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COVER STORY By **Emily Thornton**

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With the days of easy money over for private equity firms, CEOs are under intense pressure from their LBO bosses to squeeze profits out of acquired companies—or else

COVER STORY PODCAST

At 8 a.m. on a dreary Wednesday in London, Jeff Clarke, the square-jawed CEO of travel- services provider Travelport, listens as managers explain why their division is losing money. They tick off a list of problems: technology errors, fewer bookings, higher marketing costs, and on and on. One executive estimates that the business could break even in 2009. Clarke has a different idea: 2008. "Be aggressive!" he commands. For Clarke, the onetime chief operating officer of Computer Associates International who took over at Travelport in April, 2006, such exhortations aren't cheesy bits of CEO stagecraft—they're expressions of deep-seated fear. Clarke's new bosses, the private equity firms Blackstone Group (**BX**) and Technology Crossover Ventures, are even more demanding than he is. They've bet $4.3 billion that Travelport will be worth an enormous sum after it's split into pieces, and they've tapped Clarke to be the architect of the breakup. For now, anyway; one slip and he'll catch unshirted hell from above. "You have to constantly drive returns," he says as he ducks into the back seat of a black sedan to race to his next meeting. "Time will kill you." The clock is ticking faster for private equity CEOs—and their millions of employees—all over the world. Coming soon to business pages and water coolers near you: tales of quick and brutal corporate breakups, rollups, and reorgs, an onslaught that could rival the downsizing binge of the early 1990s. "There will be radical internal restructurings," predicts Colin C. Blaydon, director of the center for private equity at Dartmouth's Tuck School of Business. That is because the easy money has already been made. For years private equity firms reaped vast sums by acquiring companies, sucking cash from their balance sheets, and then selling them or taking them public. But the strip-and-flip era came to an abrupt end in July when

two Bear Stearns (**BSC**) hedge funds collapsed, prompting a global credit crunch. That took away the funding that private equity firms need to make big leveraged buyouts. It also dashed their hopes of refinancing the massive amounts of debt they've taken on. And that has made it more difficult for them to justify raiding the coffers of their debt-laden companies or to persuade others to buy them. Stripping a company "would be difficult right now, because the markets are pretty much shut down," concedes one senior executive at a major private equity firm. **FIGHT OF THEIR LIVES** With financial conditions so tight, buyout chiefs' best shot at generating strong returns in the U.S. lies in their ability to make the companies they control more profitable—slashing costs, boosting sales in global markets, and paying down debt. Firms "have to go back to their bread and butter: operating the portfolio companies," says one private equity partner. All of which means firms will lean more heavily than ever on the CEOs they've tapped to run their companies. Chief executives "are going to be under even more pressure to improve operations," says Blaydon. Hard-chargers who've known nothing but success—star executives such as Travelport's Clarke, Gerald L. Storch at Toys R' Us, Mary Petrovich at truck-axle producer AxleTech International, and Steven J. Demetriou of aluminum producer Aleris International—are in for the fight of their lives. They must create value when bond investors are expressing serious doubt. And they must keep employees focused even as their companies endure painful dislocations. The toughest CEO jobs in America just got tougher. For the minions at these companies, meanwhile, the career options may be dismayingly limited in coming years: get with the new, gut-wrenching program or get out. "It will be survival of the fittest for employees," says Robert Finkel, founder of Prism Capital, a Chicago-based private equity firm. Even the most aggressive CEOs will have difficulty in the new environment. Some recent, high-profile buyouts are already struggling. Univision Communications, bought by five firms for $13.5 billion in March, lost $19.6 million in the three months through June as its debt soared to $9.8 billion from $922 million. Semiconductor maker NXP, taken private by five firms in August, 2006, for $12 billion, saw its operating earnings plummet by $372 million in the first half of the year. Military field-ration supplier Wornick, bought by Veritas Capital three years ago, couldn't cough up the interest payment on its debt in July. In fact, half of the dozen U.S. companies that defaulted on their debt this year were owned by private equity firms, say Thomson Financial and Global Fixed Income Research at Standard & Poor's (**MHP**). Making matters trickier, the broad-based layoffs of yore won't be easy to pull off now. U.S. companies are relatively lean after four years of lackluster job growth. Andrew Metrick, an associate professor of finance at the University of Pennsylvania's Wharton School of Business, notes that it was far easier to trim payrolls in the early 1990s, after the bloat of the 1980s, than it will be next year. Cuts are always painful, but the next wave could be gruesome. None of this, however, has slowed the parade of CEOs moving to private equity firms. The lure: big equity stakes in the

