afford the risks and my broker thinks these two stocks will double in the coming 12 months.

W.N.

Portland, Ore.

Dear W.N.: I think your broker may have a few loose micro-singularities blocking various nerve synapses in his parietal lobe.

Private equity firms theoretically purchase undervalued companies, reduce expenses, change management, scoop out a huge dollop of cash for themselves by highly leveraging the balance sheet, sell the stock of the newly positioned company at a higher price, then take a second big stash of cash.

I'm somewhat perplexed by this. Private equity firms extol the virtues of and wax eloquently about taking a public firm private. Now in a surprising twist that seems rather contradictory, these private equity firms are in a snit to come public, probably because many of them sense their market has topped out. Interesting, that!

Frankly, I wouldn't touch the shares of Fortress Investment Group LLC (FIG-$21.05) or the shares of the Blackstone Group (BX-$25.85) because I believe management is fueled by rapturous and insatiable greed. I wouldn't own their shares because I don't trust the people who manage FIG and BX to give shareholders a fair shake.

These guys are accustomed to running the show like an emperor with absolute power and immediate obedience. Today's private equity managers wallow in ego, require extravagantly obscene perks fit for a pasha and won't give them up because outside board members (a lower life form) demand accountability.

Private equity firms never had outside directors that might hobble their running styles like a pebble in a shoe. Heaven help those whose directors get tough!

Do you really think that Steve Schwartzman (chief executive officer of Blackstone), who personally pocketed over $7 billion, gives a fig or ficus about the welfare of his firm's stockholders? Do you believe for even a moment that megabillionaire Schwartzman and Blackstone can integrate their takeover tactics with the niceties of a public company in the Sarbanes-Oxley era?

I'm concerned when there's a decision to be made in which management's interests don't conform to those of shareholders that management will prevail. What will be the size of personal bonuses? How much net income should be paid in dividends rather than to the partners? How much can management spend on salaries, rent, limousines, private jets, airfare, lunches, gifts, travel, entertainment, art, executive furniture and office decoration, etc., ad nauseam?

The buyout boom has become frenzy and private equity funds are coming under pressure. Congress is bashing the huge paychecks of executives from Kohlberg Kravis, Blackstone, Apollo Management, Texas Pacific and the Carlyle Group. And Congress is also bashing the extra-special corporate tax treatment that the private equity funds have engineered for themselves.

Meanwhile, unions are complaining about huge layoffs that often follow these deals and now the courts are taking a hard look at CEOs who appear to be joining forces with private equity deals at the expense of shareholders. And with so many interested parties pushing private equity business some insiders believe that future deals will deliver much smaller returns if not losses.

I think BX and FIG are overpriced. Both trade at 18 times earnings and I believe that their share prices may have a lot further to fall. If you must purchase BX and FIG I'd certainly not own them at the current prices. Frankly, I believe a fair price for both of these firms is half of their current market value or perhaps about 12 times earnings.

Some observers believe that management of FIG and BX took their companies public at the top of the market. And the public bought shares of FIG and BX like they were going out of style. Well they didn't quite go out of style, rather they collapsed like a Steinway piano crashing down a deep mine shaft.

If that pinhead broker of yours believes this is such a hot sector, please ask him why the share values of the two most pre-eminent private equity funds in the world have imploded.

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