

# PRIVATE EQUITY

# international

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# PRIVATE EQUITY **international**

*The global magazine for private equity*

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# Knowledge seeker

PRIVATELY SPEAKING

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*Before Steven Klinsky's New Mountain Capital makes an investment, it does a 'deep dive' into the mass of data surrounding its industry of interest. This strategy mirrors Klinsky's own zeal for intelligence gathering and for making money from growth, not leverage. David Snow profiles one of Wall Street's smartest – and nicest – investors.*

PHOTOGRAPHY BY THOMAS BUGARIN





In the early 1990s, back when he was still single, friends of Steven Klinsky knew where to find him after hours and on weekends – at the office.

“I’d come to work at odd hours and Steve was often there,” remembers Tom Lister, a former colleague of Klinsky’s at seminal New York private equity firm Forstmann Little, and now a partner in the New York office of Permira. “He’d often be sitting there with a sheet of paper trying to sketch out his theory on something. He’d become convinced of a point of view and pursue it in a fairly dogged way.”

When not engaged in deep analysis at his desk, Klinsky, who became a partner at Forstmann Little at the age of 30, would often haunt the nearby Coliseum Books on West 57th Street, searching for material to feed his voracious reading appetite.

The pursuit of knowledge has characterised almost every aspect of Klinsky’s life, but most manifestly it has led him to investment success, both during his tenure with Forstmann Little, where he played a leading role in some of that firm’s best deals, and more recently at the helm of his growing private equity firm, New Mountain Capital.

Today, Klinsky is confident that his firm is ideally structured and staffed for success. Limited partners, who have swarmed into New Mountain’s funds, clearly agree – yet another example of Klinsky’s calculations paying off in a big way.

#### DEEP DIVES

One of New Mountain’s secrets to success may be the result of a fairly rudimentary impulse on the part of Klinsky – he tries to hire people that are like himself. They must excel at research and intellectual rigor, but they must also be “nice”, he says, “people who can work together.” Klinsky alludes to Goldman Sachs in the early 1980s as a culture he’d like to emulate at New Mountain.

Klinsky is very smart and also very nice. He habitually walks visitors to the elevator bank outside the glass doors of New Mountain’s offices and waits with them until they are on their way back down the 49

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floors to the lobby. He is quick to tell stories about his four young children. A photographer who recently climbed up on a delicate chair in Klinsky’s office to get a shot made Klinsky nervous, but not visibly annoyed.

“He is a very, very solid guy,” says Lister. “People really like to work for him.”

But just being nice doesn’t cut it at New Mountain. Klinsky says he hires people who “have a real focus on intellectual honesty” and who have the stamina for what Klinsky calls “deep dives” – very thorough, often years-long data collections and analyses of targeted business sectors. Klinsky says that given the choice between a professional with deal experience, and one with stellar

research skills, he’ll pick the research pro every time. “By research, I don’t mean sitting in the library,” he says. “I mean really being able to understand companies fundamentally and in a very deep way. That comes ahead of deal doing.”

Each year, Klinsky and his team identify seven or eight “new ideas” that will get the deep-dive treatment. These ideas must have several attributes that fit through the New Mountain filter for an attractive business sector – its strongest companies do well within any type of economy, they are high growth, they have strong free cash flow, and they have high barriers to entry.

For example, by the time New Mountain was launched in early 2000, Klinsky had become enamoured of the for-profit education sector in the US because of its relative immunity to recessions and



potential for explosive growth, thanks in part to America's growing wage gap between workers with higher education and those without.

Over the course of a year, Klinsky, Steffey and a small team of New Mountain researchers confirmed their thesis, built relationships with education and student loan regulators, and created a database of more than 4,000 properties in the space. "I think it's still the best database out there," says Klinsky with pride.

New Mountain brought on board Scott Steffey, the vice chancellor of the State University of New York, as an executive in residence. The firm later brought in Rob Silberman, the former president and chief operating officer of CalEnergy Company, as a second executive in residence.

At the end of 2000, New Mountain had settled on one company – Strayer Education, a publicly traded operator of graduate and undergraduate degree programmes with campuses in and around the

Washington DC area. New Mountain invested \$110 million (€92 million) in the form of convertible preferred securities convertible at \$26. A co-investor, DB Capital Partners, invested \$35 million. Silberman became and remains CEO of Strayer.

By 2005, Strayer had grown from 14 to 35 campuses and seen its revenue double. The firm's share price rocketed to more than \$100 and New Mountain has reaped approximately \$500 million in cash profits from the sale of its preferred stock. New Mountain sold the last of its Strayer holdings in August.

