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BIG DEALS

David Rubenstein and His Partners Have Made Billions With the Carlyle Group, the World's Hottest Private Equity Firm. How Have They Made All That Money? Why Are They in Washington?

By James K. Glassman

The Carlyle Group may be the city's richest, most successful business, but most people know it only through rumor and innuendo.

It is a private-equity firm, by most measures the largest in the world. It owns 144 companies plus 99 sizable pieces of real estate. Around the world, its businesses last year employed 184,000 people and generated $46 billion in revenues.

If it were a conventional corporation, Carlyle would rank 37th on the Fortune 500, ahead of Microsoft and every company based in DC, Maryland, and Virginia. Each of Carlyle's founding partners is worth more than a billion dollars.

Private equity has become the white-hot center of finance—"the most compelling thing going on now," says cable mogul John Malone. What is so remarkable is that the hottest of the hot is headquartered not in New York or San Francisco but here in modest offices on Pennsylvania Avenue between the Capitol and the White House.

Twenty years ago, the idea of a significant private global financial institution being based here would have been considered ludicrous. But Washington is now a very different city. "This is no longer a hick town," says Arthur Levitt Jr., former chair of the Securities and Exchange Commission and a Carlyle adviser. "It is a major financial center."

The story of the Carlyle Group—and of its most conspicuous partner, David Rubenstein—is the story of how Washington has changed.

"If you're Jewish, sometimes people think your father is a lawyer or a doctor," Rubenstein says as we sit down in his office, which features some of the widest expanses of blank walls I've ever seen in Washington. His father was a postal clerk who didn't graduate from college and never made more than $8,000 a year.

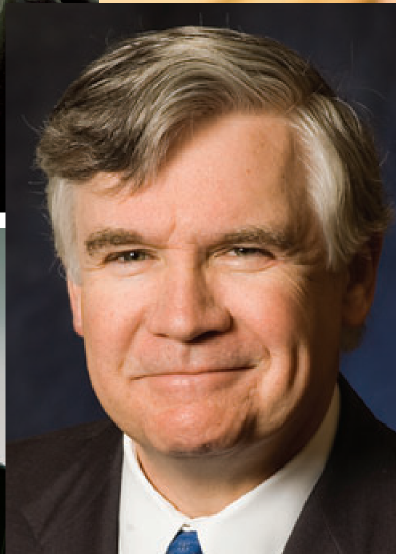
Rubenstein spent an insulated childhood in Baltimore: "I was literally 12 or 13 before I realized that everybody in the world isn't Jewish." Then he went to a public high school where he realized that "virtually nobody is Jewish. . . . I didn't have any real money, so I got a scholarship to Duke and went there."

At the start, it is a classic bildungsroman: Rubenstein graduated from college Phi Beta Kappa, went on to get his law degree at the University of Chicago, where he was on the law review, and then to Paul, Weiss, Rifkind, Wharton & Garrison, a Democratic law firm in New York. He chose the firm because he was attracted by Ted Sorensen, a partner: "I didn't think that I had the looks or the money or the personality to be John Kennedy, but I was inspired by public service, and Sorensen was the adviser to Kennedy. I figured maybe I could be an adviser to somebody."

He worked at Paul, Weiss for a few years and got up the nerve to ask Sorensen to help him find a position in Washington. "By hook or crook, I got a job as chief counsel for the guy I thought might be president of the United States: Birch Bayh." Rubenstein was Bayh's counsel on a Senate Judiciary

Photograph by Gary Landsman

In his twenties, David Rubenstein became king of the workaholic wonks at the White House. Then, with three partners and not much money, he started the Carlyle Group. A dry, witty ascetic, Rubenstein is an unlikely salesman, but last year he raised $12 billion.



Carlyle's brain trust, clockwise from above: Cofounders Dan D'Aniello, a former high-school gymnast and Marriott executive who concentrates on real estate and operations, and Bill Conway, former chief financial officer of MCI and now Carlyle's top dealmaker; Ed Mathias, who raised the cash that got Carlyle started and now focuses on venture-capital deals; former White House official Dick Darman, who has become more mellow and rich at Carlyle.

Darman photograph by Terry Ashe/Time Life Pictures/Getty; D'Aniello by Gary Landsman; others courtesy of the Carlyle Group

subcommittee, but the 1976 campaign for the White House fizzled.

Then he lucked into working with Stuart Eizenstat on the presidential campaign of a Georgia governor, Jimmy Carter, who won the Democratic nomination and then defeated incumbent president Gerald Ford. Eizenstat was named domestic-policy adviser. "I was Stuart's deputy," says Rubenstein. "So I'm 27 years old. I've got an office in the West Wing of the White House."

He practically lived there. In early 1978, Rubenstein gained minor celebrity as a sort of king of the wonks. He became the subject of a five-paragraph story in *Newsweek,* coauthored by Eleanor Clift, with the headline WHITE HOUSE WORKAHOLIC. The article said that while Carter was typically the first person to report for work in the West Wing of the White House each morning, Rubenstein was second.

"But when Carter calls it quits about sixteen hours later, Rubenstein is usually still toiling . . . . He rarely leaves before 11 o'clock at night, even on weekends, and he frequently stays as late as 2 in the morning."

Living in an efficiency apartment, Rubenstein didn't have enough money to buy a car. He skipped breakfast, ate lunch in the West Wing mess, and dined on yogurt and crackers from a vending machine. "Machine food," he said, "is underrated."

If you have heard of the Carlyle Group at all, you probably know it in the black-helicopter version made popular by Michael Moore in the movie *Fahrenheit 9/11* and by writers like Maureen Dowd of the *New York Times,* who recently referred to Carlyle as "the creepy John Grisham–style Washington firm . . . suffused with Arab connections and money." Carlyle has been tagged as the inspiration for the firm that tries to get its brainwashed candidate into the White House in the 2004 remake of the movie *The Manchurian Candidate.*

As Chris Ullman, Carlyle's communications chief, admits, "Carlyle is an easy target." The only book on Carlyle, a slim, overwrought volume called *The Iron Triangle: Inside the Secret World of the Carlyle Group* by Dan Briody, says on its jacket flap: "According to some, the Carlyle Group is a company that epitomizes corporate cronyism, conflicts of interest, and war profiteering—and they may be right."

In a long article in *Le Monde,* the daily newspaper of the French intelligentsia, Eric Leser wrote, "Carlyle is a unique model, assembled at the planetary level, on the capitalism of relationships. . . . The group incarnates the 'military-industrial complex' against which Republican Dwight Eisenhower warned the American people."

If you Google "Carlyle Group," you'll find thousands of entries touting conspiracy theories—the main one being that George W. Bush started the war on terror in order to enrich his father, a Carlyle adviser from 1998 to 2003.

Democratic congresswoman Cynthia McKinney, who gained notoriety this year in a confrontation with Capitol police, pointed a finger at Carlyle after the 9/11 attacks, claiming that "persons close to this administration are poised to make huge profits off America's new war" and that despite "numerous warnings," they did not alert the "people of New York who were needlessly murdered." She asked, "What do they have to hide?"

The conspiracists are right about Carlyle's employing many out-of-work political celebrities. In addition to former president George H.W. Bush, they have included onetime Secretary of State James Baker, Defense secretary Frank Carlucci, and British prime minister John Major. A common view of the firm is that it has succeeded by practicing what Michael Lewis, in a 1993 *New Republic* article, called "access capitalism." In other words, old pols beguile investors into giving Carlyle their cash, then the pols find defense companies for Carlyle to buy on the cheap, then the pols cajole the Pentagon into giving these companies big contracts. Big profits result, and Carlyle and its investors make lots of money.

In the early days, it's true that Carlucci was critical in identifying defense deals, Bush and Baker opened doors, and Carlyle often promoted the Washington connections as a branding strategy. But today, the politicos are gone—they're no longer needed. The big names Carlyle has been attracting are former CEOs like Kent Kresa of Northrop Grumman,

The Carlyle Group is headquartered at 1001 Pennsylvania Avenue, between the Capitol and the White House.

David Rubenstein and his wife of 23 years, Alice Rogoff Rubenstein, in Nantucket, where their compound is on an 18-acre peninsula. Alice, a Harvard Business School graduate, worked as Donald Graham's assistant at the Washington Post Company and as chief financial officer of *U.S. News.* She now chairs an organization that promotes native Alaskan art.

Building photograph courtesy of the Carlyle Group; Rubensteins by Porter Gifford/*Washington Life* magazine

Louis Giuliano of ITT Industries, and Louis V. Gerstner Jr., who became chair of Carlyle in 2003 after leaving IBM. Gerstner's main functions are to give advice on transforming the companies Carlyle buys and to help the firm become an institution that, unlike others in the business, will survive its founding partners. His corporate ties also are useful. "Lou Gerstner," says Dan D'Aniello, one of Carlyle's founders, "is one phone call away from every chief executive officer in the United States."

What does a private-equity firm do? It gathers cash from outside investors into a fund. It dips into that pool of money to buy companies, holding them for an average of five years, then selling them to other companies or taking them public.

The private-equity firm makes its profit by running the company better, by restructuring it—for example, selling off subsidiaries or refinancing loans—and, ultimately, by finding someone to buy it at a higher price. When the company is sold, Carlyle takes a 20-percent cut of the gain, a figure called the "carry."

Carlyle's success at this game has been remarkable. Since its founding in 1987, the firm has produced average returns of 33.8 percent annually. Subtract Carlyle's carry, and investors get returns of about 27 percent—compared with the 12 percent the stock market gained in the same period.

Usually, high returns come with high risk, but Carlyle's strength is its consistency. The firm has lost money for investors in only 3 percent of the buyout deals it has completed.

How do Rubenstein and his partners do it? Being in Washington makes a difference.

Carlyle still takes on former government officials as advisers, but they're hired more for their business expertise than their connections: Mack McLarty, who was President Clinton's chief of staff and, before that, chief executive of a large utility company; Arthur Levitt Jr., who became chair of the Securities and Exchange Commission after running an investment firm and a stock exchange; and Charles Rossotti, who cofounded American Management Systems, the Virginia-based information-technology firm, and later became Internal Revenue commissioner. McLarty helps with Mexican acquisitions; Levitt has made key introductions, including Gerstner and Warren Buffett, to the Carlyle partners and sits on the boards of Carlyle companies; and Rossotti focuses on high-tech acquisitions.

Carlyle is now viewed on Wall Street and, more important, among the pension funds that provide nearly half of its capital, as a top-tier financial firm that has lots of investors and does lots of deals. It's an established organization.

