20 March 1989

Junkman in DC

Henry Kravis prefers doing deals to cajoling Congress. But for the moment, Washington has taken precedence over Wall Street for this leveraged buyout artist and his creative colleagues at Kohlberg, Kravis and Roberts (KKR). The investment bankers are acutely worried that Congress may take away their paints.

Last December, some of the most powerful in Congress were clamoring for an abrupt end to the buyout madness after the unprecedented $25 billion RJR Nabisco deal. No fewer than nine investigations were launched. In response, the normally secretive Kravis promptly assembled a supporting cast of lobbyists and personally began trying to convince key senators and representatives that LBOs are elixirs for what ails corporate America. And Kravis appears to be succeeding, with help from such unlikely parties as Representative Tom Downey, a liberal New York Democrat who is a member of the pivotal Ways and Means Committee. Downey has helped arrange meetings for Kravis with Democrats on Capitol Hill, even though Kravis was one of George Bush’s major fund-raisers last year.

As Disraeli once said, there are “three kinds of lies – lies, damned lies, and statistics,” and LBO partisans have labored mightily to keep Congress awash in the last. Instead of taking the word on LBOs from Kravis now, Congress should invest at least one of those nine investigating committees with subpoena power so it can investigate some of the target companies inside out. The buyout by KKR of Houdaille Industries is a perfect place to start.

In 1979, KKR “leveraged,” or bought largely with a debt issue, Houdaille (pronounced “WHO-dye”), a Florida-based conglomerate with some 8,000 employees and gross annual sales of $410 million. The deal was not just a buyout; it was a benchmark. Until then, no corporation worth more than $100 million had ever been leveraged. When KKR engineered the $355 million deal, Wall Street investment bankers said, Holy Mackerel, look at this! LBOs began getting bigger and bigger.

The firm of Kravis et. al. is quite proud of the Houdaille buyout, calling it, in a thirty-four-page study it commissioned on the virtues of LBOs, “a case study in the ability of LBOs to withstand economic adversity.” The report contends that all “of the Houdaille constituents” . . . fared well in the LBO.” Owners of Houdaille stock, which was trading at around $15 a share before the buyout, received $40 per share. Top management was handsomely rewarded; as were those managers who stayed on; the institutional investors; the banks that bought Houdaille’s “junk bond” debt offering; and, of course, Kohlberg, Kravis and Roberts.

But what was the price of success? The KKR report doesn’t mention Houdaille’s almost complete collapse as a major machine tool builder or the hundreds of high-paying manufacturing jobs that were lost as a result. Nor is there one word about a factory that became a warehouse for foreign imports. Yet these facts are just as much a part of the Houdaille story as the "superior" returns realized by KKR and investors.

For the first two years after the buyout, Houdaille was able to go about its business as usual. By 1982, however, the conglomerate was caught in a triple bind of debt, recession, and competition. Debt, of course, was a given. But no one in 1979 foresaw the worst recession since the 1930s, or the Japanese competition in machine tools. In pre-buyout days, Houdaille could have suspended dividend payments to tide itself over until better times or borrowed money to help make itself more competitive. But the heavy debt it had to service as a result of the LBO ruled out those alternatives.

At the time of the buyout, Kohlberg, Kravis and Roberts promised investors a pot of gold by 1984 – that is, a financial windfall when Houdaille reissued public stock after paying down its debt. Instead, the Houdaille stock became a "dog," to borrow from the vernacular of Wall Street.

Houdaille doesn't exist anymore except as a hollow shell, a holding company with a letterhead. John Crane, its most profitable division, was sold to a British conglomerate in 1987. Other parts of Houdaille were either merged, purged, or taken over in other leveraged buyouts. Yet according to the KKR study, the chief (and to KKR the only) significance of the buyout was that "Houdaille never fell behind on its debt service . . . [and] superior returns were *realized* by the investors." [Emphasis in original.]

Before corporate indebtedness becomes the nation's fourth debt crisis, Congress should not invite but compel Kravis and his kind to defend publicly their reshaping of corporate America.

This article first appeared in *The Nation*, 20 March 1989