In a conversation with a reporter soon after the Strayer deal closed in 2001, Klinsky responded to a question about other private equity firms investing in the for-profit education space by saying, "Well, we already did the Strayer deal, and that was the best of the lot."

New Mountain has an even bigger hit in National Medical Health Card, another publicly traded company, which manages pharmacy benefits. A New Mountain team spent three years examining the pharmacy benefit management space before zeroing in on National Medical at the end of 2003. New

Mountain bought 55 percent of the company by investing \$80 million in convertible preferred shares with a 7 percent cash yield, convertible at \$11.50. Following two strategic acquisitions identified by New Mountain, and a rebuilding of National Medical's board and management team, the company's stock now trades near \$30.

Klinsky calls 2005 the firm's "best year ever" for new deals, with a total of almost \$500 million of equity invested in Deltex Systems, a provider of software for project-based businesses; MailSouth, a mailed marketing company targeting rural and suburban neighborhoods; and Validus Holdings, a Bermuda reinsurance platform led by Aquiline Capital.

#### GOING PUBLIC

New Mountain's success right out of the starting block has made it very popular with investors. At the end of



2004, the firm held a final close on its second private equity fund, rounding up \$1.55 billion but turning away an additional \$2.5 billion in LP demand. “We really didn’t think it was appropriate to take all \$4 billion,” Klinsky says.

In forming New Mountain, Klinsky gained an early convert in the California Public Employees’ Retirement System, which not only backed his debut fund but also acquired a small stake in the carry of New Mountain’s debut, \$770 million fund. Klinsky was introduced to the staff of the pension giant by CalPERS’ consultants at Grove Street Advisors, who were aware of his track record at Forstmann Little.

Klinsky says he is “agnostic” about fund size. He says the hardest part is finding talented people to match the dollars capable of being raised. “We can put out unlimited amounts of money,” says Klinsky. “But the question is, can we put out unlimited amounts of money at our quality standards?”

Klinsky is a fervent believer, however, in the quality of research that his firm produces, enough so that it pains him to miss opportunities just because New

Mountain Capital is primarily a private equity fund. Although Klinsky declines to discuss the topic, citing regulatory prohibitions, public filings and recent published reports reveal that New Mountain has launched a public markets vehicle called New Mountain Vantage – Klinsky’s first hedge fund, for lack of a better term.

In short order, New Mountain Vantage has raised more than \$750 million to take long-term, concentrated positions in public companies. The idea for the fund was first suggested to New Mountain in 2003 by CalPERS, which was eager to put more money behind “corporate governance” investing, where money managers exert some form of transformational influence on portfolio companies. The pension invested \$200 million in New Mountain Vantage. The fund will take advantage of New Mountain’s “deep dives” by investing in the stock companies that fit all of Klinsky’s criteria of an attractive opportunity, but where a control investment is not available.

Directly overseeing New Mountain Vantage are two new managing directors, both recruited from Lehman

Brothers. At Lehman, Andrew Wellington and David DiDomenico managed over \$3 billion of publicly traded institutional and mutual fund assets.

As yet, there are no plans for a London office, an Asia fund, or a real estate fund. “We’re not in the fund of the week club,” he says.

Klinsky, adds, however, that he expects to see New Mountain’s funds grow in size, and that given careful planning and the right set of people and circumstances, he wouldn’t shun geographic expansion.

Klinsky differs from most of his GP peers on another topic, too – leverage. Although he says he doesn’t want to appear to “be on a soapbox” on the subject – a charge often leveled at his former boss, Ted Forstmann – he is fond of reminding investors, reporters – everyone – that his firm accomplishes its returns without much debt, if any. “Some people still think that if there isn’t debt on the deal, it isn’t a private equity deal,” he says. “We don’t think that debt and private equity are synonymous. We’re focused on growing the enterprise value of a company. If we can,

of women’s clothing today. Klinsky’s grandfather, Albert Klinsky, founded a women’s clothing store in Detroit during the Great Depression. Albert’s, as the retailer was called, eventually grew to more than 100 outlets under the management of Klinsky’s father and uncle. Steven worked in the stores as a teenager and expected to stay in the family business, but Albert’s was sold in 1978, while the would-be retail heir was in graduate school. (Many of the New Mountain deal pros also grew up in family businesses, a background that tends to instill a stewardship ethos that Klinsky highly prizes.)

Klinsky tore through his schooling and quickly ended up a Wall Street star. He completed his undergraduate studies at the University of Michigan after only two years and then earned a joint law and business degree from Harvard. At Harvard, Klinsky studied a then-emerging type of investment – the leveraged buyout. His interest was based in part on the thought that he and his father might purchase another business.