"When IBM was on the top of its game, there was a saying that you couldn't get fired for buying their equipment," says William Walton, head of Allied Capital, a Washington-based company that's also in the buyout business. "Well, now you can say, 'You can't get fired for investing in Carlyle.' "

In early 2001, the giant California Public Employees Retirement System, or CalPERS—a pension fund that manages $200 billion for the state's current and future retirees and has a reputation as an advocate for socially responsible investing—bought a 5.5-percent ownership stake in the Carlyle partnership. That's the business equivalent of the Good Housekeeping Seal.

Today, defense represents just 1 percent of the value of Carlyle's holdings, although the firm still has expertise in businesses that are heavily regulated or otherwise dependent on government, including firms like Hawaiian Telecom and a company called U.S. Investigations Services, the largest supplier of background checks for the federal Office of Personnel Management. But what now distinguishes Carlyle from its competitors is not the political nexus but its investing style and the breadth of the companies it buys.

"Just take a look," says Danielle Fugazy, editor of the trade journal *Thomson Buyouts,* flipping through reports. "In the past few months, they have done a manufacturing deal, an education deal, a consumer-products deal, a buildings deal, and a financial-services deal."

Carlyle owns such household names as Hertz, Dunkin' Donuts, and Baskin-Robbins. In early April, the firm finished rais-

ing $4.5 billion for two funds to invest in energy, including renewable infrastructure, like a giant solar-generating operation in the Mojave Desert. Among scores of other properties, Carlyle owns an educational-software provider based in Washington (Blackboard), a chain of acute-care hospitals (LifeCare Holdings), the nation's ninth-largest cable-TV company (Insight Communications), a maker of invisible teeth straighteners (Align Technology), the world's largest supplier of artificial Christmas trees (Boto International), an infant-car-seat manufacturer in Britain, a jet-engine maker in Italy, the largest heavy-equipment manufacturer in China, and a job recruiter in Japan.

Middle East money—the subject of many of the conspiracy tales—represents roughly the same proportion of Carlyle's investment dollars as it always did: 3 percent. There's virtually no money from Saudi Arabia; almost all of it comes from small Gulf states like Kuwait and Qatar and from Arabs who live in New York and London. People who fall for the Michael Moore vision of Carlyle, says Fugazy, "don't understand how private equity works."

The way it works is that investment dollars flow to firms that have great track records.

Carlyle was started with $5 million of other people's money by four young men who had never made a private-equity deal. Today, Carlyle has 653 employees in 14 countries and has $39 billion under management—which means, even with a modest amount of borrowing, it can do deals worth a total of about $150 billion.

From his White House vending-machine days, David Rubenstein's career took some unlikely turns. Now, 29 years later, he's not a lobbyist or a deputy Treasury secretary or a lawyer at Covington & Burling like his mentor Eizenstat. Instead, Rubenstein, with two other founding partners, runs the Carlyle Group. Besides his home in Bethesda, he has a 10,000-square-foot house in Beaver Creek, Colorado, and a compound on an 18-acre peninsula in Nantucket. In 2004, he gave $10 million to the John F. Kennedy School of Government at Harvard.

In many ways, Rubenstein has changed not a whit. He's still a workaholic and an ascetic. He doesn't drink or smoke or eat meat. When I went to lunch with him one Sunday in Georgetown, we skipped the restaurant at the Four Seasons, our meeting place, because he thought it was too noisy and instead walked down the street to La Madeleine. He dined on a bowl of lettuce without dressing. He doesn't ski or sail. I had heard that he owned a 200-foot yacht.

"Do you own a boat?" I asked.

"No," he said. "The reason is, one, as I observe people that have these large boats, you have to spend all of your time calling people, begging them to get on the boat. If I don't have it occupied, it's like a hotel room that's vacant at night." Second reason: "I'm not a boat person."

What kind of person is he? Back in his office on Pennsylvania Avenue, I asked him what he did in his spare time.

"This," he said, pointing to the desk.

To those who know him, Rubenstein is the subject of wonderment and speculation. Much of Carlyle's success is owed to the division of labor among the three founders: William Conway is the investment specialist, admired in the industry for his ability to judge and structure deals. Dan D'Aniello, number two on the investment side, concentrates on real estate and on operations—Carlyle prides itself on having a strong back office, where the checks are cut, the forms are filled out, and the reports are written. Rubenstein is the asset gatherer, the money raiser, though he has a hand in investments as well.

Why does the troika work so well? "We're not on top of each other," says Rubenstein. "We don't socialize."

One Carlyle watcher says that the key to success is that the three wives are not jealous of one another as none wants to be a DC socialite and as they rarely see each other. "Wives can ruin partnerships," says the observer. "But not this one."

A fourth partner, Stephen Norris, left after seven years. Norris's more flamboyant, independent, mercurial style did not sit well with the other three current partners, and his exit, to run his own firm, was negotiated. By all accounts, it was unpleasant.

All three also place a high value on modesty. When I ask Rubenstein whom he admires, he says George H.W. Bush, father of the current president: He's "an easygoing, nice, polite, gentle, and charming individual without a big ego."

Collectively, Rubenstein, Conway, and D'Aniello—David, Bill, and Dan—are known in the firm as "DBD." Richard Darman, one of Carlyle's managing directors, describes the firm's decision-making process for investing in companies: "The fund has veto power, but it also needs the approval of something called the investment committee. The investment committees are either DBD plus a few other people or are one or two of DBD plus a couple of other people."

Rubenstein, *primus inter pares* of DBD, doesn't look like a salesman. Far from dominating a room, it's almost as if he isn't there. At first, he appears shy and blends into the background of his office. You expect someone in his position—someone who last year raised $12 billion—to be, as Rubenstein himself puts it, "a guy who wears suspenders, smokes cigars, chases women, and plays golf." Rubenstein does none of those things. His only concession to Wall Street conventionality is the dark pinstriped suit, white shirt, and red Hermès tie (only once I saw him wear a blue tie). He's been married for 23 years, has a daughter at Harvard; another daughter, a competitive skier, on the way to Harvard in September; and a son in eighth grade at a local private school.

Spend some time with Rubenstein and you understand some of his appeal. "David is extraordinarily intelligent, focused, and charming," says Levitt, who advised Carlyle both before and after he was at the SEC. But Rubenstein's sense of humor is as dry as dust, and he doesn't spend time chitchatting. "He's not a schmoozer," says a friend, but he does like gossip in small helpings.

He perseveres. One investor turned Rubenstein down on eight sales calls, then relented on the ninth go-round. The investor went on to become Carlyle's largest.

"Nobody realized he would be the fundraiser par excellence," Arthur Miltenberger, who handled the Mellon family's money, says about Rubenstein. "It isn't what you expect when you meet him."

Still, says Edward Mathias, a Carlyle managing director who, as an executive at T. Rowe Price, was present at the creation, Rubenstein has qualities that encourage people to turn over large sums to him. "He is persistent and unbelievably direct," says Mathias. "He answers questions on the spot. He gives the impression that he is going to be successful, and you ought to get aboard."

Rubenstein doesn't seem to sleep, which helps. I first interviewed him on a Friday. The next day he was flown in the Gulfstream jet he owns to Japan, where he dined Sunday with his staff and some investors. Monday he had nine meetings, then a dinner speech, then a flight to Germany. On Tuesday and Wednesday in Frankfurt, he gave four speeches and met with investors and staff. Rubenstein picks up the itinerary: "I got on a plane and flew to New York, where I spent all day Thursday in meetings and went to the Asia Society dinner Thursday night. And I left that dinner and flew down to Duke, where I'm on the board, and had meetings all day Friday." He flew back to Washington late Saturday for more meetings and watched his son's basketball game. On Sundays, he and the other two founders meet at a McLean hotel for a two-hour breakfast to discuss how the business is going.

Rubenstein travels on business 250 days a year and reads ten newspapers a day and eight books a week. From the time he graduated from law school at the University of Chicago in 1973, he says he's never missed a day of work because of illness. "He works

Photograph by Gary Landsman

The chosen few: Carlyle senior associate Michael Gershenson of the real-estate group; vice president Mark J. Johnson, a telecom expert who grew up in Anacostia; and associates Candice Szu, also in the telecom group, who chose Carlyle for its reputation for having good mentors, and M. Benjamin Dorr, who works with Ed Mathias in the venture-capital division. All four like Washington. "It's a great town, it's a young town," says Szu, 25, who, like Johnson and Dorr, went to Harvard. Gershenson graduated from Georgetown.

harder, longer hours than anyone I've ever known," says Levitt.

Rubenstein has another asset as a manager. "He doesn't internalize problems," says Mathias. "He deals with them. His attitude is, try it. If it works, do it some more. If not, drop it."

Carlyle, for example, moved into the hedge-fund business in 2001, with a fund of funds run by Afsaneh Beschloss, a former World Bank official and wife of historian Michael Beschloss. It didn't work as well as private equity. Carlyle spun it off 18 months later.

While Rubenstein was at the White House in the 1970s, he worked so late that with no one around he would go into the President's private study and put his own memo on the top of Carter's in-box each night. That way, it would bypass the gatekeepers and be read first the next morning.

The green-eyeshade types at the Office of Management and Budget were not happy about being undermined by some of Rubenstein's spending memos, so, he says, "they hired a young woman to figure out what some of my tricks were to get the President to do certain things."

The young woman—Alice Rogoff, a recent Harvard Business School graduate—did figure out how Rubenstein got his memos to the top of the pile. She then put *her* memos on top of his. "I didn't talk to her for a couple months because I was so mad. But ultimately we got married."

When Jimmy Carter lost to Ronald Reagan in 1980, Rubenstein underwent another classic Washington experience, that of being a loser.

"All these people had told me, 'David, you are one of the smartest young lawyers I've ever met. You are a brilliant young guy. When you want a job, you call me up.' Well, I started calling those people right after the election, and I haven't gotten those calls returned yet. . . . When you're out of power, you're a dead man."

Especially if you're a 30-year-old former Carter aide trying to sell access to the Reagan administration. Eventually, Rubenstein joined the law firm now known as Pillsbury Winthrop Shaw Pittman. And this is where the story takes an un-Washington turn.

"I didn't really enjoy what you had to do to be a successful Washington lawyer/lobbyist," he says. "I didn't want to raise money for politicians."

He also realized that "the skills you acquire to be a great young lawyer are acquired years four to six or seven out of law school. Well, I was in the White House then, so I didn't acquire those skills." What he found he did very well was getting business—that is, rainmaking, bringing clients to the firm.

