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News

Carlyle's Debt Team **Is a Secret Weapon**

Close-mouthed private equity giant opens up about goals of a novel unit

The Carlyle Group, one of the most powerful and close-mouthed investment firms in the U.S., credits much of its recent good fortune in buyout transactions to its decision to become a player in lower-rated sectors of the debt markets.

Having an in-house operation focusing on investing in areas like distressed debt and high-yield securities—and now entering the realm of mezzanine finance—has provided the Washington, D.C.-based firm with several advantages that complement its overall business strategy. Most importantly, Carlyle now has its own unbiased window into the day-to-day debt markets, which gives the firm more ability to decide when deal terms are too strenuous and what the range of investor sentiment is in any given period.

It is still a relatively rare phenomenon for a VC powerhouse to have its own set of debt players. Carlyle's group, which is four years old, is still considered an oddity by some VC players, although rivals like the Blackstone Group have recently launched a similar debt platform. Carlyle now has four separate debt investment vehicles.

Carlyle's Attwood: 'You get a different dimension when you're thinking about what to do next.'

Carlyle's debt group plays by a different set of rules than an investment bank. A bank's debt operation, for example, is charged with getting the tightest prices possible on new issues and making profits on secondary trades. Carlyle's debt operation, by contrast, first works to supplement the overall firm's strategies. Its paramount role is to serve as the firm's goodwill ambassador in the debt markets, and thus secure a ready base of buyers that will be there in darker hours.

James Attwood, a managing director who supervises Carlyle's investments in such areas as global media and telecom, said that the in-house debt group has become invaluable to his team's efforts. "It is important to have not just an independent observer but someone that can give good advice," he said an interview with *IDD*. "You get a different dimension when you're thinking about what to do next."

"We've taken our knowledge of the debt markets and made it a core competency of the broader buyout firm," added Michael Zupon, a managing director and one of three officials who run the debt operations.

The debt team's presence in junk and distressed debt—in some cases making markets for deals when other participants had pulled out of the market—have helped create favorable market conditions for such

colossal deals as Carlyle's successful bid for Qwest Communications' $7.05 billion spinoff of its QwestDex yellow pages directories business, which it closed in two parts this year. The latter segment, a $4.3 billion bond and loan financing for QwestDex West (renamed Dex Media West), required the firm to hit the market in August, when the bond and loan markets were roiled with volatility.

"At various stages in the process of origination, the market deteriorated," Attwood said. "Being able to test what the market sentiment was became very important in assessing what risks we could take as a firm."

Having a nontraditional approach to debt is paying off, as Carlyle's debt initiative is seen as a key factor in its overall strategy. "They have their finger in various sectors," said Richard Brennan, a portfolio manager at Soros Fund Management's Quantum Fund, who has been a co-investor in the past with Carlyle. "They have always been someone who has a great nose for value—they understand the value of a transaction, and don't overreach on a deal."

A loss leader?

It may seem odd that Carlyle places so much stock on its market reputation. After all, due in part to its extensive web of government connections, not to mention its employment of such political luminaries as former President George H.W. Bush and former Prime Minister John Major, the firm's rep has taken a thorough pounding in many a magazine or newspaper article and in books, as well—some reasoned and some lurid. Yet the company said that its reputation in the business community is a far different thing than in the general public, and that one of its debt operation's primary functions is to keep investors contented.

Carlyle's Zupon: 'We've made [debt market knowledge] a core competency of the broader buyout firm.'

In some cases, that may mean pulling back from the kill, Zupon explained, and not trying to get the absolute tightest pricing on a debt financing to reassure investors that the bonds' value will not plummet in the aftermarket.

"Our goal is to use our capabilities to ensure availability of credit throughout the capital markets cycle," Zupon added. "We are not looking to drive the credit markets to deliver the absolute tightest and most aggressive terms so that [investors] lose money after the deal breaks."

Carlyle believes that having debt bankers on hand prevents it from making serious mistakes, as it allows the firm to have a level of knowledge not dissimilar to that of the bankers placing its deals in the debt and equity markets. For example, Carlyle Management Group's $325 million loan financing to merge Breed Technologies Inc. with its Key Automotive Group unit earlier this year encountered some initial distrust in the bond and loan markets.

Lead arranger Citigroup came to Carlyle and said it would have to restructure a portion of the deal to make it more palatable, adding things like a second lien that made the transaction more expensive for Carlyle. Because Carlyle's debt team could verify this market sentiment, and had the expertise to help contribute to the revised deal terms, it was able to concur with Citigroup's assessment.

By contrast, one banker said, a VC group without any real taste for debt could have suspected its lead manager of fumbling the deal and acted angrily—telling the manager it was on its own and leaving a trail of bitter investors and griping underwriters in its wake. ■

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