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A BOOMING MARKET

Corporate bankruptcies turning into big opportunities for manager

By Ricki Fulman

NEW YORK — Bad markets have always translated into good investment opportunities for George Siguler.

And these days, as the number of corporate bankruptcies skyrockets, there are more opportunities than ever in distressed debt, said the managing director at Siguler Guff & Co. LLC, a New York private equity firm.

Distressed debt has been gaining more interest among institutional investors in recent months as the economy has contracted, and Mr. Siguler is no stranger to distressed debt. He is one of the founders of Harvard Management Co., Boston, which in 1978 was the first endowment to invest in the asset class.

Mr. Siguler's latest fund uses the same strategy as the Harvard endowment did in 1978 to take advantage of inefficiencies in the market. The Siguler Guff Distressed Opportunities Fund has raised $150 million so far and is scheduled to close in the first quarter with $300 million to $400 million in assets. It will be structured as a fund of funds that will invest in seven to 10 different distressed debt funds.

"It's a great time for the asset class," he said. "As the recession unfolds, new product is added every day from companies like Enron, whose debt now exceeds $8 billion. In 2001 we had the highest amount of distressed debt ever, at over $400 billion. But so far, only an estimated $40 billion has been dedicated to this, and most of that has already been invested."

The default rate is increasing and projected by Moody's Investors Service to peak at 10% in 2002, he said. "Entire industries like the steel industry and airline industry are in trouble and could go bankrupt; they are in need of financial restructuring. At the same time, there are limited financing alternatives."

George Siguler said distressed debt investment has been gaining interest among institutions as the economy contracts.

Greater diversification

Mr. Siguler, who projected the fund will offer annual risk-adjusted returns of 20% over the next five years, said the fund-of-funds approach is being used to offer investors greater diversification than they would get from a single fund.

"You get good returns by avoiding mistakes on the downside, and diversification mitigates negative events," he said. "The typical fund manager has 20 to 30 issues in their portfolios, because they are labor-intensive and tend to be concentrated. Some managers use bankruptcies; some buy part of the debt, speculating in various types of debt. Insiders go on the creditors' committees and can't trade much. There are many good viable strategies, and it adds a fair amount of value to have the diversification."

Siguler Guff grew out of the private equity unit at Mitchell Hutchins/PaineWebber, formed in 1991. Drew Guff and Mr. Siguler bought it out in a friendly deal in 1995. The firm now has $1.7 billion in assets under management, divided among seven different funds. Three are venture leasing and lending. The others focus on energy, mortgages, natural resources and Russian investments.

Investors include the $900 million endowment of Smith College, Northampton, Mass.; the $6 billion endowment of Stanford University, Menlo Park, Calif.; the $1.6 billion endowment fund of Dartmouth College, Hanover, N.H.; the $22 billion pension fund of AT&T Co., Basking Ridge, N.J.; the $2 billion pension fund of Michelin North America, Inc., Greenville, S.C.; the $3 billion Boston City Retirement System; and the $1.3 billion San Antonio (Texas) Fire & Police Pension Fund.

The firm uses the same model Mr. Siguler used in 1973 when he was hired by Harvard University to start a separate management company to invest for the endowment. He was always intrigued with investing for institutions, he said; in fact, in his second year at Harvard Business School he wrote a paper titled: "How to Run an Endowment."

At Harvard Management, "we would make and buy, taking advantage of the market's inefficiencies," he recalled. "That meant getting involved with every conceivable form of arbitrage, including options, risk, convertible, and giving money to outside people to invest. We managed to get over the legal hurdles required to invest in venture capital in about a year. And we also invested directly in deals and co-invested with the (venture capitalists) in a lot of deals. "

Picking the cream

In those days, a number of today's hot venture capitalists were just starting out, and Mr. Siguler was able to pick the cream of the crop. Harvard Management signed on with such top-tier managers as Greylock Management Corp., and TA Associates Inc., both of Boston; Welsh, Carson, Anderson & Stowe, New York; Kleiner, Perkins, Caufield & Byers, Menlo Park, Calif.; and Oak Investment Partners, Westport, Conn. Through those funds, Harvard's endowment helped back such companies as Apollo Computers, which later became the server business of Hewlett-Packard Co.; Biogen Inc; and Genetic Institute, which was acquired by American Home Products Corp.

With the latest fund, Mr. Siguler's firm also backed Russian MTV, which has been every bit as successful as its U.S. counterpart, MTV Networks. It is an investment of Russian Partners Management, Moscow, a wholly owned subsidiary of Siguler Guff. Siguler Guff raised $155 million from U.S. investors for the Russian fund, which also owns and operates Russian TV stations in 10 cities. In addition, the fund owns Russia's largest cement company and a pulp and paper company. ■