When David Rubenstein was growing up in Baltimore's religious ghetto around Park Heights Avenue, Dan D'Aniello, three years older, was a big man on campus of the class of 1964 at a high school in Butler, a steel town in western Pennsylvania. He was president of the student council, captain of the state-champion gymnastics team, everyone's friend.

He still is. Like Rubenstein, D'Aniello is not what you expect in a billionaire private-equity executive. He's Rubenstein's opposite, bubbling over with enthusiasm. I ask him about travel. "I love to travel," he says. "Occasionally, the family can double up on a business trip and have fun. This is my life! Really, I levitate out of bed. I don't get out of bed. What a gift! What a gift to run to work in the morning."

"Dan is a regular guy," says a colleague. "He's a sort of balance wheel for the other two. His big thrill is getting up in front of the audience and introducing the talent [like Tony Bennett or the cast from *Chicago*] at the annual investor conference." He's been married 30 years, has two daughters in their twenties, and devotes himself to an entrepreneurial internship

program he funds at his alma mater, Syracuse University.

But growing up was not easy. D'Aniello's father died when Dan was eight, and he went to work in a food market at nine. He was raised by his mother, an insurance claims adjuster who was also a pianist.

D'Aniello went to Syracuse on a scholarship, joined the Navy for three years, then went to Harvard Business School, Trans World Airlines, PepsiCo, and finally Marriott.

In the 1980s, J.W. Marriott Jr. had assembled a kind of corporate SWAT team, doing mergers and acquisitions and financing billions of dollars of hotel deals. "I was working with one powerhouse of a team there," says D'Aniello. It included Steve Bollenbach, now CEO of Hilton Hotels; Al Checchi and Gary Wilson, who in 1989 led a leveraged buyout of Northwest Airlines (Wilson is still chair of NWA, the parent company); and John Dasburg, former CEO of Burger King and now head of DHL Airways.

But what was occupying much of D'Aniello's time was an adventure that has become known in some quarters as the Great Eskimo Tax Scam. The Eskimos were the force that brought together D'Aniello, Norris—who was also a Marriott executive—and Rubenstein.

In 1984, a law was passed allowing native corporations in Alaska—that is, Eskimo-owned companies created by Congress to manage native lands—to sell their losses to businesses looking for tax write-offs. The Marriott executives, working with Rubenstein at Shaw Pittman, discovered the Eskimo clause and vigorously bought the losses to offset gains.

Meanwhile, the last of the founders, William E. Conway Jr., was following a more conventional path. He grew up in New Hampshire, where his father, now a consultant and author of several books on management, worked his way up to chief executive officer of Nashua, then a Fortune 500 manufacturer. Young Conway graduated from Dartmouth in 1971, then worked for a Chicago bank and got his MBA at night at the University of Chicago. One of the bank's clients was MCI Communications, and in 1981, Conway was recruited as treasurer, eventually becoming chief financial officer.

Conway learned a lot about finance at MCI, which was trying to grow fast, building out a fiber-optic network with little funding. MCI's angel at the time was Michael Milken of Drexel Burnham Lambert, who in 1983 helped the company raise $1.1 billion in what was then the largest debt financing in history.

Conway and I have something in common. We used to take the bus down Bradley Boulevard to work together. At the time, we both lived in Hillmead, a development of split-level ranch homes in Bethesda. Conway has moved up. In 1999, he bought Merrywood, the 17,000-square-foot mansion on seven acres overlooking the Potomac in McLean where the future Jackie Kennedy moved when her mother married Hugh Auchincloss. Conway sold Merrywood last year for $24.5 million to Steve Case, cofounder of AOL.

D'Aniello, by contrast, lives in the same Vienna house he owned when he was at Marriott. He jokes that at a Carlyle gathering, employees were shown slides to help them distinguish among DBD. First, a big house in Nantucket. Next, Merrywood. Finally, for D'Aniello, a log cabin.

A high-profile home like Merrywood doesn't fit the Conway persona. He's a member of Burning Tree golf club (with a 15 handicap), but he's low-key and shuns publicity. He's a Catholic who goes to Mass almost every day, profoundly admires his father, and brags about his son, a Georgetown Law student who works for the DC public defender.

In his thirties, Conway, like D'Aniello, was working for what was then one of Washington's few large national businesses. Both Marriott and MCI were run by very smart leaders. The late William McGowan, who recruited Conway, was probably the most gifted CEO in the city's history. He broke the AT&T monopoly and built a small company providing communications services to truckers into the nation's second-largest long-distance carrier.

"You know," Conway told me, "the world is full of people who do the irrelevant perfectly. McGowan was exactly the opposite. He did the essential about as well as it could be done. . . . The other big thing I learned from him is to try to figure out what people can do rather than what they can't do. Nobody can do everything, so I've tried to learn what can somebody do, and then I put them in a job they can do."

Dan Akerson, who followed Conway as CFO of MCI and then joined Carlyle much later (after stints running such businesses as General Instrument and Nextel Communications), was also influenced by McGowan. "The one thing I learned from him," said Akerson, "is that you can just never, never quit."

Good companies spring from other good companies, and without Bill Marriott and Bill McGowan laying the groundwork by bringing talents like D'Aniello and Conway to Washington and inspiring them, there might have been no Carlyle Group.

Two other people were necessary. One was William Simon, the other Scarsdale Fats. In *Big Deal,* his history of mergers and acquisitions, Bruce Wasserstein writes about "a legendary early LBO," or leveraged buyout:

"In 1981, Wesray, an investment partnership owned by former Treasury secretary William E. Simon and investment manager Ray Chambers, purchased Gibson Greetings from a stumbling RCA. Debt financing provided $79 million of the $80-million purchase price. Gibson's existing managers, who stayed on to run the company, owned 20 percent of the common equity. A year later, Bill Simon looked like a genius."

The recession ended, corporate operating profits rose, and the stock market turned around. On May 19, 1983, Wesray took Gibson public, selling about a third of the company for $96 million. In all, Simon and Chambers would reap a $250-million profit on a $1-million investment.

Rubenstein took notice. He went to Bill Miller, his colleague from the Carter administration, and said, "Bill, you were secretary of the Treasury, like Bill Simon, and you were chairman of the Fed. So why don't we form a firm in Washington that can do what Bill Simon did, these kinds of buyouts?"

Miller agreed, and Rubenstein recruited three employees for him, including Alice Rogoff, who was working as Donald Graham's assistant at the Washington Post Company.

G. William Miller & Co. evolved in a different direction from what Rubenstein had in mind. Rather than taking bold positions like Bill Simon, Miller preferred a quiet, advisory role. But Miller, who died in March at 81, can be called the founder of Washington's first buyout firm—though it bears little relation to the Carlyle Group of today.

Rubenstein's wife, Alice, left the Miller firm shortly after joining it. She went to *U.S. News & World Report,* where she and I worked together for Mortimer Zuckerman—she for 12 years as business manager and chief financial officer, I for just two as executive vice president.

She is a down-to-earth, engaging woman who is no slouch in the workaholic department. When her first child was born, she went back to work at *U.S. News* in ten days. Today, in one of the coincidences that decorate this tale, Rogoff chairs the Alaska Native Arts Foundation, which she cofounded.

What about Scarsdale Fats?

Immortalized in Adam Smith's 1967 book, *The Money Game,* Scarsdale Fats, a.k.a. Bob Brimberg, now deceased, was a Wall Streeter who had a knack for convening financiers informally to talk about what they were buying and selling.

"He exists, he gives lunches and everybody comes," wrote Smith—the pen name of George Goodman. In the 1970s, Scarsdale

Fats brought his operation to Washington. "He had dinners, usually at the Madison Hotel," says Ed Mathias, who makes it a point to try to know everyone. "His whole business was bringing people together." In Washington, he brought the financial types into contact with the political types. Smith offers a Wall Street/Washington anecdote:

"Scarsdale is supposed to have introduced Neddy Johnson, the junior Johnson of Fidelity, to a senator and to have said, 'This man controls two billion dollars.' And the senator says, 'So what, we spend that in a half an hour.' "

It was at a Scarsdale Fats dinner that Mathias met Rubenstein. They kept in touch.

Let's pause to explain more about how private equity works. There are three parts to the process.

First, the private-equity firm goes around to large investors—pension funds like CalPERS, large insurance companies like Equitable Life, hedge funds like the Soros Fund Management as well as banks, university endowments, and wealthy individuals—and gathers commitments for a fund. Carlyle has 900 investors in 55 countries. About 65 percent of Carlyle's money comes from the USA, 25 percent from Europe, and 6 percent from Asia; the rest is from Latin America and the Middle East.

In recent years, the typical pension fund or university endowment has been increasing the share of its assets devoted to private equity. Today, the average proportion is 5 to 10 percent, but Yale's endowment, considered the best in the business, has had as much as one-fourth of its assets in private equity.

At the time they make their commitments, the investors don't know exactly where their money will go beyond broad categories. Carlyle has funds for Europe, Asia, real estate, energy, venture capital—a total of 39. The biggest are the US buyout funds. There have been four to date. Carlyle Partners I closed in 1990 with $100 million. CP II, as it's called, closed in 1996 at $1.3 billion; CP III in 2000 at $3.9 billion; and the largest, CP IV, in March 2005 at $7.85 billion—at the time the largest buyout fund in history.

With the target money raised, the firm moves to the second stage: making buys. That's the job of the fund's investment professionals. For CP IV, there are 66 of them, based in Washington, New York, and Charlotte and led by Allan Holt and Daniel Akerson, both MCI veterans. The team has made eight acquisitions in the first 12 months. It's a diversified portfolio that, in addition to Dunkin' Donuts and Hertz, includes a maker of axles and brakes, a maker of steel pipe, two health-

While Carlyle is mainly known for buying businesses, the firm has been investing heavily in Washington real estate, such as this Clarendon building in Arlington.

Spending Billions on Local Real Estate

"In the last 18 months," says Robert Stuckey, director of Carlyle's US real-estate funds, "we've invested about $1.4 billion in Washington. We've done 18 projects. That involves office and residential, hotel, retail, senior living, and mixed use."

Carlyle is one of the biggest real-estate players in Washington and New York, but the firm works quietly, with partners' names, not its own, in the public eye.

Stuckey likes Washington because "on the demand side, the metro area benefits from a strong job-growth engine, which adds over 60,000 jobs per year" while on the supply side, "it's relatively difficult to develop new properties." Also, he says, "our headquarters is here, so we have been able to find opportunities."