companies they manage and, if all goes well, big paydays when the companies are sold. For example, in the four years since buyout firm TPG recruited former Gap (**GPS**) CEO Millard "Mickey" Drexler to run clothier J. Crew Group (**JCG**), which he took public in July, 2006, the CEO has hauled in more than $323 million, reckons compensation researcher Equilar. But along with the upside potential comes constant accountability to private equity bosses, near-impossible timetables, ever-increasing financial goals, and grueling board meetings in which standout numbers are met with blank faces and on-target results can be disappointing. "We expect CEOs to exceed our plan, and we talk to them daily or every other day," says one chairman and CEO of a private equity firm. "They're under a microscope." Indeed they are. According to a recent Ernst & Young study, buyout firms replaced CEOs or CFOs at 17 of the 23 U.S. companies that they sold or took public in 2006. Consider the assessments of Clarke by two of his superiors. Will Griffith, a partner at Technology Crossover Ventures, is complimentary—to some extent. "I'm not sure he can go faster; he has already taken the floorboard out of the car," says Griffith. But he also makes it clear that Clarke won't be cut much slack should the economy weaken. "Many initiatives are independent of the economic environment," he says. Paul "Chip" Schorr, a senior managing director at Blackstone, seems even less inclined to ease up: "I think they can go faster," he says of Clarke's team. "They're a couple of years ahead already, so why not?" Only the most tenacious executives can survive private equity's rigors. Steven Kaplan, a professor of finance and entrepreneurship at the University of Chicago's Graduate School of Business, studied 150 private equity CEOs, based on assessments from leading recruiter Geoffrey H. Smart, and shared his working paper with *BusinessWeek*. Kaplan found that CEOs who bring "hard" qualities such as aggressiveness, persistence, insistence on high standards, and the ability to hold people accountable are significantly more likely to succeed. Those who offer primarily "soft" skills that are often effective at public companies—like listening, developing talent, being open to criticism, and treating people with respect—are unlikely to work out. Says Smart: "Successful private equity CEOs are cheetahs." **'CREATIVE DESTRUCTION'** Clarke certainly understands the need for speed. In the past year he has merged Travelport with Worldspan, one of its biggest rivals; taken online reservation business Orbitz Worldwide (**WWW**) public; and sucked $1 billion from Travelport's coffers to pay its private equity owners, a huge sum for a company with just $2.6 billion in 2006 sales. Now comes the hard part: melding Travelport's 23 businesses into bigger chunks and then selling them off or taking them public. First he must make those businesses profitable. But given Travelport's increasingly cutthroat competition and $4.2 billion debt load, there's no room for error. And so Clarke is racing even faster. In one three-day stretch in June, the 46-year-old CEO stormed through Russia, France, and Britain. Clarke says he prefers working out of Europe to Travelport's Parsippany (N.J.) headquarters because he can do more business on the European clock. He

unwinds at night by thumbing through the biography of economist Joseph Schumpeter—coiner of the phrase "creative destruction"—which he keeps on his night stand. And while he usually wakes up at 5 a.m. to go running, he says, sometimes he dives right into e-mails. Private equity firms expect their CEOs to succeed on two fronts. They must make the smart and aggressive moves needed to yield quick financial improvements. And they must radically alter corporate psychology so that the changes they make stick. For Clarke, that means constantly setting loftier goals and higher standards. Managers of one business recently flew to London from office around the world to explain how they got the unit on track to triple profits and beat its 2007 target by millions. "You're ahead of plan," Clarke concluded at the end of the presentation. "And we want more." Clarke also takes every opportunity to reiterate that private equity equals change. He spells out on the company blog exactly what employees should expect. When rumors of an Orbitz IPO started flying, Clarke reminded workers that "private equity ownership generally is not a long-term proposition. The day will come when our [owners] will decide to take Travelport public, sell off individual businesses, spin off groups of businesses, or pursue some other exit strategy." He's equally up front about job cuts. Since Travelport went private, it has slashed expenses by $147 million and laid off 841 people, or 10% of its work force. In August, after the U.S. Justice Dept. approved Travelport's merger with Worldspan, Clarke told employees at a town hall meeting in Atlanta that "there will be a lot of consolidation in this merger, and it will impact many of the ways we work. Some of our colleagues will lose their jobs." Private equity's constant restructurings encourage cold-eyed realism from human resources departments once given to rah-rah morale boosting. "You can't guarantee people jobs in this world," says Jo-Anne Kruse, Travelport's executive vice-president for human resources. "We are here to manage the cost and productivity of labor." The straight talk, she says, should be comforting. "It can be taken as a very negative thing, but I don't believe that's what it is," says Kruse. "If you're in a financially healthy company, you know your check will clear." A private equity CEO's psychological war can be just as important as the strategic one. When Gerald Storch, a 50-year-old former vice-chairman of Target (**TGT**), took over as CEO of Toys R' Us for Kohlberg Kravis Roberts, Bain Capital, and Vornado Realty Trust (**VNO**) in February, 2006, his first goal was to administer shock treatment. "Victim thinking," he says, pervaded all corners, from store clerks to senior executives, all of them dispirited by years of poor results at the hands of cheaper rivals such as Wal-Mart (**WMT**). Storch quickly purged upper management; today, with one exception, everyone on the senior executive team is a fresh recruit from another major retailer. "I've intentionally made a team that will not accept the possibility of failing," he says. Now Storch is setting his sights on the rank and file, who wear badges pledging that they're "Playing to Win." Laggards "have got to go," Storch told a group of store managers recently. "If you don't get rid of poor performers, they turn into your biggest problem." So far, Storch's

