

PRIVATE EQUITY AT WORK

When Wall Street Manages Main Street

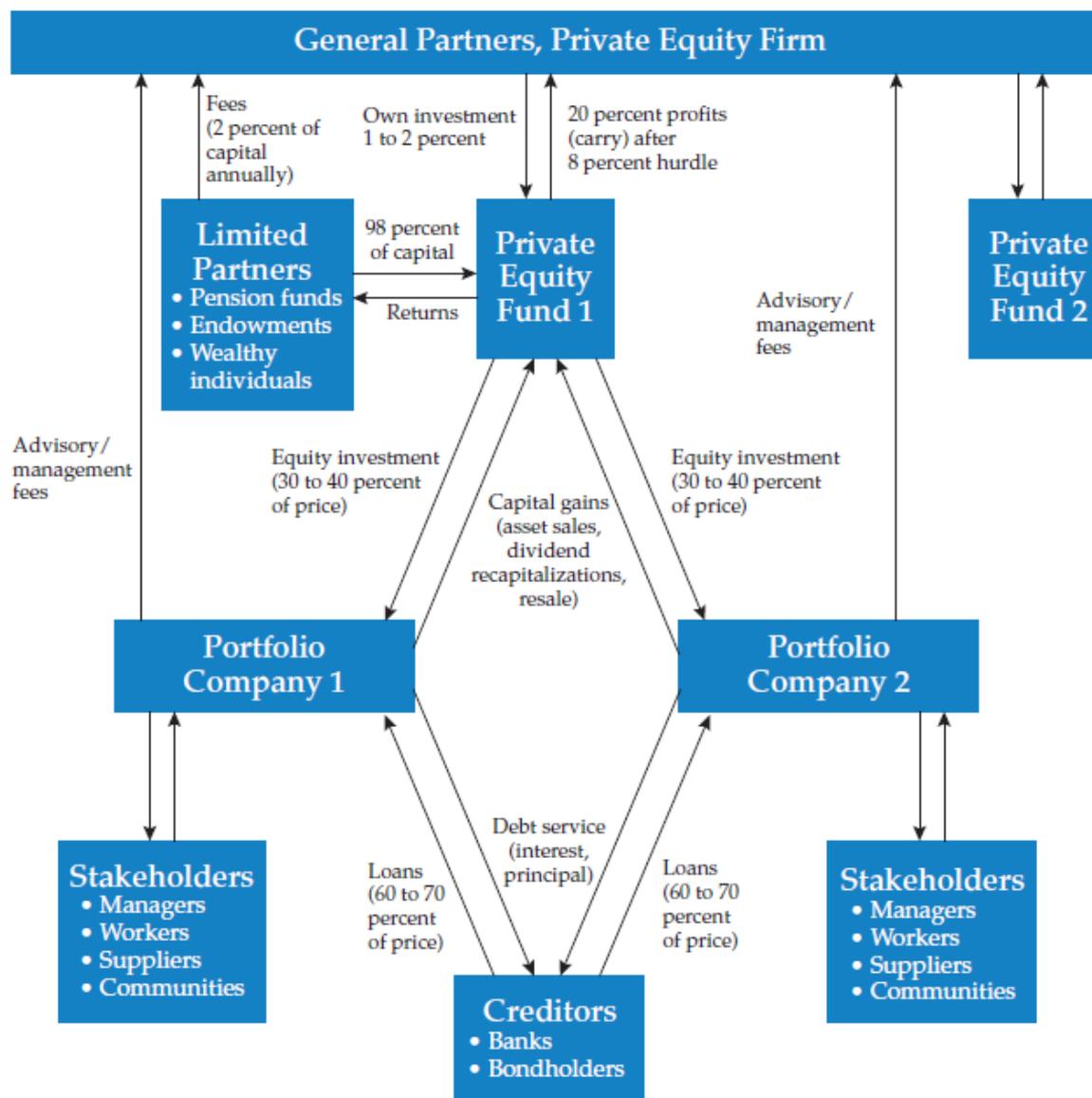
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Figure 1.1 The Structure of Private Equity: Firms, Funds, and Portfolio Companies