Carlyle now has seven real-estate funds, with total equity of $4 billion (indicating buying power, based on typical borrowing, of about $12 billion). Four funds concentrate on the USA, two on Europe, and one on Asia. The funds own 99 pieces of property, including 77 acres on Manhattan's West Side between 59th and 65th Streets, purchased from Donald Trump and a consortium of Chinese investors last year for $1.8 billion.

The internal rate of return on Carlyle's real-estate purchases has been about 30 percent annually. How do you get numbers like that? Stuckey likes buying older buildings with problems and turning them around. An example is 261 Fifth Avenue, at 29th Street in New York. It was 85 percent leased when Carlyle bought it. "We leased it to 97 percent," says Stuckey, through capital improvements and good marketing and sold it in 18 months, making a profit of 2½ times Carlyle's equity investment.

In Washington, Carlyle is going through the same process with 1275 K Street, Northwest, turning the building into a "core investment" for a buyer who won't have to worry about hunting for tenants. Washington real estate "has a strong international following, so there are always buyers here," says Stuckey. "I would say the District is perceived as the best office market in the country."

Carlyle also owns condominium projects like the new one at 1010 Massachusetts Avenue, Northwest, and, with Jerome J. Parks Companies, is developing 12 acres in downtown Annapolis into a complex called Park Place that will include condos, a hotel, offices, retail space, and a performing-arts center.

Looking ahead, Stuckey likes the multifamily rental market in the Washington area, the office sector in Virginia, and hotels practically everywhere.

Stuckey became head of Carlyle's real-estate operations at the age of 36 after a stint as a wunderkind at CarrAmerica, a Washington-based REIT. Blackstone Group, one of Carlyle's private-equity rivals, announced in March it was buying Carr for $5.6 billion.

—James K. Glassman

"We want people," says David Rubenstein, "who have their egos in check and aren't Masters of the Universe."

care companies, and one each in software and telecommunications.

If you're an investor who has committed $10 million to a fund, you aren't asked for your money all at once—but you do have to pay an annual fee of 2 percent of the total, or $200,000. When the firm decides to make a purchase, it goes back to you for your share. You might be asked for $1 million, for example, a few months after the fund closes and another $500,000 a month later.

When a private-equity firm makes a purchase, it uses money from the fund plus outside borrowings and sometimes additional equity. Last year, Carlyle and two other firms bought Hertz, the world's largest car-rental company, from Ford Motor Company for $15 billion. The private-equity firms put up $2.3 billion from their investors and borrowed the rest. That's more leverage than usual, but Hertz was a special case. It had a fleet of 450,000 vehicles, and, says Conway, "those cars were very financeable and very liquid." The loans came at low rates from Lehman Brothers and Deutsche Bank. Hertz was owned by the kind of company you want to buy from—a motivated seller in need of cash.

Says Akerson: "We looked at Hertz and said, 'Gee whiz, this is an interesting company!' " There were economies that could be taken quickly, including a bloated information-technology department. "So," says Akerson, "you say to yourself, 'Can we go in there and manage this company even marginally better?' And the answer, as we did our due diligence with our partners, was a resounding yes." The new owners discovered that a hidden gem—Hertz Equipment Rental Corporation, which rents construction cranes, backhoes, and the like—had a relatively young inventory and a strong competitive position.

The process of buying companies usually goes on for five years until the fund exhausts its capital. Then, over the next five years (and occasionally more—Carlyle has owned U.S. Investigations since 1997), the firm conducts the third part of the private-equity process: selling the companies. CP III is six years old. It has bought about 30 companies and has "realized," or completely sold, eight of them. Sometimes the sales happen faster. And sometimes the firm can do a "dividend recap," pulling cash out of the purchased business and distributing it to the investors.

In August 2004, with two private-equity firms as partners, Carlyle bought 80 percent of PanAmSat, a satellite provider of audio and video services, for $2.6 billion. The cash investment from CP III was $146 million. "Within two months," says Akerson, "we did a dividend recap on 40 percent of the equity, and then we took it public."

In other words, nearly immediately, the investors got about $60 million back. Within another six months, PanAmSat launched an initial public offering, and the investors got all the rest of their initial investment while hanging on to a big chunk of PanAmSat stock. Then in August 2005, another publicly traded satellite company, Washington-based Intelsat, announced it was buying PanAmSat. That deal is expected to be approved soon. If it happens, says Akerson, "then, within about 2½ years, we'll make over four times our money."

Another CP III acquisition was Dex Media, a phone-book publisher bought from another motivated seller, Qwest Communications, in November 2002. The price tag was $7 billion, which Carlyle split with another private-equity firm, Welsh, Carson, Anderson & Stowe. Each put up $809 million—a Carlyle record. A year later, Carlyle took out $375 million in a dividend recap, then another $125 million. In July 2004, Dex went public, and Carlyle sold a large chunk of stock, pulling out another $367 million for investors. Then in January 2006, R.H. Donnelley, a publicly traded printer and publisher, bought most of Dex, and Carlyle took out $480 million more.

The total now stands at $1.35 billion extracted for investors on an investment of $808 million. But Carlyle continues to own 9 million shares of Donnelley, valued at about $500 million. So, if the firm cashed out now, fund investors would more than double their money—a gross profit of $1 billion—in 3½ years.

Carlyle's cut of the billion-dollar profit, its carry, is 20 percent, or $200 million.

Where does the $200 million go? Rubenstein says that because of competition for top dealmakers, Carlyle gives between half and three-fifths of the carry to the team that runs the fund. Imagine that as a team member you are entitled to 2 percent of its share of the carry. You would pocket, in this example, about $2 million.

In addition, Carlyle's investment professionals can invest their own money in the funds without paying the carry. These opportunities are the main incentives for former CEOs and Washington officials—like Rossotti and Levitt—to serve as advisers to the firm. "We now have probably a billion and a half dollars of the money from people who work here invested in these deals," says Rubenstein. "And it helps convince investors we are serious."

What about the other $100 million or so that Carlyle earns from the carry on a $1-billion deal? It goes to the partnership that owns the private-equity firm and pays its operating expenses. Carlyle managing directors—there are 104—make $275,000 a year (just raised from $250,000, where it had been since 1987), and there are more than 500 other employees, about half involved in back-office operations. Carlyle also hands out bonuses.

Of the remaining profit after expenses, about half goes to the three founding partners, one-twentieth to CalPERS, and the rest to Lou Gerstner and the 42 other partners, all managing directors.

The cash rolls in—and out. In 2005, Carlyle distributed to investors more than $4.6 billion: $3 billion from corporate buyouts, $800 million from energy deals, $500 million from real estate, $260 million from venture-capital investments, and $96 million from what's called "leveraged finance," or high-interest lending. Europe was hot, generating $1.3 billion, about the same as the United States. The new Europe fund is producing an 82 percent internal rate of return. In Japan, Carlyle made more than five times its money on Asahi Security, a cash-management company, in a sale to Toyota Industries.

In a typical year, it is not unusual for a Carlyle managing director to make more than $1 million. Sometimes, if a fund scores a huge profit, there are multimillion-dollar payments—sent in what Bill Walton of Allied Capital calls "a life-changing wire transfer."

As for the three founders, my research indicates that the net worth of each is around $500 million—not including the value of their ownership in the partnership itself. Since CalPERS bought 5.5 percent of Carlyle for $175 million, we can deduce that the value of the entire partnership is $3.2 billion. But that was in 2001. Carlyle today has three times as much money under management, and if it went public, it could be worth more than $6 billion—which means that each of the three, if he cashed out, could collect about $1 billion.

When I showed Rubenstein an article in *Forbes* that listed nine private-equity executives—including Stephen Schwarzman of the Blackstone Group and Thomas H. Lee of Thomas H. Lee Partners—as billionaires and asked why he wasn't on it, he said: "We spread the wealth."

If you want to join Carlyle, you have plenty of company. It hires 13 to 17 people annually for a two-year associates program plus a few others at higher levels. About half the associates are women. The three founders are aware that the firm is short on females. "The dictate from on high is to hire more women," says a Carlyle executive. "The headhunters know it."

Only seven of the 104 managing directors and only three of the 46 partners are women. But Carlyle has two of the highest-ranking women in the industry—Sandra Horbach, head of the global consumer and retail team, and Karen Bechtel, co-head of global healthcare. Horbach spent 17 years at Forstmann Little & Co., a private-equity firm, after graduating from Wellesley, spending time in Shanghai in the early 1980s, and going on to business school at Stanford. Bechtel, a graduate of the University of Texas and Harvard Business School, spent 28 years at Morgan Stanley.

What is Carlyle looking for? The baseline is intelligence and hard work. It is not a place for eccentrics or loners. "You might be a brilliant, brilliant person and a great deal doer," says Rubenstein, "but if you can't work as part of a team, you're probably not going to work out here." We want people, he says, "who have their egos in check and aren't Masters of the Universe," the term for Wall Street hotshots that Tom Wolfe made popular.

D'Aniello told me about a slide show he put on for Carlyle employees. "One had the three monkeys—don't hear you, don't see you, don't talk to you—and I said, 'No isolationists.' The second slide had a baby crying: 'No crybabies.' And the third had this Mexican bandito with bullets across his chest and said, 'No mercenaries.'

"We want people who want to be partners, colleagues. Life is too short. You want to get up in the morning and look forward to the people you work with. The skill base is presumed. The compatibility thing is the big issue."

Most of the private-equity business—or any other high-powered financial occupation, like bond trading or investment banking—does not lend itself to cooperation and camaraderie. You get paid mainly for what you produce, not for what the firm produces. In fact, you might make more if you undermine your colleagues—not only refuse to help them but steal clients from them.

Carlyle says it tries to be different and, from what I saw, seems to succeed. The idea is "One Carlyle," introduced about five years ago. Says Conway: "If you come here, and you say to anybody at Carlyle in an e-mail or a voice mail or a phone call, 'Hey, I need help. Does anybody know about the fiberglass business? Does anybody have contacts with so-and-so? Does anybody know someone on the board of this company?' people help you."

If you're planning to get a start at Carlyle as a summer intern, forget it. The firm takes none. The partners don't want to be pressured to hire clients' kids, and the work is too sophisticated for college students—or even the newly graduated. Instead, says Allan Holt, co-head with Akerson of the US buyout group, "We tend to bring in people after two years on Wall Street."