results have been strong, but the pressure from his bosses hasn't eased. In private equity, extraordinary managerial success merely raises the bar. When a CEO is a year ahead of plan, the bosses press for two. Or, as in Storch's case, they craft a whole new plan. There's little opportunity to manage expectations or rest on laurels. For 44-year-old Mary Petrovich, CEO of Troy (Mich.)-based AxleTech, the challenge is to continue beating rapidly rising benchmarks. When Chicago-based private equity firm Wynnchurch Capital bought AxleTech in 2002 for $28 million, the maker of truck axles was slumping. Wynnchurch handed the keys to Petrovich, a former division head at auto supplier Dura Automotive, at the end of 2002; today, AxleTech is a profitable $400 million business with some 300 customers ranging from heavy-equipment makers to the U.S. military. Yet Petrovich plans to boost sales by 25% next year for her new bosses at Carlyle Group, which bought AxleTech in 2005 for $345 million. Petrovich, the second of eight children of a widowed Detroit hairdresser, was ready to pounce the moment she arrived at AxleTech. Her first accomplishment was her most audacious: persuading hardened workers at the company's main factory in Oshkosh, Wis., to sign a new United Auto Workers contract. Workers resigned themselves to a 33% cut in wages and benefits. It was bitter medicine. "Employees are angry about the wage cuts forced on them, and they will be angry about it until they die," says one former employee who asked not to be named. Petrovich also attacked expenses by forcing executives to fly economy instead of business class and setting dollar limits on hotel costs. Those and other moves have worked: Carlyle estimates it has already doubled the value of its investment, and then some. Petrovich is "about a year ahead of our investment plan," says Gregory S. Ledford, a managing director at Carlyle. **`YOU CAN'T HIDE FROM MARY'** Such results might stand out at a publicly held conglomerate, but not necessarily in private equity. Many of Carlyle's CEOs are ahead of plan—so Petrovich must push her people even harder to stand out. "She is probably the most disciplined, focused person I've ever met," says John A. Hatherly, president of Wynnchurch. "She's very demanding. You can't hide from Mary. If you're not performing, she'll find you." High expectations cascade down AxleTech's entire corporate structure. One Thursday night in June, 51-year-old engineer Richard Clisch received a call at home from a multimillion-dollar customer who needed retooled parts by Monday. During the next 40 hours, Clisch raced the clock, frantically arranging deliveries of crucial components from around the world and then flying to the customer's plant in New York to make sure other parts were in working order. Clisch says he took just one half-hour nap—on Saturday afternoon—and finished the project at 11 p.m., nearly 50 hours after he had begun. But Petrovich is toughest on her senior managers. In an August, 2006, presentation to a trade group, she noted that she had changed six of the seven top executives who reported to her. Today, four of those recruits are gone. "The executive turnover rate is very high—the highest I have witnessed in over 25 years in industry," says Daniel H. Burns, a former vice-president for operations