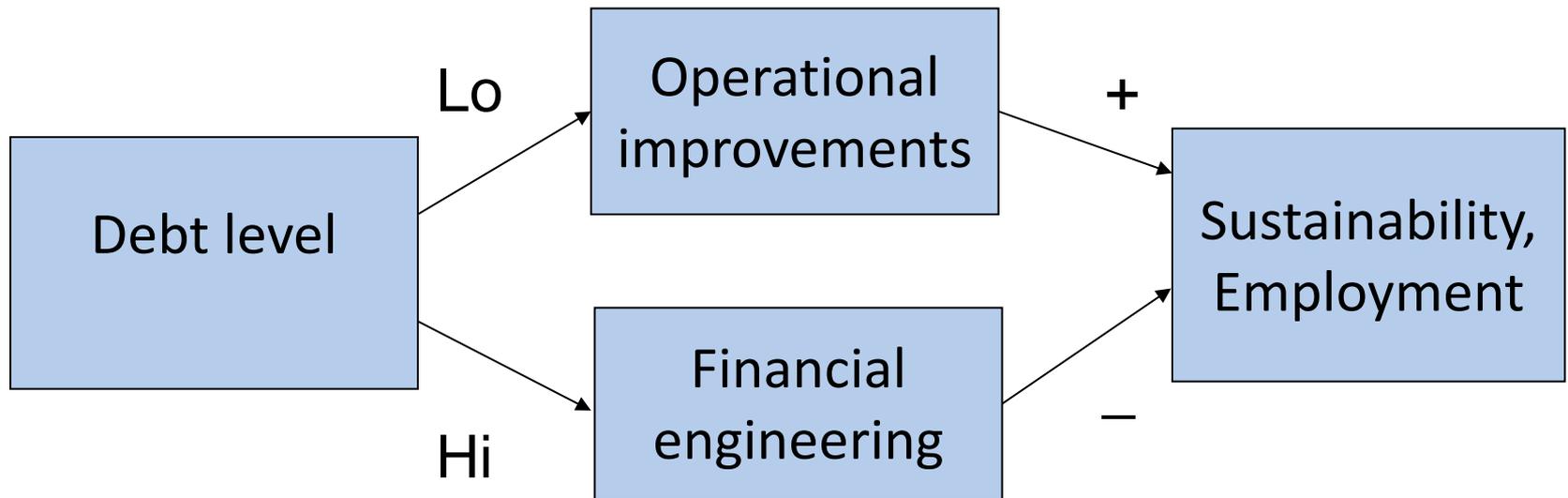
Source: Adapted from Watt 2008.

Private Equity Business Model

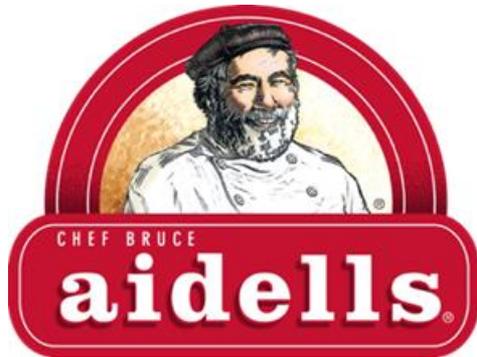
- Debt is lifeblood of the PE model
- Low risk, high reward for PE firm partners
- High risk strategy for portfolio companies
- Speculating with other people's money
- Taxpayers subsidize PE returns

Two Routes to Extracting Value

Capital structure → Strategy → Enterprise outcomes



PE & Operational Improvements: Aidell's



Aidell's' Sausages

- Small family-owned iconic SF firm
- PE provides resources for growth

Asset Stripping at Red Lobster



GOLDEN GATE CAPITAL

Red Lobster

- Large restaurant chain
- Sold by Darden to Golden Gate PE in 2014
- Golden Gate immediately strips assets

Investors as Employers & Managers



Mervyns Department Store

- Iconic California Company
- 30,000 workers lost jobs

Investors as Labor Negotiators



Energy Future Holdings

- Texas utility
- Largest buyout ever - \$48 billion

Quantitative Effects on Workers & Pensions

- Higher Bankruptcy Rates
- Lower Employment and Wages
- Mediocre Returns to Pension Funds

PE and Dumping Pension Liabilities



Scott Brass

- Sun Capital
- Pension liabilities in bankruptcy case

PE-Driven Bankruptcies

The logo for Friendly's, featuring the word "Friendly's" in a red, cursive script font with a registered trademark symbol.The logo for Sun Capital Partners, Inc., consisting of the text "SUN CAPITAL PARTNERS, INC." in white, uppercase, serif font, centered within a dark blue rectangular box. A white horizontal line with a diamond-shaped center is positioned below the text.

