NEW MOUNTAIN CAPITAL – 10 YEARS OF ACYCLICAL INVESTING

View from the summit

Steven Klinsky, Ex-Forstmann Little partner and co-founder of Goldman's LBO group, has drawn on his 30 years of private equity experience to build a new firm, New Mountain Capital. Here, he tells PEI where he thinks the industry still needs to improve

New Mountain Capital founder Steven Klinsky has business-building in his blood. Growing up in suburban Detroit, Klinsky's father and uncle built a retail clothing chain, which they eventually sold to The International Shoe Company (now Interco) while Klinsky was at Harvard Business School.

"One of the reasons I went into private equity was because I thought maybe I would buy another business with my dad," Klinsky says. "Plus, I was about the youngest person in the business school and I had no real work experience in anything else."

Today, Klinsky has 30 years of private equity investing under his belt, including 15 years as a partner at Forstmann Little where he oversaw transactions totaling more than $10 billion. Previously, Klinsky had co-founded the leverage buyout group at Goldman Sachs.

In 2000 he founded New Mountain Capital, with the aim of investing in businesses whose performance did not depend on the economic cycle.

"I said, 'It's the beginning of a new decade and a new century. Let's pick what we call acyclical, defensive growth sectors. What has the wind at its back? What can keep growing whatever happens to the macro-economy?'"

The firm has deployed all three of its private equity funds using the same strategy. For example, one of its most recent investments was Stroz Friedberg, a digital risk management and investigations firm specializing in digital forensics, data breach and cybercrime.

"The economy may be slow, but the need for corporations to protect against cyber issues is growing very rapidly, as is the need to collect computer data as evidence for lawsuits and investigations," Klinsky says. "It's those types of industries that we focus on. We're not trying to outguess the macro cycles."

DOWN WITH DEBT

New Mountain also avoids trying to generate returns by relying on leverage, a strategy Klinsky hopes the private equity industry as a whole is starting to move away from.

"The old mindset of private equity was about financial engineering, access to debt and taking more risk so you can make more return. We've been trying to evolve a totally different meaning of what private equity is all about," he says. "I hope one of the key lessons from this past decade has been that private equity is not a form of finance; it's a form of business."

In fact, New Mountain has used debt in less than half of its acquisitions. "People have gotten used to leverage as being some sort of magic elixir to make returns," Klinsky says. "What we do is apply the capital that we've been entrusted with by pensions and others, and combine it with the management skills that we've accumulated at the firm."

Ten years of accumulating those skills has given New Mountain a solid base from which to build companies. Says Klinsky: "That's where the name New Mountain comes from: the idea of building 'new

> Private equity is not a form of finance. It's a form of business

Klinsky: *building 'acyclical' businesses*

mountains' in the industries where we invest, and trying to build our own firm with some permanence."

BUILDING A FIRM

For Klinsky, the idea of establishing a lasting institution was one of his key aims for New Mountain. This was something that Forstmann Little never managed to do, he believes.

"I used to think of Forstmann Little as being like a great basketball team where there were five of us on the floor plus a few supporters," he says. "None of us really thought much about the firm as an institution, and I think to really succeed in a lasting way, you can't just be about one person or even a few people. It's really the strength of the team overall and the process and the repeatability of the process. For example, I take no personal credit for the success of any investment we make. The attribution of success is very broadly distributed."

While it may be too early to declare his mission a success, New Mountain has had virtually no turnover among its senior investment professionals, managing to retain a core group of young talent since inception.

Klinsky cites the example of managing director Matthew Holt. "It's guys like him," he says. "He was the first associate we ever hired, and now he's a pretty important managing director."

Socially responsible investment has also been a theme at New Mountain. Since its founding, the firm has added or created 8,600 jobs at its portfolio companies, net of any losses, and as of the end of 2010, had spent a total of $997 million on research, software development and capital expenditure.

"We put a social dashboard out every year and talk about all the jobs we've created and the money we've invested in research and development," Klinsky says. "We've never had a bankruptcy and we've never missed an interest payment in the history of our firm. So we think we're doing pretty positive stuff."

The firm also gives its LPs a detailed plan for every individual investment. "Since the beginning, when we make the investment we write a six or seven page thesis letter saying 'This is how we see the industry [and] this is what we plan to do with the company.' It's like calling your shot in baseball," he says. "These are all archived so [the LPs] can go back through every investment we've ever made and compare what we did to what we said."

While Klinsky has seen private equity take steps in the right direction during the past decade – particularly in terms of moving from a focus on financial engineering – he still believes there are areas in which general partners need to raise their game. "When things are going well, people can get very arrogant. And when things are bad, they get very nice," he says. "We're trying to be nice and avoid arrogance all the time."