Each year Carlyle hires associates fresh from investment-banking firms like Goldman Sachs and Lehman Brothers. Roughly half work in Washington, and most stay at Carlyle for two years and leave, usually to get their MBAs. Afterward, some return to Carlyle as senior associates.

Carlyle recruits its associates almost as though they were CEOs, using headhunting firms. Candice Szu, for instance, graduated from Harvard College in 2002 and went to work at Goldman—Carlyle's favorite source of talent, in part because its cooperative atmosphere is closest to Carlyle's own—in a two-year program analyzing telecommunications companies. After the first year, she started getting calls from headhunters and meeting with firms. Szu, now 25, liked private equity because "I knew I wanted to be on the principal side"—that is, to work with a company that owned things—"not just be an adviser." She chose Carlyle because of its reputation for having good mentors.

M. Benjamin Dorr, 27, an associate in the venture-capital division in Washington, agrees. A 2001 Harvard graduate, he came to Carlyle—after stints at Morgan Stanley in New York with Mary Meeker, a leading investment banker in high technology, and at Salomon Smith Barney in Silicon Valley—to work with Ed Mathias.

Harvard pops up a lot. We analyzed the backgrounds of the 362 Carlyle professionals—108 in Washington—listed on its Web site and found that Harvard accounts for 20 undergraduate and 55 graduate degrees. In Washington, we found that among professionals . . .

92 are men, 16 women.

19 have Asian surnames.

Top undergraduate colleges were Harvard (nine), Georgetown (seven), Princeton (five), Dartmouth (five), and Duke (five).

Top graduate school for MBAs is Harvard (16), followed by the Wharton School of the University of Pennsylvania (five) and the University of Chicago (three).

But don't conclude that it is a homogeneous place. Mark J. Johnson, 32, came to the telecom division of Carlyle in 2004 after working at Merrill Lynch and two private-equity firms, J.H. Whitney & Co. and Blackstone Group. An African-American, he grew up in DC's Anacostia, started school off Naylor Road, then transferred to Murch Elementary, a public school in Northwest DC, and eventually to St. Albans. When I asked Johnson how he got to St. Albans, he smiled and said he took the 36 bus. Johnson received his undergraduate degree from Princeton and his MBA from Harvard.

Like everyone on Carlyle's investment side at the level of senior associate and above, Johnson, a vice president, gets a piece of the acquisitions his team makes. He flies to Japan every two months to work with a wireless company called Willcom, but he's happy to be back in his hometown (his wife is from Northern Virginia) after his time in New York. Does he worry about being out of the Wall Street loop? Not at all. "I try to make sure I am not out of the loop in Tokyo," he says. "New York is a lay-up."

The associates with whom I spoke were enthusiastic about Washington. "It's a great town, it's a young town," says Szu, who has lived in California, New Hampshire, New York, Boston, and Taiwan.

"The one word that comes to mind," says Michael Gershenson, "is how livable Washington is. You have a lot going on here, but people are not on top of each other." Gershenson, a senior associate with a degree from Georgetown, is in the real-estate group. He says that over the four years he's been at Carlyle, he's seen the finance sector in Washington grow significantly. There's now an organization for young professionals in private equity.

Holt, who has been at Carlyle since 1991, says that Washington is probably a plus in recruiting: "So, far we've been able to attract talented people from Wall Street and top business schools."

What do you do your first few years at Carlyle? "Right from the start," says Szu, who will go to Harvard Business School later this year, "you're an integral part of the deal team. You look at possible deals, run models, help with the due diligence," working with lawyers and accountants and doing a lot of on-site work with companies that may be acquired.

Rubenstein may be a workaholic, but he claims that Carlyle doesn't take smart young people, drive them through hundred-hour workweeks, and discard them, as many of the New York investment-banking firms do. "We don't have a macho style here," he says.

"The investment business is about judgment," says Johnson. "You can't burn people out and then have them coherently assess projects." Szu, Dorr, and Gershenson agree. You work hard at Carlyle, and when a deal is closing, the hours can be grueling,

but the firm doesn't eat its young. "It's more collegial here" than at a New York firm, says Dorr.

Richard Darman, who joined Carlyle in 1993 from the first Bush administration, where he was budget director, says that not being in New York is a help. "The New York culture," he says, "is still largely set by the investment banks, and it's somewhat of a dog-eat-dog mentality."

By contrast, Conway ended his January 31 memo to Carlyle employees with this: "Be humble, ethical and optimistic."

And then there is the style of living. Washington offers a "far more attractive life" than New York, says Bill Walton, whose Allied managing directors, making between $750,000 and $1.5 million a year, can buy far more housing for the money than in New York. "And you can be eight minutes away from the office."

For Darman, Washington was important in his decision to join Carlyle. He wanted to stay here "because my kids were very happy in school."

When Darman joined Carlyle, at the same time Jim Baker came on as a senior adviser, the firm had 26 employees in a single office and "just $7 million—not billion, but million—in dry powder." At 63, he's now a senior adviser and managing director at Carlyle, specializing in energy, telecom, and high-growth companies and sitting on about half the investment committees that make the go/no-go decisions.

What's surprising to Darman is that Carlyle has kept its collegiality for nearly two decades. "I wouldn't have predicted that this organization would grow as it has, both in size and geographic scope, and still be able to preserve that," he says.

The answer seems to be both the division of labor among the three founding partners and the Washington setting, which has provided Carlyle with intellectual capital, given it a distinctive identity, brought it deals as a global crossroads, and kept its partners sane and happy.

Rubenstein likes to say that Christopher Columbus was the forerunner of the successful private-equity executive. Columbus insisted on getting reimbursed for all his expenses in advance. And he negotiated a 10-percent carry from Queen Isabella.

But the modern buyout firm is only three decades old. In 1976, Jerome Kohlberg and two cousins, Henry Kravis and George Roberts, left Bear Stearns, a Wall Street firm, to try to succeed on their own with $120,000 in capital. The firm, known as KKR, specialized in using large amounts of debt to buy publicly traded companies. Typically, KKR would retain the top managers, giving them a share of the business as an incentive. The debt would be repaid from the company's profits and through the sale of its subsidiaries. These deals were called leveraged buyouts because their essential element was debt, or leverage.

In 1984 KKR had put together its first billion-dollar buyout fund, and two years later the firm bought Beatrice, a Chicago-based conglomerate, for $6.2 billion. Here's where the money came from: $4 billion in bank loans, $2.5 in junk-bond financing, and just $407 million in equity (cash put up by the investors). The junk bonds, key to many of the LBOs of the 1980s, were floated by Milken.

Then, in 1988, in a similar LBO, KKR bought RJR Nabisco in a deal immortalized in *Barbarians at the Gate,* a book by Bryan Burrough and John Helyar. RJR still stands as the biggest private-equity deal in history at $24.5 billion.

During the 1980s, Darman, referring to a Brookings Institution study, says, "There really was not much value creation. There was financial engineering, and . . . there was the artful creation of leverage. Once you did it, you had the ability to attach yourself to a stable cash flow, and the math did the rest automatically."

By the mid-1990s, some of the buyout deals were producing profits that were quick and huge. Forstmann Little made $700 million selling Ziff-Davis Publishing to a Japanese company after a year. Thomas H. Lee and Bain & Co. made $500 million by selling a division of TRW in just seven weeks.

Later in the 1990s, venture-capital deals—which involved early-stage companies with big potential for growth—dominated. Venture investments tend to be smaller and riskier, with firms typically taking minority positions and riding on the founders' coattails. Kleiner Perkins Caulfield & Byers, best known of the venture firms in Silicon Valley, has invested in more than 300 companies, including AOL, Amazon, and Google.

The fun ended, for both buyouts and venture deals, in the late 1990s as the high-tech bubble burst, the stock market skidded, and liquidity dried up. Rubenstein calls the period from 1999 to 2002 the "dark ages" for private equity. Holdings lost $300 billion in value, and many firms went out of business. Carlyle, run more cautiously than the others, fared well. It has lost money in only a handful of buyout deals, including Gemini Air Cargo, a Dulles-based supplier of outsourced air-freighter services, bought in 1999 for $121 million, and DigiPlex, a European communications-infrastructure company, bought in 2000 for $45 million.

The financial industry quickly recovered, in part because pension funds, whose stockholdings were clobbered three years in a row, were looking for alternative investments to balance traditional equities. By 2004, there were 1,600 buyout and venture firms, running 3,000 funds with a total of $764 billion under management. Carlyle's $7.85-billion CP IV fund was soon eclipsed by Apollo at $10 billion, Blackstone at $10.5 billion, and, in April, Texas Pacific Group, headed by David Bonderman, once a lawyer at Washington's Arnold & Porter, at $14 billion.

The individual deals are getting larger. Carlyle joined Clayton, Dubilier & Rice, one of the oldest private-equity firms, and Merrill Lynch Global Private Equity in buying Hertz last year for $15 billion. Then early in 2006, Cerberus Capital Management led a group of private-equity firms along with Supervalu and CVS (which, as operating businesses, are called "strategic buyers") in buying Albertson's, the supermarket chain, for $17 billion. In April, Cerberus said it was buying 51 percent of GMAC, the financing arm of General Motors, for $14 billion. Cerberus has former vice president Dan Quayle as its chair of global investments.

Other recent buyouts by private-equity firms include J.Crew, Toys "R" Us, Neiman Marcus, Georgia-Pacific, and Metro-Goldwyn-Mayer. In Washington, CarrAmerica, a real-estate investment trust, was bought out by Blackstone, whose chair is Peter Peterson, secretary of Commerce under President Nixon.

None of these deals approaches the RJR record of $24.5 billion, but I expect that record will fall fairly soon. One reason is that going private has become more attractive to executives of public companies. Complying with the Sarbanes-Oxley law, enacted after the Enron and WorldCom scandals and applying only to publicly traded corporations, is expensive and time-consuming.

Also, says Bill Walton of Allied Capital, the scandals led to new regulations that forced Wall Street firms to cut back on their research, so smaller public companies get ignored—and, in many cases, find their stock prices suffering. "It's not viable to be public unless your market cap is over $1 billion or you have a compelling growth story," he says.

CEOs are also getting tired of having to set and meet quarterly-earnings targets or lose Wall Street's support. They're unhappy about having their compensation exposed in the press and about being treated like criminals on probation—having to endorse the company financial statement and risk jail terms.