who left AxleTech earlier this year. Says Petrovich: "Most senior leadership departures in private equity are driven by an inability to perform at the highest standards expected for value creation. AxleTech has been no different." On a steamy summer day, Petrovich is presiding over a quarterly meeting of top managers, all men, who are updating her on some 100 projects. She calls out any who warn of less than 100% success, giving them a minute to explain the problem and another to outline a solution. The spectacle is reminiscent of The Apprentice, except that the prize isn't getting a job—it's keeping one. After two hours, Petrovich heads back to her office for more planning. If people don't come through by the next quarter, she says, "that will be the one and only time that will happen." The paradox of private equity is that expectations are often highest for the weakest companies, which offer the biggest turnaround potential. Aleris' Steven Demetriou is presiding over a company whose industry has been written off for dead as overseas competitors drive down prices. The best hope for the Beachwood (Ohio)-based producer of aluminum, zinc, and other metals, bought by TPG in August, 2006, for $1.7 billion, is to roll up companies and slash overhead, spreading costs over as wide a base as possible. **'CONSTRUCTIVE PARANOIA'** Demetriou didn't set out for a career in heavy metal. The son of a Boston restaurateur spent 16 years at ExxonMobil (**XOM**), rising to vice-president, then moved to a specialty chemicals company and a crop-nutrients outfit before joining chemical producer Noveon International as CEO in 2001. Three years later, Noveon's three private equity owners sold the company for $1.8 billion. Next Demetriou took charge of an aluminum producer called Commonwealth Industries, where he was already on the board. Business was so weak that for a spell the company considered branching into a new business: recycling chicken manure. Demetriou instead merged the company into a struggling aluminum recycler to create Aleris in December, 2004, and then snapped up five metals-related businesses stretching from North Carolina to Brazil. In August, 2006, TPG persuaded Demetriou to take the company private. Now the 49-year-old CEO is in a bind. Aleris' revenues almost doubled, to $3.2 billion, in the first half of the year, but operating income shriveled by 43% as debt payments soared. Yet Demetriou must keep buying companies or the consolidation strategy will fizzle. On Sept. 11 he picked up Wabash (Ind.) metal producer Wabash Alloys for $194 million. On Sept. 19, S&P, which like *BusinessWeek* is part of The McGraw-Hill Companies, put Aleris' debt on watch for possible downgrade. "A prolonged period of economic weakness could significantly constrain Aleris' ability to generate cash and lower its debt burden," says S&P analyst Marie A. Shmaruk. "We remain concerned." Two days after the ratings announcement, Aleris said it would close a Wabash plant in Dickson, Tenn., and eliminate 67 jobs. Bobby Palk, a 40-year-old factory worker and onetime president of the United Steelworkers Union Local 244, was one of those displaced. "Everybody put their heart and soul in that plant," he says, "and we got shafted." Before the announcement, workers say, they'd been led to believe they

would work for a new owner long into the future. They pored over "Welcome to Aleris" pamphlets, collected free pens and water bottles, and even painted the factory in Aleris' colors, all with no sense of impending doom. Now, Michael Malone, 29, and others are looking for work in a town of fewer than 13,000 where other manufacturers have been downsizing. Also in September, car-parts maker Nemak Tennessee said it would lay off 95 workers, or 20% of the factory staff. "We have 175 people looking for jobs," says David Hamilton, CEO of the Dickson County Chamber of Commerce. Two smelters, in Arkansas and Alabama, have sent employment listings. Malone and others don't want to leave town, but "it's get what you can' right now," he says. Demetriou says he didn't plan on closing the plant until he took control and saw the operation firsthand. "It became obvious that [the plant] was in an uncompetitive situation that needed to be part of the value creation of these two entities," he says. "There wasn't an intention to string [workers] along but rather to give them a full chance." Painful though it may be, cost-cutting is Demetriou's only route to survival. TPG founding partner James Coulter seems pleased with the results—so far. "By no means is TPG declaring a massive victory yet," he says. "What we're declaring is good progress." Coulter says Demetriou possesses the most important trait for a private equity CEO: "constructive paranoia." The man, says Coulter, "never seems relaxed where he is. Great CEOs have to be leaders, willing to constantly drive change." Demetriou agrees with Coulter's assessment: "I'd much rather be looking forward than looking over my shoulder." At a recent monthly meeting, Demetriou made his way through a thick black book filled with financial plans for 50 production facilities around the world. Managers briefed him on minutiae from safety goggles to half-penny moves in metals prices. When one manager offered soft goals, Demetriou snapped: "Are we going to have negative synergies? Raise your stretch targets!" When another confessed he had ordered too much material, Demetriou seemed incredulous. "It just blows my mind," he said. "This is a page you should put up in your offices and get pissed off!" And this, evidently, was a good day. "We actually had a great quarter," says Demetriou after the day-long session. "I just felt it was my responsibility to dive into these guys." Adds one employee who has seen Demetriou in action many times before: "People got off easy." **Join a debate** about the tax breaks on private equity gains Thornton is an associate editor for *BusinessWeek*

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