THE WALL STREET JOURNAL.
28 November 2006

Private-Equity Spree Hits Home
By Jaclyne Badal

Private-equity firms have been on a spending spree this year, and the ripples are reaching to even the smallest stock-market investors.

A year ago, many people had never heard of these firms, which use money raised from pension funds and other big investors to buy companies owned by public shareholders. But lately, a rash of large deals have cemented the role of private-equity firms as Wall Street celebrities. In the past two weeks, private-equity firms have announced agreements to buy real-estate titan Equity Office Properties Trust for $20 billion and radio behemoth Clear Channel Communications Inc. for $18.75 billion, as calculated by market researcher Dealogic. (Figures exclude any assumption of debt.)

So far this year, Dealogic says, private-equity firms have announced deals for 939 U.S. companies valued at $357.88 billion. That is more than the going-private deals announced in all of 2003, 2004 and 2005 combined.

While individuals generally can't invest in private-equity pools, here are four major ways the transactions affect them and the stock market broadly:

Benefiting From a Buyout

A private-equity buyout is often considered a windfall for target-company stockholders, because the purchase price is typically higher than where the stock had been trading. Clear Channel, for example, is being bought at a 17% premium to its 4 p.m. price Oct. 24, the day before the company signaled interest in a buyout. The Equity Office deal is at an 8% premium to the previous day's price.

Some investors are trying to capitalize on the going-private trend by buying stock in possible targets. Bad idea, says Arnie Berman, chief technology strategist at Cowen & Co. He warns investors can get burned if they gamble on a takeover and disregard company fundamentals. Charles Massimo, president of CJM Fiscal Management, adds if a company is rumored a buyout target, the stock has probably already moved up as a result.

Are Premiums Too Low?

Although the premiums on Clear Channel and other stocks are an unexpected boon for many investors, some people on Wall Street gripe that holders aren't getting paid enough when companies are taken private.

Consider Fairmont Hotels & Resorts, which agreed to sell itself to Colony Capital LLC and Kingdom Hotels International. Some investors protested the firm was worth more than the $3.47 billion sale price. Complaints grew louder when Fairmont sold seven properties for $1.5 billion. Fairmont declined to comment.

Critics of recent deal prices note premiums have become smaller. This year, the average premium on a buyout target has been 29%, Thomson Financial says, compared with 44% in 2000.

The Justice Department has been looking into private-equity dealings, concerned some firms may collude to keep purchase prices low.

Next Stop: Public Again

While private-equity firms are taking some companies out of public hands, they are responsible for some new public offerings of stock. For instance, car-rental company Hertz Global Holdings Inc. recently sold a 28% stake in a $1.32 billion public offering, just 11 months after three private-equity firms bought Hertz from Ford Motor Co.

On average, stock offerings of former buyout targets outperform other initial public offerings and the stock market as a whole, according to a recent study by Harvard professor Josh Lerner and Boston College's Jerry Cao. Notable exceptions to the study's finding were some "quick flips," or companies that went public less than a year after going private.

Public Companies Respond

Private equity's focus on building stronger companies can have an even broader impact, says Fentress Seagroves, a partner with PricewaterhouseCoopers Private Company Services.

Many managers who want their companies to stay public are being more careful about their investments or more aware of the need to trim costs, Mr. Seagroves says. But cost-cutting can hurt employees when it involves layoffs.