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Working With Unions Is Labor Of Love For KPS

By Giada Cardoletti

For many buyout firms, the presence of a strong union at a troubled company might be a reason not to invest. Unions are notoriously prickly about cost cuts – which can be key to a successful restructuring.

But **KPS Special Situations Funds** finds that courting strong unions early in the process can actually take some of the risk out of often precarious situations.

KPS, New York, has built its reputation on being union-friendly, and about three-quarters of its deals involve unionized companies. Eugene Keilin, one of three founding partners, in particular brought a history of cordial union dealings with him from Lazard Freres & Co., where he served in the 1980s as a restructuring adviser.

“We are not looking to subsidize crazy wage rates,” says David Shapiro, a founding partner and managing principal at KPS. “But you don’t have to get rid of the unions in order to come out with a competitive cost structure. In fact, if you keep the unions you can come out with a structure that is more positive.”

If what the firm has done with its first fund is any indication, Shapiro has a point. The \$210 million **KPS Special Situations Fund LP**, raised in 1998, is 90% invested, and sports 25% gross returns so far, with four of its eight investments exited (or written off, in one case). The firm raised \$404 million for its second fund last year.

KPS says its union-friendly status gives it an edge in finding deals; the firm will sometimes get a heads up ahead of its

competitors when a union company goes on the block, for instance. More importantly, having unions on board can be a big help when KPS begins the hard work of restructuring – as the firm’s acquisition of bus manufacturer New Flyer Industries Ltd. in 2002 shows.

New Flyer, Winnipeg, had supply chain problems, union problems and was operating in the red, says Michael Psaros, another KPS founding partner and managing principal. The firm negotiated a collective bargaining agreement with the company’s union, which accepted layoffs and other changes. This fix to the company’s cost structure helped KPS convince other parties that New Flyer was viable. KPS was able to orchestrate an out-of-court restructuring, negotiate easier terms with 24 vendors, obtain a capital infusion from the province of Manitoba and work out deferred payments to trade creditors. The firm also recruited a new chief executive to run the business.

The end result – a \$28 million investment turned into a \$200 million distribution to limited partners, a roughly eight times return, when KPS sold the company in 2004, said Psaros. It was the fund’s most successful exit thus far.

Another deal from the first fund shows KPS’s savvy in getting unions on board while still slashing costs. In May 1999, the firm created paper maker Blue Ridge Paper Products from some assets that unionized forest product company Champion International Corp. was abandoning.

KPS agreed to sell 45% of the company to employees in exchange for a 15% reduction in overall compensation. Not only did the wage cuts reap immediate savings, the stake sale allowed KPS to put into place a tax shield that accompanies employee stock ownership plans. That saved some money, which Blue Ridge was able to reinvest to modernize outdated production equipment and slice costs further.

KPS still owns Blue Ridge. The company last year had to deal with hurricanes that flooded one of its mills twice, but thanks in part to the rising costs of paper it has regained profitability in the two most recent quarters. Today, the company is four times more profitable than when KPS got involved, says Psaros.

While having a friendly union in place is one way KPS can minimize the risks of distressed investing, there is nevertheless little room for error. The first fund’s largest investment, in steel bar producer Republic Engineered Products Holding LLC, ended up as a write-off after a power blackout caused a blast furnace to overheat, resulting in an explosion that forced the company to cease production.

At a Glance

KPS Special Situations Fund LP

Vintage: 1999**Size:** \$210 million

Select Portfolio Companies: Paper manufacturers Blue Ridge Paper Products, Blue Heron Paper Co. and Curtis Papers; Devlieg Bullard, a manufacturer of industrial precision machine tools, Genesis Worldwide, which makes machinery for the flat metal processing industry

Select LPs: BellSouth Corp., Connecticut State Treasurers Office, Invesco Private Capital, General Electric Corp. and Bank Boston