Friendly's Ice-Cream

- Fast track sales in bankruptcy
- Pension fund liabilities shifted to PBGC

Recent PE Bankruptcies

- Archway & Mother's Cookies (2008)
- Linens 'n Things (2008)
- Mervyns (2008)
- Extended Stay Hotels (2009)
- Reader's Digest (2009)
- Anchor Blue Clothing (2009, 11)
- Stuyvesant Town and Peter Cooper Village (2010)
- Simmons Mattress (2010)
- Uno's (2010)
- Friendly's Ice Cream (2011)
- NewPage (2011)
- Coach America (2011)
- Harry & David (2011)
- Golden Guernsey Dairy (2013)
- Energy Futures Holding (2014)
- Caesar's Entertainment (2015)



Net Effect on Companies, Jobs, and Wages

PE owned companies and bankruptcy rates

- Have 2x annual bankruptcy rate of publicly traded companies
- Bankruptcies often lead to large pension losses

(Source: Stromberg 2008)

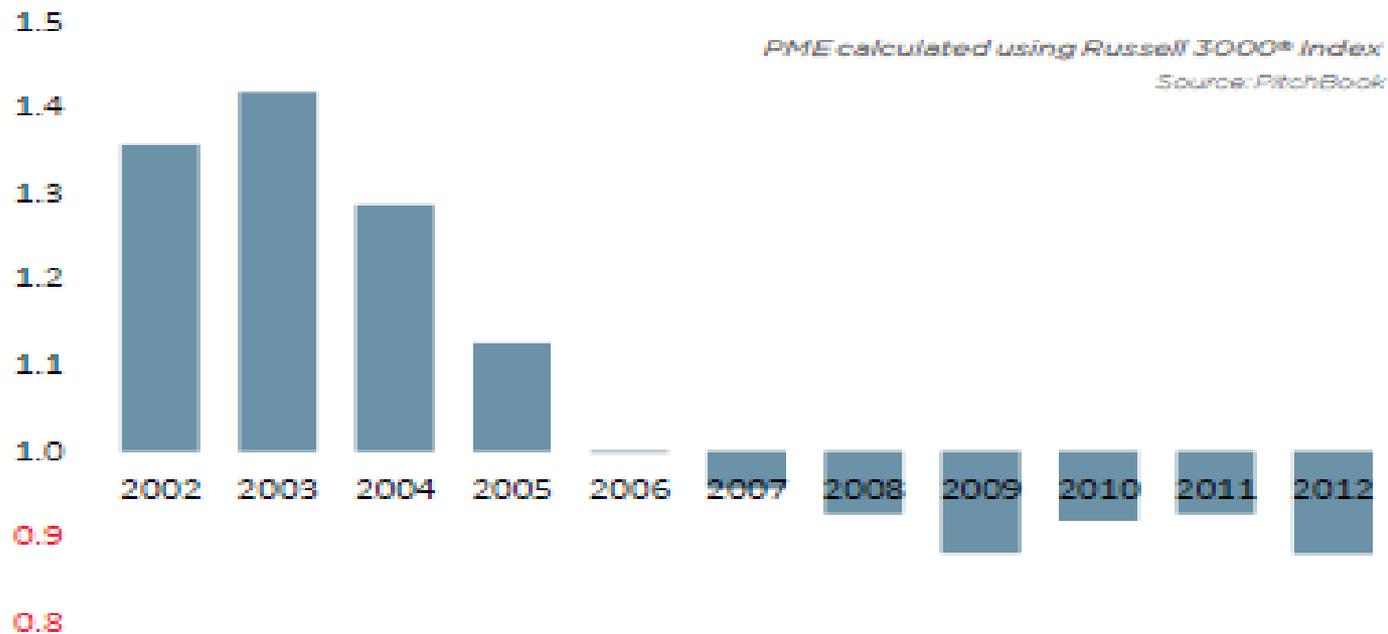
PE-owned companies and job and wage losses

- PE typically buys better performing companies
- Post-buyout: PE owned establishments had 3.2% lower job growth after 2 yrs.; 6.4% over 5 yrs.
- Wages fall relative to comparable publicly traded companies

(Source: Davis, Haltwinger et al., 2011)

PE Hasn't Beaten Stock Market Since 2005 (PitchBook 3Q2015 Benchmarking Report)

PE KS PME BENCHMARK BY VINTAGE



When using a KS PME, a value greater than 1.0 indicates outperformance of the public index (net of all fees). For example, the 1.13 value for 2005 vintage PE funds means investors in a typical vehicle from that year are 13% better off having invested in PE than if they had invested in public equities over the same period.

Smart Regulation

- **Increase transparency**
- **Limit leverage** to limit risk to workers, creditors, others
- **Discourage financial engineering**
- **Close tax loopholes**
 - Carried Interest
 - Management Fee Waivers
 - Monitoring Fees
- **Update employment, bankruptcy, & pension laws**
 - WARN Act, 363 bankruptcies, ERISA

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