Lou Gerstner warns, however, that being owned by a private-equity firm has benefits and drawbacks. "For some managers," he says, "the change is positive. You are no

Businesses are going private. CEOs are getting tired of having to set and meet quarterly targets or lose Wall Street's support.

longer being watched by the equity markets or the media. You can concentrate on the long term. For others, the permanent pressure of the funds and the relentless expectation for performance is hard to deal with. The management teams often change along the way."

Just as there are more companies to buy and take private, there are more private-equity firms to buy them. "All these dollars looking for returns are driving returns down" by driving acquisition prices up, says Bill Walton. Bargains are disappearing.

Cash, both equity and debt, is abundant because of low interest rates and record profits. Buyouts of existing companies, on a friendly basis, dominate. Only one-fifth of the money raised by private-equity firms goes into venture capital.

In addition to Lou Gerstner, former top CEOs getting into the private-equity game include Jack Welch of General Electric and Jacques Nasser of Ford. "Back in the 1980s," wrote *BusinessWeek,* "most B-school students wanted to be investment bankers. In the 1990s, it was tech-related venture capital and dot-coms. Now, private equity is hot."

Perhaps too hot. Rubenstein says, "Nothing this good can go on forever." Nearly everyone with whom I spoke—inside and outside Carlyle—predicted that the days of 30-percent internal rates of return are coming to a close.

Lately, after the carry, investors at Carlyle have been earning about 15 percentage points—or 1,500 basis points, as they say in the trade—more than the stock-market indexes. Rubenstein sees that figure dropping, but he is sanguine about investment dollars continuing to come in: "As long as you can keep 700 to 1,000 basis points ahead, you will keep your base."

"Some of this stuff gives me heartburn," says Ed Mathias. We are having lunch at Les Halles near the White House, and he's not talking about the cassoulet. He's recalling the birth pangs of the Carlyle Group.

Rubenstein wanted to start his buyout firm—"we called it a 'merchant bank,' whatever that was," says Mathias—but he didn't want to leave his day job at the Shaw Pittman law firm. Still, everything was moving. D'Aniello and Norris were on board and so, after a cold call, was Conway. (There was a fifth founder, Greg Rosenbaum, but he dropped out after less than three months.)

Conway's story: He realized that he was never going to run MCI, so he started looking around for a job. Rubenstein, who, like Mathias, maintains a wide intelligence network, heard about the imminent departure. He called "out of the blue," says Conway, "and he said that he and a group of guys were thinking of starting this buyout firm in Washington, that he didn't know me and I didn't know him, but . . . I should check him out and then we should get together and meet."

Rubenstein had a hard time committing. Mathias recalls: "Finally he said, 'Oh, well, I'll do it.' So I said, 'I'll raise the money.'"

Mathias raised $5 million—$2 million to operate the firm for two years and $3 million to invest. The capital came from Baltimore investment firms T. Rowe Price and Alex. Brown & Sons, First Interstate Bank of Los Angeles, and the Richard King Mellon family. After a year, Mellon bought out the other investors. Thirteen years after Carlyle was launched, Mellon sold its interest to CalPERS for what one Carlyle partner told me was the largest return the Mellon family had ever made on an investment.

The new business was named after the New York hotel where André Meyer, senior partner of the investment firm Lazard Frères, used to live. Mathias recalled that Carlyle's founding partners were reading Cary Reich's biography of Meyer, and Norris especially was enthralled. Reich's book, *Financier,* described Meyer's Carlyle apartment as "a two-bedroom suite crammed with rare Louis XIV furniture and adorned with an imposing collection of Monets, Chagalls and Picassos."

"There was no serious business plan," says Mathias, who is now a Carlyle managing director concentrating on venture-capital deals, "but we knew that they would do well, whatever they did."

In the early days, Carlyle tried lots of ways to make money. The partners continued doing Eskimo tax-shelter deals until the loophole was closed. They invested $1.25 million in a movie-production company associated with Gerald Rafshoon, a former adviser to Carter. They bought up shares of Chi-Chi's, the Mexican-restaurant chain, in what Rubenstein called a "toehold" or "bear-hug" deal—an attempt to take over the company by starting with a small purchase of stock. Carlyle was outbid by Foodmaker but still made a $3.5-million profit. A similarly small profit was generated in a toehold deal with Fairchild Industries, the Virginia defense contractor.

In 1988, Carlyle bought Oakite Products, a chemical company. One of the three divisions went bankrupt, and the company was eventually sold at a small profit, but the internal rate of return (or IRR, the measure of success in the trade) was only 8 percent. The purchase of Coldwell Banker Commercial Group also produced an IRR of only 8 percent, and Ticketron's sports and entertainment division was a total loss.

Carlyle was foundering until Bob Woodward intervened.

In 1976, Woodward and Carl Bernstein had published *The Final Days,* their book about Richard Nixon's self-destruction. Among other things, it highlighted the President's anti-Semitic paranoia. "Late in 1971," they wrote, "Nixon had summoned the White House personnel chief, Fred Malek, to his office to discuss a 'Jewish cabal' in the Bureau of Labor Statistics. The 'cabal,' Nixon said, was tilting economic figures to make his Administration look bad. How many Jews were there in the bureau? He wanted to know. Malek reported back on the number and told the President that the bureau's methods of weighing statistics were normal procedure that had been in use for years."

Flash forward to 1988. Malek, summoned by George H.W. Bush, leaves the job as president of Marriott Hotels that he's held for seven years to run the Republican convention and then become deputy chair of the party. With Malek back in the news, Woodward, with fellow reporter Walter Pincus, revived the story about counting Jews (Malek found 13 in a sample of 35), and it created a furor.

Malek, denying that he was anti-Semitic, was now out of a job because of the uproar and looking for a place to land. His ex-colleagues Norris and D'Aniello were at Carlyle. Rubenstein thought Malek, a loyal lieutenant to Nixon, had been treated shabbily. "Geez," he told me over lunch in March, "I thought it was a little unfair."

Malek, then 51, did not officially join Carlyle. He just camped out in the office, but he played a key role in luring Frank Carlucci to the firm—an important moment in Carlyle's history, says Mathias. Carlucci, Reagan's departing Defense secretary, "gave Carlyle credibility." Carlucci and Malek have been close for more than 30 years. They served together under Nixon, and they live near each other in McLean.

Malek also helped bring Carlyle a buyout the partners would rather forget. "I teed the deal up," he told me. The

"We put him on the board. . . . He told a lot of jokes. . . . I kind of said to him, . . . 'Maybe you should do something else.' . . . His name is George W. Bush."

company was Caterair—originally In-Flite, the airline-catering arm of Marriott, which was trying to unload the business in 1989. Caterair had revenues of about $1 billion and was earning pretax profits of $100 million. Carlyle bought it for $637 million. It looked like a great deal, but it ended up illustrating the pitfalls of private equity. As Rubenstein would say later: "It's number one in the world. Management team has been there for ten years, and Marriott said, 'We're not going to do an auction. We're going to sell it to you guys because some of your people used to work at Marriott.' . . . What could be better?"

The timing, for one thing. Shortly after Carlyle made its purchase, the Gulf War, higher fuel prices, and a recession had the airlines looking for ways to cut costs. "They began pulling food off planes," says Malek. Caterair suffered. On Wall Street, it earned the nickname "Craterair."

In 1990, Malek brought a 43-year-old Texan to Carlyle's attention as a possible Caterair board member. As Rubenstein later related it in a speech, Malek told him, " 'Look, there's a guy who would like to be on the board. He's kind of down on his luck a bit. Needs a job. Needs a board position.' I met the guy. I said I don't think he adds that much value. We'll put him on the board because—you know—we'll do a favor for this guy," meaning Malek.

Rubenstein continued, "We put him on the board, and [he] spent three years. Came to all the meetings. Told a lot of jokes. Not many clean ones. And after a while, I kind of said to him, . . . 'You know, I'm not sure this is really for you. Maybe you should do something else. Because I don't think you're adding that much value to the board. You don't know that much about the company.' He said: 'Well, I think I'm getting out of this business anyway. And I don't really like it that much. So I'm probably going to resign from the board.' And I said thanks. Didn't think I'd ever see him again. His name is George W. Bush."

Bush left the board. Caterair defaulted on some of its bonds in 1994, and Carlyle sold the company at a loss to Onex, a Canadian private-equity firm.

Malek went on to start his own private-equity firm in 1993. It is called Thayer Capital Partners after the founder of the US Military Academy at West Point, Malek's alma mater. Thayer's offices are also on Pennsylvania Avenue, but they're in the office building attached to the Willard InterContinental Hotel and are much nicer than Carlyle's. Malek's walls, unlike Rubenstein's, are adorned with photos of the office occupant smiling with the great and near-great: Colin Powell, Reagan, George W. Bush at a Texas Rangers game.

Thayer Capital has $1.5 billion in capital and owns such companies as Qualitor, a Michigan manufacturer of auto parts. Another specialized partnership, Thayer Hotel Investors, has $2 billion in assets and has lately been selling many of its real-estate properties—including the Marriott Wardman Park, a $300-million deal—taking advantage of high prices.

Back in its early days, Carlyle, with Norris as the point man, was developing a relationship with Prince al-Waleed bin Talal of Saudi Arabia, a connection that came through Alphonso Christian, a lawyer at the DC law firm Hogan & Hartson. The prince had about half a billion to spend, and Carlyle advised him to buy a chunk of America's largest banking company, Citicorp—an investment that turned into a big success, worth $7.6 billion by the time Citigroup was created in a merger with Travelers in 1998.

Luck played a role. Carlyle won the prince's business in part because practically every investment-banking firm in New York had potential conflicts of interest through their dealings with Citicorp. The prince later made investments in Euro Disney, Motorola, Rupert Murdoch's News Corp., and Apple Computer.

The Saudi connection earned fees, but it wasn't the private-equity business. There, it was the Carlucci connection that proved much more rewarding.

Carlucci had met the four founders late in 1988, but they hadn't heard from him in months. D'Aniello picks up the story: "Carlucci was going to be on David Brinkley's Sunday-morning show. So Bill, David, and I were watching. And Brinkley asked him, 'Secretary Carlucci, what do you plan to do upon leaving the administration?'

" 'Well,' he says, 'I'm probably going to sit on some boards, do some consulting, and I'm going to be joining a private-equity firm in Washington called the Carlyle Group.'

"This is on national TV! I almost fell out of the chair. It was stunning. The phone rang the rest of the day."

Carlucci, who served as Carlyle's chair from 1993 to 2002, was important because he knew defense, and defense not only became profitable for Carlyle, it also gave the firm an identity—a way to be distinctive as a private-equity business outside New York.

