

## Protection money for Quadrangle

by Peter Lauria Posted 04:02 EST, 7, Feb 2005

**Quadrangle Group LLC** officials say they will see a threefold increase in the value of the firm's initial investment in security system provider **Protection One Inc.** when the company completes a debt restructuring, expected today.

The New York-based private equity firm's \$138 million investment in Protection One, made about a year ago through its private equity and distressed-debt units, is now valued at roughly \$400 million, according to Quadrangle.

Far removed from the glitzy entertainment investments that made its name, the Protection One deal underscores Quadrangle's ability to use its distressed-debt unit to aid private equity transactions.

Quadrangle first took interest in Protection One in December 2003. At the time, security companies were recovering from a two-year period of overexuberance in which they leveraged up their balance sheets competing for customers. Quadrangle seized on this development, deciding the sector would be a good place to deploy some of the money in its \$1 billion private equity fund — the firm has invested about \$950 million of the fund to date.

"We were attracted to Protection One because its distribution system is similar to that of cable," said Quadrangle managing principal David Tanner. "They use a two-way wire that connects the home directly to a central office, and their model is subscription-based."

While Quadrangle was conducting its due diligence on Protection One, David Wittig and Douglas Lake, the respective CEO and CFO of Protection One's parent company, **Westar Energy Inc.**, were being charged with defrauding the company out of billions of dollars. As a result of Wittig's and Lake's actions, regulators in Kansas, where Westar and Protection One are based, ordered Westar to sell Protection One.

Westar retained **Lehman Brothers Inc.** to conduct an auction of Protection One in June 2003. But all of the bids for Protection One came in below the \$550 million in debt it carried on its balance sheet.

"Bidders wanted to buy Protection One's equity but they didn't have the ability to restructure the debt, and Westar couldn't do it because of their own situation. That's when we came in and proposed a different kind of deal structure," said Michael Weinstock, another Quadrangle managing principal.

What Quadrangle proposed, and Westar agreed to, was a two-step process through which it would acquire Westar's 88% equity interest in Protection One and obtain the rights to the \$215 million credit facility Westar provided to Protection One in exchange for \$138 million — \$120 million upfront and an earn-out incentive that totaled \$18 million.

Two-thirds of the money for the deal came from Quadrangle's private equity arm, while its distressed-debt unit pumped in the remaining one-third.

After that portion of the deal closed, Quadrangle led an out-of-court restructuring of Protection One's balance sheet that included reducing the company's credit facility by \$120 million in exchange for 800 million shares of its common stock. Protection One then implemented a 1:50 reverse stock split that increased Quadrangle's equity stake to 97% from 88%. As part of the restructuring, Westar also agreed to pay Protection One \$73 million to settle tax sharing-related obligations. As a result of these maneuvers, Quadrangle was able to erase \$190 million of Protection One debt, lowering its overall figure to \$360 million.

Quadrangle officials said their stake in Protection One now carries a valuation of nearly \$400 million — 885 million shares at 32 cents per share worth \$283 million, a credit facility worth \$81 million and interest income and debt repayments totaling \$30 million. Using Protection One's \$84 million of Ebitda for the year-ended Sept. 30, 2004, equates to a multiple of less than 5 times that valuation. In reality, however, Quadrangle's total investment of \$138 million means the firm created its current position in Protection One at less than 2 times the company's Ebitda last year. And in less than a year's time to boot.

Quadrangle doesn't plan on cashing out its investment just yet — it will continue to hold Protection One as a portfolio company under its current management.

Though slightly different in nature, the Protection One deal marked the fifth time Quadrangle's private equity and distressed debt units simultaneously invested in the same company. The trend is expected to continue once Quadrangle finishes raising its second fund — a source said the firm is in fundraising mode and hopes to modestly improve upon the \$1 billion it raised for the first one.

Tanner, Weinstock and a Quadrangle press official all declined comment on the firm's efforts to raise a second fund