

# KKR AND TPG ACQUIRE TXU

BY CLAIRE POOLE

Soon after the record-busting \$45 billion leveraged buyout of Dallas power company TXU Corp. surfaced in late February 2007, there was every reason to think it wouldn't fly. Environmentalists and consumer groups opposed it. A major shareholder threatened to vote against it. Politicians warned of re-regulating the industry, which would have nipped it in the bud. Then the subprime mortgage crisis began to unfold, which added to worries.

Yet, despite all the obstacles, the deal closed Oct. 10 through a handy measure each of compromise, finesse and luck. While the LBO was as complicated as it was gargantuan, both sponsors and lenders showed a determination to get the deal done that was conspicuously absent in similarly large take-privates that have since fallen by the wayside.

Even before announcing it, Kohlberg Kravis & Roberts Co. and **TPG**, both of which had looked at buying parts of TXU separately before deciding to buy the whole together, were already prepping environmentalists to try to get them on board. Eventually, the sponsors made one major concession: They scrapped TXU's plans for eight of 11 dirty-burning, coal-fired power plants. Instead, they agreed to pursue cleaner energy sources and conservation. (It helped that TPG founding partner **David Bonderman**, who serves on the boards of the Grand Canyon Trust and the World Wildlife Fund, is a dedicated conservationist.) "As a firm, we made the decision up front: If we're going to get in the middle of this, we have to do the right thing," says **Michael MacDougall**, a 37-year-old partner at TPG who worked on the deal.

The buyers also agreed to cut rates for high-rate-paying TXU consumers by 15% for a year, as well as provide breaks for less well-off customers, which helped bring still reluctant consumer groups and politicians on board. "It was the right answer to forge a better relationship with consumers," says Marc Lipschultz, a 39-year-old KKR executive who also worked on the deal.

At the same time, the buyout executives were clocking many hours at the Texas capital ("We literally lived in Austin," as Lipschultz puts it), persuading congressmen not to vote for a bill that would require state regulators to clear TXU's acquisition. At one point, KKR chief Henry Kravis warned a Texas House committee that such a law could be a deal breaker. "If you look at other markets, deregulation has worked best for consumers," MacDougall argues. Darryl Sagel, a director at Lazard, which advised TXU along with Credit Suisse Group, says if the deal had gone under state regulatory review, "it's very possible that the transaction would not have gotten done." In the end, legislators and regulators in Texas agreed.

Meanwhile, troubles mounted on the shareholder front. In late July, San Mateo, Calif., money manager Franklin Resources Inc., which held a 5% stake, said it would vote against the deal because it undervalued the company's assets. The buyout came at a time when several TXU peers, including NRG Energy Inc., had become more valuable. Citigroup Inc. analyst Greg Gordon had also published a report saying TXU was worth more than the offer. About a month later, after the credit crunch hit, Franklin changed its tune and came out in favor of the deal, realizing that it was unlikely another buyer could come forward with a higher bid.

Concerns over shareholder support were quickly supplanted by financing challenges, say deal executives who made it a point to remind the deal's bankers of their commitments. No one was forthcoming about the details of the give-and-take, other than to say both sides had to give in a little. "There were some weeks of concern," says Sagel; Lipschultz concedes it "was a very tense period."

They did say the compromises were small and didn't change the risk-reward profile. "The banks all honored their commitments because we had a great set of hard assets that they could understand," MacDougall says.

“When the banks went to sell the debt, the market said, ‘This is something you’re going to want to own,’” he adds.

Of course, now, the toughest part is the operational challenge: Not only does the enterprise have to run more efficiently to generate the cash flow to cover interest payments on the \$36 billion debt, but it also needs to make some money for its sponsors. The new company, Energy Future Holdings Corp., was split into three units with three plans, CEOs and boards: Luminant, which owns the power plants; Oncor, which distributes the power over transmission lines; and TXU Energy, which sells the power to residential and business customers. On Jan. 8, the company hired a chief executive, John Young, who was executive vice president of finance and markets at the country’s biggest utility, Exelon Corp.

MacDougall and Lipschultz say they don’t plan major asset sales, except perhaps some real estate. They’re hedging aggressively, especially the company’s lignite reserves, which

fuel its plants, they say; and they’re spending billions of dollars at each unit to expand and improve them. “We want to have the best transmission company, the best generation company and the best retail company,” Lipschultz says.

As for the exit, the private equity investors have committed to own the company for at least five years. TPG’s MacDougall sees the groups eventually taking one or two of the units public, but obviously not anytime soon: “We view this as a long-term investment; we’re here for the long haul.”

While Lipschultz and MacDougall say they have their hands full, they acknowledge eyeing other energy opportunities, with TPG specifically studying oil-field-services investments it can make abroad.

“We continue to be very interested in energy markets,” Lipschultz adds. “Though the financial markets are turbulent, the need for energy resources and infrastructure is critical.”

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