"So here we are in Washington, DC," says Rubenstein. "When Frank Carlucci joined us, we were willing to kind of learn the defense business, the aerospace business. Nobody wanted to get into that business because it was too complicated, too difficult to learn, too many arms of the federal government involved. So we began to say, 'Look, we can do aerospace deals, defense deals. . . .' It just made logical sense."

Rubenstein admits Carlucci's importance: "Frank was really a guy who could get his calls returned by almost anybody. He was on a lot of corporate boards. So we found him to be very helpful. . . . His credibility as the former secretary of Defense was helpful."

Defense looked good to Carlyle for another reason. The Berlin Wall came down in 1989, the communist empire was imploding, and cutbacks in the defense budget were certain. As a result, conglomerates and other large corporations that had gobbled up defense contractors in the 1970s and 1980s now wanted to get out. They were motivated sellers.

One of those sellers—which would emerge again 15 years later with Hertz—was Ford. In 1990, Ford decided to divest its aerospace division. Carlyle wanted it dearly but lost out to Loral, a New York electronics company. Ford Aerospace owned a subsidiary called BDM International, founded by three physicists but now based in McLean and run by Earle Williams. It turned out that Williams did not like the notion of BDM being swallowed up by Loral.

"Earle knew Frank," D'Aniello recalls, "and wanted to know whether his team could manage a negotiated departure from the Loral deal and whether Carlyle would be interested in investing in them. Frank brought it to us, and we said, 'Gee, this is terrific!' "

So on September 18, 1990, the same day Loral bought Ford Aerospace, Carlyle bought BDM from Loral. The price was $130 million—compared with the $425 million Ford had paid for BDM just two years earlier. Carlyle put up $43 million in equity, and Williams and the other managers received an ownership stake in the company.

BDM proved important to Carlyle not just for its own performance—investors made 14 times their money in seven years—but also for the intellectual capital it provided to the firm. "You have a government-contracting business that really can understand the future of defense, what's going to be worthwhile and—in the context of defense budgets—the potential

profitability of other companies in the future," D'Aniello says. "And you have a person, in Frank Carlucci, who can be a credible mentor to management teams."

The BDM managers, plus Carlucci, helped Carlyle with other defense acquisitions, including LTV Aerospace, Magnavox Electronic Systems, and Howmet, a maker of jet-engine turbine blades. Carlyle investors made eight times their money on Howmet, a $104-million investment in 1995.

Another of Carlyle's biggest winners was United Defense, maker of Bradley armored vehicles, the Crusader giant howitzer, missile launchers, and other precision munitions. Carlyle bought United in 1997 for $850 million, of which $180 million was equity. Buyout firms have a reputation, left over from the cut-and-slash LBO days, for firing workers, selling off subsidiaries, and reducing spending on R&D and capital investments—that is, plundering the company for a quick sale. But today Carlyle and other firms are just as likely to enlarge a business they purchase through further acquisitions. That was the case with United Defense.

The $11-billion Crusader program, which some analysts saw as the crown jewel at United Defense, was funded in eight consecutive Clinton-administration budgets, but Bush cancelled it (with $9 billion to go) a year after taking office. The Army did reinstate a smaller contract, but United Defense no longer depended on the Crusader for major profits. The stock continued to rise, and Carlyle made its final exit in 2004, earning investors $1.3 billion, an internal rate of return of 50 percent annually, before the carry.

Conway had some personal holdings and stayed on another year, and the stock kept climbing before United Defense was sold to a British company. "When you're a chairman," Conway says, "you have an inability to sell—and it paid off for me."

Rubenstein says that from the start he tried to create an asset out of what was a potential liability: that Carlyle was based in Washington, seen by investors at the time as a financial backwater. "Everett Dirksen famously said that when you're getting kicked out of town, get out in front and pretend you're leading a parade," he told me.

As Rubenstein said, "You have what you have, and you sell it as an advantage. Well, here we were in Washington, DC—because I lived here and didn't know New York and so forth. . . . We would tell our investors that we understand government-oriented businesses better than other people. And people would say, 'Okay, these guys are in Washington. This guy worked in the White House. Maybe he does.' "

Being in Washington helped in other ways. Lots of foreign leaders and business executives came here to visit government officials. Because Carlyle was the only private-equity game in town, they would stop by the offices—and the firm would pick up intelligence and deals. Also, Carlyle was flying beneath the radar. The partners could make mistakes—like Caterair—and no one would notice because they weren't in New York, where competitors would be sniping at them.

"For raising money, it was a smart concept at the time," says Darman. But there were risks. "Carlyle was incorrectly understood to be peddling influence in some way or other, which is not true. Just to take my own case: In all the years I've been here, I have never, ever, not once, contacted the US or any other government on behalf of anything related to Carlyle."

Rubenstein and the other founding partners have stayed out of politics. Carlyle has no PAC, and DBD, as individuals, are relatively minor contributors to campaigns, especially in comparison to other private-equity moguls. Bonderman has given loads of money to Democrats, and Schwarzman, in the 2004 election cycle, made about 70 separate contributions, nearly all of them to Republicans.

Rubenstein worked for a Democratic administration and now says his political affiliation is "capitalist." Conway is a Democrat, but he's given at least $15,000 to Republican groups. D'Aniello leans Republican, though he's made several contributions to Democratic senator Evan Bayh of Indiana. But the hiring of politicians like Baker and Bush—whose jobs were to give speeches, filling a room with potential Carlyle investors, and to use global contacts to open doors of government and executive suites—reinforced the image painted by author Michael Lewis in 1993 of a firm that was merely selling access.

What Carlyle was really doing was using its presence in Washington—its lines of intelligence here and the advice of partners like Carlucci—to make good acquisitions in, as Darman puts it, "sectors that are heavily determined by government." Defense, of course. And then telecom and healthcare.

"But today," says Conway, "we're everything. We're consumer. We own Dunkin' Donuts, and I don't know what the connection is there to the US government. Maybe the FDA will publish something on coffee that says it's bad for you."

On a crystalline Tuesday morning in September nearly five years ago, the Carlyle Group was holding its annual investor conference at the Ritz-Carlton Hotel on 22nd Street. Former president Bush had spoken at a Carlyle dinner the night before at Union Station, but he'd left. Jim Baker and John Major were still in attendance, as were dozens of wealthy individuals, pension-fund officials, and Carlyle executives, including DBD. A buzz went through the crowd, television sets came on, and the gathering watched, horrified, as videotape showed—again and again—an airliner crashing into the World Trade Center.

Among the investors at the Ritz that morning was Shafiq bin Laden, one of Osama bin Laden's many half-brothers. Shafiq was representing his family, which built its wealth in the construction business and disowned Osama in the 1990s. But Shafiq's presence at the Ritz on that day in American history—"a disconcerting and freakish coincidence," according to author Dan Briody—helped establish Carlyle as a mother lode for conspiracy theorists.

"In fact," says narrator Michael Moore in *Fahrenheit 9/11,* his film about George Bush and the war on terror, "the bin Laden family was invested in one of their defense funds, which ironically meant that, as the US increased defense spending, the bin Laden family stood to gain from those investments through the Carlyle Group."

Actually, Carlyle has no "defense funds." The bin Ladens had invested $2 million in CP II, a $1.3-billion US buyout fund that closed five years before. CP II's portfolio did include Howmet and United Defense, but it also featured many nondefense companies, including the Dr Pepper/7-Up Bottling Group.

About a month after 9/11, the bin Ladens severed their ties with Carlyle. But the word had spread. The Ritz affair opened the floodgates for caricature. In his movie, Moore claimed that Saudi interests "have given" $1.4 billion to firms connected to the family and friends of George Bush. Nearly all that money comes from a Saudi contract for military training that went to a company called Vinnell, which came into the Carlyle fold when BDM purchased it in 1992. But Carlyle sold BDM to TRW in 1997—five months before George H.W. Bush joined Carlyle as an adviser.

The *Economist* magazine, citing the bin Laden connection, claimed, "The secretive Carlyle Group gives capitalism a bad name. . . . At a time when America is aggressively promoting democracy and capitalism abroad . . . it would be helpful if its politicians and businesses were regarded as cleaner than clean. Shrouded in secrecy, Carlyle calls capitalism into question."

If you look, you'll find Carlyle is one of the least secret private companies anywhere. Carlyle's Web site lists every employee and adviser, with brief biographies, plus descriptions of more than 200 businesses it owns or owned.

But Carlyle deserved some of the criticism—not because it was doing anything illegal or unethical but because it had promoted the notion that it was well connected and provided the grist for the conspiracy theorists' mills.

In recounting Carlyle's history, Rubenstein described to me how Baker, the first Bush, and Major had joined up and, "after a while, people began to say, 'Wait a second! These guys in Washington, they have all this power, all this influence.' People began to intuit that we had influence, that we were influencing government, that we had power that we really didn't have."

He added, "Because the press, particularly the press in Washington, was involved with all these names, we got so much attention that I think to some extent maybe we were happy with it at times because it gave us visibility in the early years, and people knew who we were.

"But then later, it became a bit of a problem because people thought we were this club of ex-presidents. . . . It got maybe a little out of control."

More than a little. Carlyle had become too important an institution to risk being regarded as a nest of access capitalists. The founders realized they needed to change, and they began before 9/11.

"What we started to do in 2000," says D'Aniello, "is to morph a bit from sort of a Washington-based, politically connected firm to more of a business base, bringing in a larger complement of former CEOs to work with our deal teams and sit on our boards."

The presidents club was disbanded. "Their contributions were invaluable in helping to build the firm," Rubenstein told me, "but our needs evolved." Also, Bush, Baker, and Carlucci hit Carlyle's retirement age of 75 (Bush exceeded it by five years).

Rubenstein likes to say, "This is not your father's Carlyle." He's right, but in part the founders have themselves to blame for becoming the conspiracy theorists' favorite punching bag after the Trilateral Commission (of which Rubenstein is a member).

The image persists. During the Dubai ports imbroglio this year, Maureen Dowd and other opinion makers jabbed Carlyle for a shadowy conspiracy that never existed. Dubai International Capital was an investor in CP IV; Carlyle once owned a container-shipping company; national security was involved; and so was George W. Bush, the son of a former Carlyle adviser. Ergo . . . .

"The problem with the future is that it has not happened yet," wrote Bill Conway in his memo to Carlyle employees at the start of 2006. In the early years of the new millennium, the wind was at Carlyle's back, Conway tells me. "You had flat energy rates, you had flat interest rates, you had enormous spare capacity in the US. Everything just conspired to make things wonderful." That's changing: "I think energy prices will stay high. I think there will be increased competition" from other private-equity firms.

