

This Billionaire Made His Fortune on \$50 Chainsaws

By Tom Metcalf

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- ▶ Eric Smidt raised debt against Harbor Freight to diversify
- ▶ CEO used dividends to purchase real estate, art works



Eric Smidt Photographer: Alex J. Berliner/ABIImages via AP

Debt pays. Just take a look, if you can get close enough to it, at Eric Smidt's 10-acre Beverly Hills estate, a monument to a fortune built by the leveraging of Harbor Freight Tools USA Inc.

Smidt is chairman and chief executive officer of the discount tool retailer known for its \$49.99 chainsaws and a 130-piece tool kit that goes for \$37.99. He has raised \$5.1 billion in debt against the closely held company since 2005, according to data compiled from Moody's reports and court documents. He's received about \$2 billion in dividends, according to calculations by the Bloomberg Billionaires Index, which puts Smidt's net worth at \$2.3 billion.

"It's like a money-printing machine," said Lloyd Greif, founder and CEO of the investment bank Greif & Co. in Los Angeles that specializes in representing entrepreneurs and their companies. "He's mastered the art of the dividend recap."

Smidt declined to be interviewed for this article or to comment on Bloomberg's valuation.

The Beverly Hills property, with a white-brick Regency mansion, outhouses and manicured gardens offering uninterrupted views of the city, is valued by area brokers at around \$250 million. Smidt bought the Knoll, as it's called, from the estate of the late industrialist Marvin Davis in 2005 for a sum the local media reported was around \$46 million and has since given it an extensive facelift.

"There are only a couple of privately owned properties in Beverly Hills that are in the same league," said Joyce Essex Harvey with Coldwell Banker Residential Brokerage in Beverly Hills. "The house may be one of the finest."

Smidt also has an apartment in Manhattan, and an art collection that includes works by Mark Rothko and Jackson Pollock. ArtNews magazine has named him one of the country's top 200 collectors for eight years running.

"High leverage," Greif said, "in this case equals high lifestyle."



Smidt home Photographer: Tom Metcalf/Bloomberg

It's a strategy often embraced by private equity firms such as KKR & Co. and Platinum Equity, though some entrepreneurs have joined the party in recent years as historically low interest rates have enabled Smidt and others to diversify their investments while still retaining full ownership of their companies. Dividend recaps, when a company incurs debt to pay a dividend, totaled about \$50 billion in the U.S. in 2016, up from \$38 billion in 2015, after hitting a record \$70 billion in 2013, according to LCD, an offering of S&P Global Market Intelligence.

Smidt's father, upset by management changes made to re-position Harbor Freight after the 2008 recession, criticized the practice of borrowing to take cash out

of the business in a 2010 lawsuit, filed over a decade after he sold his interest to his son. Allan Smidt, who died last year, said Eric Smidt had "dramatically leveraged the company" and enriched himself at its expense. The suit cited a loan in excess of \$500 million that "has had serious negative consequences, including inability to keep inventory on shelves." Interest on the loan, the suit said, was at one point as high as 10 percent.

The elder Smidt accused his son of kicking him off the board of directors and looting Harbor Freight in part to buy the Knoll, a painting for \$100 million and a Manhattan apartment for \$20 million. Eric Smidt denied the allegations -- in a statement reported in local media at the time the company called them "completely unfounded" -- and the case was settled out of court.

At 57, he's now one of the richest residents of Los Angeles. He started out anything but. His mother had multiple sclerosis and his father, overwhelmed, sent him to an orphanage when he was nine. Four years later he went to live with an aunt in Tennessee, returning home after two years but moving into his own apartment on his 16th birthday.

"His childhood is such a dramatic story," said Michael Govan, CEO of the Los Angeles County Museum of Art, to which Smidt and his wife Susan pledged \$25 million in October. "He's a role model not just for the fortunate and wealthy but also for those who grew up with nothing."

Smidt has difficult memories. "It's so blurry, that part of my life," he was quoted as saying in the Los Angeles Times on Oct. 28, 2016. "It was very hard. I was very angry and miserable."

That didn't stop him from going into business with his father. After he left high school, the pair converted the family's telephone-sales operation into a direct-mail outfit selling imported industrial supplies and tools. That became Harbor Freight, which today has more than 750 locations nationwide. Since 2016, a new store opens roughly every three days.

The younger Smidt was the driving force behind the success, Greif said. "He's his dad on steroids. Eric has bigger plans and bigger ideas."

Breakneck growth has enabled Harbor Freight to periodically increase debt levels and then deleverage through steady earnings increases, Moody's Investor Service said in a research report in August.

Greif said that for Smidt, "who's having the time of his life and has no plans to retire," leveraging makes perfect sense. "If you have a business that's minting money, as Harbor Freight is, then doing dividend recaps until the cows go home is a no-brainer. A private equity firm would leverage the company in any event, so why not do it yourself and still call all of the shots?" And the extra spending money can come in handy.