Instead, after graduating in 1981, Klinsky went to

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Klinsky notes that neither Strayer nor National Medical were levered. In fact, Strayer now has \$120 million of cash on hand. He says that he isn’t against leverage, and in fact notes that he was an early developer of the dividend recapitalisation while working at Goldman Sachs in his 20s. But Klinsky’s personal view on leverage seems to be that it isn’t sporting; it doesn’t meet his rigorous standard for adding value: “Let’s say a company is worth \$100 million and you take a \$90 million dividend out. You haven’t actually created any return at all,” he argues. “You could have just started with \$10 million of equity on day one. There’s nothing magic to it. What I don’t support is shoving tons and tons of debt on a company and thinking you’re making money.”

#### RETAIL ROOTS

Had history taken a different course, Steven Klinsky would likely have been an extremely successful retailer

Goldman Sachs, where he pursued LBOs for the firm. His work at Goldman drew the attention of Forstmann Little, which hired Klinsky in 1984.

Forstmann Little was and remained during its long reign at the top of the private equity food chain a small firm. It was co-founded in 1978 by two brothers, Ted and Nick Forstmann, and Brian Little. Nick had worked at Kohlberg Kravis Roberts, while Ted was a lawyer and investment banker. Little was a former Merrill Lynch banker.

The firm gained a great deal of attention on Wall Street in the 1980s for a series of leveraged buyouts, and was involved in the famous takeover battle for RJR Nabisco. But the firm made its biggest dollar gains in the 1990s when there wasn’t nearly as much leverage available. “The real breakthrough in the 1990s was that we started to focus much more on high quality companies with what were then considered conservative capital structures versus other firms,” says Klinsky.

One Forstmann Little deal in particular that enriched the firm, and in which Klinsky was a key player, was General Instrument Corporation. Forstmann Little





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invested approximately \$180 million in the maker of cable and satellite television equipment in 1990. Nine years later, the firm cashed out its remaining shares, realising a total profit of \$1.65 billion, or more than nine times its initial investment. (Current US Defense Secretary Donald Rumsfeld, who was CEO of General Instrument from 1990 to 1993, also did well.)

Some of the partners at Forstmann Little had originally resisted the deal, put off by General Instrument’s many disjointed divisions. It was Klinsky who pushed hard for it, and did so based on his own analysis. A 1993 article in *Fortune* magazine recounted a confrontation between the younger and older partner: “One foggy June night, Klinsky drove to Forstmann’s house in East Hampton, New York. He demanded: ‘If we’re not going to buy this, what will we buy? It has everything we said we wanted when we raised money.’ He spread papers on a table. ‘Lay these numbers against your rhetoric.’”

“Steve stayed after it for a long time,” says Lister of the General Instrument deal. “He was very disciplined in how he did his analytics.”

Lister also points to a 1994 deal that got away as further proof of Klinsky’s uncanny analytic abilities – Western Union, a then-bankrupt wire transfer company which, after a protracted bidding war, was eventually sold to Atlanta credit card processor First Financial Management for \$1.19 billion. “Steve was relentless in going after [Western Union],” says Lister. “First Financial wasn’t going to let us win. But Steve’s instincts were right. It ended up being worth \$10 billion.”

Whether or not it was the result of analysis or luck, Klinsky left Forstmann Little at precisely the right time. His departure came in June 1999. On August 30, 1999, Forstmann Little announced a \$1 billion PIPE investment in McLeodUSA, the first of two major telecom investments that would

prove the undoing of an otherwise highly successful firm.

Klinsky founded New Mountain together with Robert Grusky, a former executive from the principal investment team of Goldman Sachs, and David Wargo, a well known securities analyst and founder of Wargo & Co.

#### HEAD AND HEART

Fostering the pursuit of knowledge is a personal mission for Klinsky as much as it is a business plan. While still at Forstmann Little, Klinsky founded what has become a major after-school tutoring programme for low-income children in New York City’s public schools. In 1999, Klinsky founded Victory Schools, an education consulting group. Victory helped establish New York City’s first charter school, or privately managed public school. Victory Schools now provides services to 12 schools throughout New York, Delaware and Philadelphia.

Victory Schools is not yet profitable, meaning Klinsky has indirectly propped up the operations of a dozen lower-income schools out of his own pocket.

Klinsky now plays no golf, little tennis and, other than for his educational interests, isn’t seen as frequently on the social circuit as other GPs of his stature. Most of his scarce free time is spent with family, he says.

The family, it turns out, may be Klinsky’s one valuable asset to which he devoted almost no initial analysis. According to a 1995 *New York Times* profile of his wedding, Klinsky first saw his future wife from a moving cab, immediately ordered the driver to halt, and leapt out to introduce himself. Not the kind of due diligence that would pass muster at New Mountain, but a deep dive nonetheless. ■