Blackstone Profit Falls 89% on Credit Market Meltdown (Update6)

By Jason Kelly
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March 10 (Bloomberg) -- Blackstone Group LP, manager of the world's largest buyout fund, said fourth-quarter profit plunged 89 percent after a "meltdown" in the credit markets and predicted a shortage of financing for takeovers in 2008. Profit excluding costs tied to its June initial public offering declined to $88 million, or 8 cents a share, from $808.1 million, or 72 cents, a year earlier, when leveraged buyouts were booming. Blackstone fell as much as 5.2 percent in New York trading as earnings missed analysts' estimates. "Credit market problems persist and if anything have gotten worse," Tony James, president of the New York-based company, said on a conference call with reporters today after the results were released. "We're looking to 2009 before we see much of an improvement.'' Blackstone, which has lost 55 percent of its market value since the IPO, hasn't completed a takeover of more than $2 billion in five months as credit costs doubled and the LBO market shut down. Chairman Stephen Schwarzman, who owns 23 percent of the company, is struggling to close the $6.6 billion buyout of Alliance Data Systems Corp., the Dallas- based credit-card processor, announced in May.

The company was expected to earn 20 cents a share, the average estimate of seven analysts surveyed by Bloomberg. Seven of the eight analysts who rate Blackstone still recommend clients buy the stock. The other recommendation is a "hold." Blackstone fell 28 cents, or 1.9 percent, to $14.30 at 1:10 p.m. in New York Stock Exchange composite trading. It earlier fell to $13.82, the lowest since the IPO. "They didn't tell us anything of which weren't already aware, but it's a cause for concern and that's why the stock is at $14," said Bruce Foerster, president of South Beach Capital Markets and a former managing director of Lehman Brothers Holdings Inc. "Fortunately for people who look at Blackstone, they do some other things besides big LBOs."

Earnings were hurt by a decline in fees earned by completing acquisitions and a writedown of its investment in New York-based bond insurer Financial Guaranty Insurance Co., the company said today in a statement. James told investors on a conference call Blackstone wrote its FGIC stake down to "a few cents on the dollar." Blackstone invested $2.33 billion of capital in the quarter, down 31 percent from a year earlier. "We are in the midst of a severe financial crisis," Schwarzman, 61, said on the call.

LBO financing evaporated last July as banks and investors pulled out of the market amid the fallout from rising subprime- mortgage delinquencies. The value of deals announced in the second half of 2007 plunged two-thirds from the first six months, according to data compiled by Bloomberg. "We're a proxy for the credit markets," James, 57, said at the Super Returns private equity conference in Munich on Feb 26.

Wall Street analysts base their estimates on what the firm calls "economic net income," which doesn't conform with generally accepted accounting principles for net income and excludes compensation costs related to the vesting period for Blackstone executives' ownership stakes in the firm.

Including those expenses, Blackstone had a fourth-quarter net loss of $170 million, compared with net income of $1.18 billion a year earlier. The company will continue to post net losses during the next five years because of the vesting expenses. Revenue rose 17 percent to $3.05 billion. After the close of the quarter, the firm agreed to buy GSO Capital Partners LP for as much as $930 million to expand investments in distressed debt and leveraged loans. Assets under management jumped 47 percent to $102.4 billion, driven by real estate, which doubled to $26.1 billion. Money-management assets rose 65 percent to $44.5 billion. Private-equity assets gained 7 percent to $31.8 billion.

Co-founder Peter G. Peterson reaped $1.88 billion from the IPO, while Schwarzman got $684 million and James received $191 million. James owns 4.9 percent of the company, while Peterson held on to a 4.2 percent stake. Among the largest outside holders of Blackstone is China Investment Corp., a state-owned fund. It paid $3 billion for a 9.4 percent stake in conjunction with the IPO. The shares are now worth $1.42 billion. Other publicly traded companies that make private-equity investments also have suffered. New York-based Fortress Investment Group LLC has fallen 58 percent in the past year, while 3i Group Plc of London has lost 42 percent.

Part of the problem is that the financials of private- equity firms are hard to understand, said Brian Hamilton, chief executive officer of Sageworks Inc., a Raleigh, North Carolina-based firm that uses computer programs to analyze financial statements. "They're an enigma from a financial analysis perspective," he said.

Blackstone is considering smaller transactions because investment banks don't want to fund large deals until they sell off more than $200 billion of LBO debt sitting on their books, James said. "It's been a reasonably steady decline in market conditions,"James said. "We're getting one-off proposals for smaller deals. There's not much of a robust market." Blackstone may also seek small companies it can merge with existing investments, James said. The firm is holding off on more purchases to expand Blackstone for the time being, he said. The firm is raising money for nine new funds, including for its private-equity and hedge-fund businesses. Blackstone also is seeking investments in debt securities whose prices have dropped amid broader concern about the credit markets. Still, the firm is cautious that the worst is yet to come. "There's no evidence it's bottomed out yet," James said on the call.