Conway says that as a result, he's "a little more conservative than I used to be . . . but it would be hard for me to say I've crawled into [a] shell." Today, it's tough to find companies to buy at the valuations of ten years ago, when Carlyle typically paid six or seven times EBITDA (annual earnings before interest, taxes, depreciation, and amortization), the industry standard for profits. Now, Conway is paying eight times and more.

Dunkin' Donuts, which also owns the Baskin-Robbins ice-cream chain, went for 11.5 times EBITDA, a total of $2.4 bil-

If You Want to Invest in Private Equity . . .

After reading that the Carlyle Group has produced annual returns of some 34 percent since 1987, you may want to invest. But to qualify you have to commit a minimum of $5 million. Because a reasonable personal portfolio should include a proportion of private equity no bigger than 10 percent, that means you should have $50 million in investable assets.

If you're not so well heeled, you can invest indirectly in Carlyle or several other private-equity funds through J.P. Morgan, Credit Suisse, and other private banks using "feeder funds." Morgan was recently offering its clients the chance to invest in a Carlyle Asia fund with a minimum of $500,000—and, with a Morgan waiver, perhaps even less. Morgan charges an "origination fee" of 2 percent if you put in less than $1 million and, of course, Carlyle takes its 20-percent carry.

There are other choices in the public markets if you don't want to invest lots of money. One of the best is a Washington-based company, Allied Capital, traded on the New York Stock Exchange as ALD.

William Walton runs Allied Capital, a DC-based company that behaves like a private-equity firm and trades on the New York Stock Exchange. You can buy a share for about $30—a good deal less than the $5-million minimum at Carlyle.

Photograph by Cade Martin/courtesy of Allied Capital

Allied, founded in 1958, used to be primarily a lender to midsize companies. But more and more it has become a part-owner of such businesses, and it now describes itself as "a publicly traded private equity fund." William Walton, its CEO since 1997, says that Allied's advantage is that it makes its purchases using a permanent pool of low-cost capital, raised from its shareholders, rather than from pension funds and other investors that want their money back in five to ten years. As a result, Allied can nurture businesses over a longer time.

Allied's portfolio includes 100 companies that generate annual revenues of $10 billion and employ 85,000 people. It focuses on smaller businesses than Carlyle, including Insight Pharmaceuticals, maker of Sucrets and Anacin; Mercury Air Centers, which operates private-aircraft terminals; and Meineke Car Care Centers. In late March, Allied sold Advantage Sales & Marketing for a gain of $430 million on an investment of $75 million—its most profitable deal ever.

Allied, as a business-development corporation, passes earnings through to investors in the form of dividends, which have been paid since 1963 and have risen for 12 straight years. Currently, the stock yields 7.9 percent.

Another publicly traded choice is Apollo Investment Corp. (AINV), a business-development company started in 2004 that lends money to midsize businesses and takes equity stakes in them. It currently has a yield of 9.5 percent. The company's CEO, John Hannan, cofounded Apollo Management, one of the largest private-equity firms.

KKR, the firm that pulled off the largest private-equity deal in history, has launched KKR Financial (KFN), a real-estate investment trust that mainly invests in mortgage loans and yields 7.4 percent.

In early May, KKR brought another security public—KKR Private Equity Investors. It will use its capital to invest in KKR funds. So for a few hundred bucks or even less, you can become a private-equity investor. The security trades like a conventional stock but only on European exchanges in Amsterdam, Munich, and elsewhere. Starting in mid-July, you can ask your US broker to buy it for you, but beware that disclosures and protections are less extensive than they are in the United States, and fees are high.

David Rubenstein, one of Carlyle's three founders, expects that private-equity firms will go public here soon—though he's not saying Carlyle will be one of them. When the first real private-equity IPO is launched on an American exchange, be careful. This is a risky business. Not all firms do as well as Carlyle and KKR, and there are no guarantees that the winning streaks of even the best firms will continue. A study by two economists, Steven Kaplan and Antoinette Schoar, found that after fees, the average returns produced by private-equity funds "approximately equal the S&P 500," the benchmark for US stocks.

—James K. Glassman

lion. "We paid a full price," says Horbach, who crafted the deal, but Carlyle—along with two other private-equity partners, Lee and Bain, managed to borrow most of the purchase price at a fixed 6.5 percent for five years. Horbach thinks the management team of the chain of 6,100 shops is terrific, and "it is a stable, predictable business" that, she expects, will grow as the company takes on Starbucks, currently trading at around 18 times EBITDA.

More and more, private equity is becoming a business not of financial engineering but of strategic management. That's why Carlyle's chair is not a former secretary of Defense but a former architect of one of the greatest turnarounds in corporate history. "Gerstner understands the consumer," says Horbach. "He looked at Dunkin' before the purchase. He really liked the business."

Critics of private equity say that buying and selling existing companies—unlike venture capital, which aids start-ups—is a process that adds nothing useful to society or the economy. In a scathing March article in *Forbes* headlined PRIVATE INEQUITY, Neil Weinberg and Nathan Vardi wrote that buyout executives "do not make their fortunes by discovering new drugs, writing software or creating retail chains. They are making all this money by trading existing assets." But that view is dated.

"The buyout world is radically transformed," says Darman. "So if you're making an investment in this environment, you can't say, 'Well, I'll just buy at the right price.' Almost everything goes to auction now, so you're probably going to get it pretty nearly at a fair price. Which means that if you're going to get extraordinary returns . . . it has to come from the value you add in the course of owning the business. There's a much heavier burden on people in this business to actually add that. Which is a good thing."

To succeed, a private-equity firm has to help a business get better—a task that buyout firms try to accomplish through supporting the managements of the companies they buy. "They aggressively help make additional acquisitions, they help with refinancing, they will help open markets, they will help with customer calls," says Rubenstein. Carlyle places advisers like David Squier, the former CEO of Howmet, or Tom Corcoran, the former head of Lockheed Martin's electronics division, on the boards of companies it buys—"guys that have operating experience, and these guys are getting in the middle of companies."

The problem for Carlyle is that it has to return investors' cash within five years—seven or eight at the outside—so it can't build up value over the long term. Low acquisition prices remain the holy grail ("it's hard to overcome overpaying," says Rubenstein), and, to find them, Carlyle often has to go outside the United States.

The firm launched its first European fund in 1998, its first Asian fund in 1999, and a Japanese fund in 2004. "The idea of having a family of funds had never happened in the private-equity world," says Rubenstein. Now other firms have followed Carlyle's lead, and Carlyle itself has more than three dozen funds.

Europe has been especially fertile in recent years, but the competition is getting intense, and Carlyle is turning to places like Japan, China, Taiwan, and Mexico. Today, nearly two-fifths of Carlyle's buyout deals are outside the country. The question is what this US-based firm can add in making wise acquisitions and improving corporate performance in countries 10,000 miles away.

There's another worry. Private equity has thrived in part because it's been largely unregulated. "At some point," says Rubenstein, "all private-equity firms will have to be registered by government. It is foolish to think this industry can continue to raise tens of billions of dollars without the government having a piece of it."

Rubenstein is telling me that two years ago, "I read somewhere that the average white male who was 54 will have a life expectancy that will get you to 81. So, doing the arithmetic, I realize that I had led on average probably two-thirds of my life. I decided that, while I was very happy with what I had done in the first two-thirds of my life, there are some things I wanted to do before the other third was over.

"I didn't just want to make more money and help build Carlyle further. I like Carlyle a lot, and I will stay. But I wanted to spend time with philanthropic things."

He's now a workaholic on the charity scene as well. Rubenstein sits on the boards of Duke, Johns Hopkins, the Kennedy Center, Cold Spring Harbor Laboratory, Memorial Sloan-Kettering Cancer Center, the Council on Foreign Relations, the Dance Theatre of Harlem, and many more.

I had heard from someone who knows him that Rubenstein was miffed that he was not chosen to succeed James Johnson, former CEO of Fannie Mae, as chair of the Kennedy Center. Instead, one of Rubenstein's private-equity rivals, Stephen Schwarzman of Blackstone in New York, got the job.

Rubenstein gave me a long exegesis of the process and then said that not getting the job "turned out well in the end." It gave him time for lots of things he wouldn't have had time for.

He was probably being a bit disingenuous, but if he was unhappy, he has not borne a grudge. He's still on the Kennedy Center board and has donated a good deal of money. He and Alice underwrote this season's National Symphony Pops and, with Catherine and Wayne Reynolds, served as cochairs for the Kennedy Center gala in May. And, in a Washington-goes-to-New-York switch, he's become vice chair of Lincoln Center, where he's leading a $500-million fundraising campaign.

In four long interviews, Rubenstein referred several times, without prompting, to his parents. So as we were winding up, I prompted him: "What do your parents think of your success?"

"My parents," he answered, "think what any Jewish parents would. I'm their only child, so if you're Jewish parents and your child turns out to be semirespectable, they're going to make you into something greater than you are. . . . Are your parents alive?"

"Just my mother."

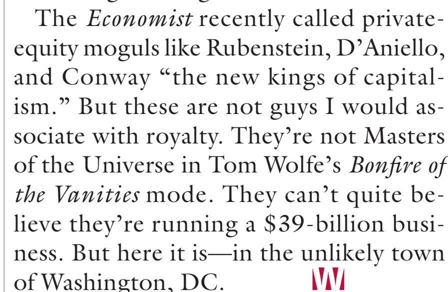
"Mother. No matter what you do, your mother's still going to think you're terrific, right?"

"That's true of my mom, anyway," I say.

"Right," he says. "My parents—sure, they're happy, but they would be happy if I were a shoe salesman or if I were in the post office. It doesn't make a difference. And, you know, I don't really think that I've achieved that much compared to all the people I keep reading about—people who win Nobel Prizes for great discoveries that change the face of humanity."

Rubenstein goes on: "I don't have the ability to cure AIDS or cancer. The most I can do is something that's reasonably meaningful in business and take the profits from it and maybe give it to people who can do something more significant."

The *Economist* recently called private-equity moguls like Rubenstein, D'Aniello, and Conway "the new kings of capitalism." But these are not guys I would associate with royalty. They're not Masters of the Universe in Tom Wolfe's *Bonfire of the Vanities* mode. They can't quite believe they're running a $39-billion business. But here it is—in the unlikely town of Washington, DC.



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