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Some Don't See 99 Cents as Deal

INVESTMENT: But discounter may be Leonard Green's next buy.

By RICHARD CLOUGH *Staff Reporter*

Petco. J. Crew. Whole Foods. Jo-Ann Fabric. Rite Aid. Container Store.

No, that's not the itinerary for next weekend's errands. It's a list of some of the major national chains owned by Leonard Green & Partners LP of West Los Angeles.

And if all goes according to plan, 99 Cents Only Stores Inc. will join them soon.

But Leonard Green, one of the most active local private-equity firms today, is facing shareholder opposition in its effort to add the Commerce-based discount retailer to its roster of well-known brands.

Though it's not a well-known name outside the financial world, Leonard Green's high-profile deals in the past few months have cemented its reputation as one of the country's leading acquirers of major retailers. It most recently snapped up East Coast retail chain BJ's Wholesale Club Inc. While many investment firms are waiting on the sidelines for the market to fully recover, Leonard Green is earning respect for persistence and boldness.

"They're aggressive, they're smart, they're good at recognizing opportunities," said Lloyd Greif, president of downtown L.A. investment bank Greif & Co., who has known Leonard Green's leaders for decades. "They've got strong fundamentals when it comes to retail. It's an area that a lot of firms don't invest in."

Started by a leveraged buyout pioneer and run by former Drexel Burnham Lambert executives, the firm, which overlooks the San Diego (405) Freeway from its offices at Santa Monica and Sepulveda boulevards, now has $9 billion under management and 30 companies in its portfolio.

Since the financial crisis, many of the local private-equity firms active in the market have been those specializing in distress investing, including Beverly Hills' Platinum Equity LLC and downtown L.A.'s Oaktree Capital Management LP. But Leonard Green, which has announced six acquisitions in the past year totaling more than $9 billion including debt and partner investments, has gone against the grain by targeting relatively healthy companies with growth potential.

Unlike its competitors, which sometimes seize control of vulnerable companies and replace key executives, Leonard Green is known for taking a softer approach, gaining management support before acquisitions and leaving the executive roster largely intact.

The strategy has paid dividends: Leonard Green is the best performing buyout firm in the world, according to a study released in December of more than 300 private-equity firms conducted by French business school HEC Paris and Dow Jones. (The study uses proprietary databases for its rankings and does not disclose the actual performance of each firm.)

A number of the firm's investments have been tremendously successful; for instance, Leonard

$9.2 billion

Total value of Leonard Green's announced deals in past year.

Green tripled its investment in VCA Antech Inc. when it exited the West L.A. veterinary hospital operator in 2004.

The firm, which does not typically disclose its performance data, is raising its sixth fund and declined to comment due to regulatory restrictions. However, many industry leaders are willing to detail the firm's strengths.

"They're very disciplined about looking for transactions that fit their criteria," said John Mack, managing director of Century City investment bank Imperial Capital LLC, which has explored potential deals with Leonard Green. "Their performance speaks for itself."

Deep roots

Leonard Green was launched in 1989, but its roots go back decades earlier.

In 1969, Leonard I. Green, the man, co-founded New York merchant bank Gibbons Green and van Amerongen Ltd., which along with Kohlberg Kravis Roberts & Co. and several other firms pioneered the leveraged buyout business.

The deals, which were financed by high-yield debt – or junk bonds – became especially popular during the 1980s. In 1986, Green, who ran the firm's L.A. office, helped arrange what was then one of the largest buyouts ever, the $520 million acquisition of Budget Rent-a-Car.

But toward the end of the decade, Green split from Gibbons Green over "philosophical differences," he said at the time, and launched his eponymous firm, which debuted with a $216 million fund. The timing couldn't have been better.

"That was the peak of the market in '89 and then it crashed," Greif said. "The key is getting that money raised and they just got it done in the nick of time."

Green died in 2002. But his guiding principles were detailed in a 1990 Wall Street Journal article: avoid companies that are highly cyclical, struggling or in need of significant capital; steer clear of high-tech companies; and get control of the company.

Brian McCarthy, a corporate attorney with New York-based Skadden Arps Slate Meagher & Flom LLP who knew Green, said he was anything but a stereotypical cutthroat dealmaker.

"He was always very professional and cordial," McCarthy said.

After the junk bond market's flameout, leveraged buyout activity slowed in the 1990s, but Green's new firm racked up several notable deals, including the 1992 purchase of Big 5 Sporting Goods Corp. In 1998, Green took a lesser role at the firm, passing control to three managing partners – former Drexel executives John Danhakl, Peter Nolan and Jonathan Sokoloff – who still run the company today.

Observers said that consistency of leadership has helped the firm remain committed to its acquisition strategy despite market cycles.

In a typical deal, Leonard Green will buy out shareholders of a public company using relatively low levels of debt and take a controlling position on the board. In most cases, the firm appeals to the management team before negotiating the purchase.

"They're not doing things that are hostile or antagonistic," Imperial Capital's Mack said. "These are guys looking to win over management teams."

Indeed, analysts were surprised in March when the firm announced that it had teamed with the family that owns 99 Cents Only to buy the franchise and take it private. The company was co-founded in 1982 by David Gold and the Schiffer-Gold family has remained fiercely protective of its ownership stake.

Joan Storms, an analyst with downtown L.A.'s Wedbush Securities Inc., said she assumed the family would balk at any deal to sell the company.

Shopping Spree

Leonard Green & Partners has announced more than $9 billion worth of buyouts and other investments in the past year.

Target Company	Date	Deal Value (in billions)
99 Cents Only Stores	NA*	$1.3
BJ's Wholesale Club	June 29	2.8
Cascade Bancorp	Jan. 28	0.18
Jo-Ann Stores	Dec. 23	1.6
J. Crew Group	Nov. 23	3.0
Prospect Medical Holdings	Aug. 16	0.36

**Announced deal has not yet been approved by board*

Source: Leonard Green & Partners LP

"I never expected them to be an LBO candidate because of the family. You need the family to be able to get a deal like that done," she said. "Clearly, (Leonard Green) makes friends with management."

Calls to 99 Cents Only were not returned.

A large shareholder has criticized the $1.3 billion offer as too low and is urging the board to find a better offer. But that could be tough, Storms said, since the family is supportive of Leonard Green's offer.

The firm is known to leave management teams largely intact at the companies it buys, largely because it targets companies that are already well-run. Experts said the firm is able to add value in part by providing capital for growth and improvement, which 99 Cents Only can use.

"I think the deal will get done," Storms said. "It really makes sense. There's a lot of investing that has to go on at 99."

Aggressive tactics

Still, Leonard Green's tactics have drawn some criticism.

The firm, along with partner TPG Capital of Fort Worth, Texas, reportedly negotiated for nearly seven weeks with J. Crew Chief Executive Millard "Mickey" Drexler before presenting its buyout offer to the board, a move that angered some shareholders of the preppy-clothing retailer. The move, critics said, essentially sealed the deal before the board could solicit better offers from other potential buyers.

Shareholders filed a lawsuit over the deal, while the New York Times, which graded the past year's deals, gave the buyers an "F" for "appearing to manipulate the J. Crew sale process unduly in their favor."

McCarthy said Leonard Green doesn't tend to pursue hostile takeovers, but he admitted, "They can be aggressive buyers."

To many dealmakers, though, that's not necessarily a bad thing.

Howard Marks, chairman of Oaktree, which has been known to take an aggressive stance when going after potential acquisitions, said Leonard Green has a good reputation in the local industry.

"They've gone on to have a consistent record of good wins and only moderate losses," he said. "That's about as good as you can do in this business."