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## SPECIAL REPORT - Romney's steel skeleton in the Bain closet

By Andy Sullivan and Greg Roumeliotis

KANSAS CITY, Missouri (Reuters) - It was funny at first.

The young men in business suits, gingerly picking their way among the millwrights, machinists and pipefitters at Kansas City's Worldwide Grinding Systems steel mill. Gaping up at the cranes that swung 10-foot cast iron buckets through the air. Jumping at the thunder from the melt shop's electric-arc furnace as it turned scrap metal into lava.

"They looked like a bunch of high school kids to me. A bunch of Wall Street preppies," says Jim Linson, an electronics repairman who worked at the plant for 40 years. "They came in, they were in awe."

Apparently they liked what they saw. Soon after, in October 1993, Bain Capital, co-founded by Mitt Romney, became majority shareholder in a steel mill that had been operating since 1888.

It was a gamble. The old mill, renamed GS Technologies, needed expensive updating, and demand for its products was susceptible to cycles in the mining industry and commodities markets.

Less than a decade later, the mill was padlocked and some 750 people lost their jobs. Workers were denied the severance pay and health insurance they'd been promised, and their pension benefits were cut by as much as \$400 a month.

What's more, a federal government insurance agency had to pony up \$44 million to bail out the company's underfunded pension plan. Nevertheless, Bain profited on the deal, receiving \$12 million on its \$8 million initial investment and at least \$4.5 million in consulting fees.

### PROFITABLE FAILURES

In his campaign for president, Romney has championed free markets and vowed to shrink the role of government. The Republican has argued that his business acumen makes him the best candidate to fix the nation's economy and bring down the stubbornly high unemployment rate. Romney's opponents point to his business career as evidence that he is willing to cut jobs and benefits.

The story of Bain's failed investment in the Kansas City mill offers a perspective on a largely overlooked chapter in Romney's business record: His firm's brush with a U.S. bailout.

His supporters say the pension gap at the Kansas City mill was an unforeseen consequence of a falling stock market and adverse market conditions. But records show that the mill's Bain-backed management was confronted several times about the fund's shortfall, which, in the end, required an infusion of funds from the federal Pension Benefits Guarantee Corp.

Romney's career at Bain included both successes and failures. That is not unusual in the private equity business, where investors buy troubled companies and try to turn them around, often through aggressive use of debt.

"Bain Capital invested in many businesses," Romney spokesman Ryan Williams said in a written statement. "While not every business was successful, the firm had an excellent overall track record and created jobs with well-known companies like Staples, Dominos Pizza and Sports Authority."

Bain showed a remarkable knack for turning a profit. A prospectus from the year 2000 obtained by the Los Angeles Times shows that the buyout firm delivered an average annual return on investment of 88 percent between its founding in 1984 and the end of 1999.

Romney headed the firm for that entire period, except for a hiatus in 1990 to 1992, when he returned to Bain Capital's sister consulting firm, Bain & Co. In 1999 he left the business to run the Winter Olympics in Salt Lake City.

The steel company declared bankruptcy in 2001. Romney continued receiving dividends from Bain after his departure. He accumulated a personal fortune of between \$190 million and \$250 million, according to campaign disclosure forms.

Steven Kaplan, a University of Chicago professor of entrepreneurship and finance, describes Bain's track record under Romney as "fantastic," even if some ventures ended in failure.

"You don't do this by just squeezing out costs. Those kinds of returns only come from growth," he said. "Yes, they had some bad investments, I guess in the same way presidents make some bad calls."

## CASHING IN

Overall, Bain made at least \$12 million on the steel company it created by merging the Kansas City mill with another in South Carolina before the new entity declared bankruptcy in 2001. Bain also collected an additional \$900,000 a year through 1999 for management consulting services, public filings show.

Some analysts say Bain should not be blamed for the company's failure, noting that a wave of cheap imports forced nearly half of the U.S. steel industry into bankruptcy during that period. Another company set up around the same time, in which Bain took a minority stake, Steel Dynamics in Fort Wayne, Indiana, thrived.

"GS and Steel Dynamics were about as different as it gets," industry analyst Michelle Applebaum said. GS's core products were vulnerable to competition while Steel Dynamics became "one of the country's lowest-cost manufacturers of steel sheet," a product with more staying power. Steel Dynamics was also a non-union shop.

Former company executives say they were generally satisfied with Bain's leadership, but they say the firm would have been better equipped to weather tough times had it not been saddled with such a heavy debt load.

They also fault Bain for putting inexperienced managers in place and spurning a buyout offer from a competitor. Workers say efforts to cut corners often backfired, driving costs higher.

The Kansas City millworkers, meanwhile, are still fuming, after being left with no health benefits and a reduced pension check.

"Romney cost me lots and lots of sleepless nights and lots and lots of money," said Ed Stanger, who worked at the plant for nearly 30 years.

## A GOOD LIVING

Since opening in 1888 as The Kansas City Bolt and Nut Co., the steelworks that sprawl along the Blue River valley in the city's northeast corner provided a steady and prestigious living for thousands of men. It was hard, dirty, dangerous work. The plant kept two surgeons on site in case of accidents, and death on the job was not unknown.

When summer temperatures would top 100 degrees, workers wore long johns under their protective suits so their sweat could offer some relief.

Still, it wasn't easy to get a job at the mill. The pay was good, lifting countless families into the middle class. Workers bought houses and cars and sent their kids to college.

"Hard work is supposed to pay off," said John Cottrell, who spent decades working with molten metal. White burn marks crisscross his massive forearms, and years of asbestos exposure have left him short of breath. Sitting at his kitchen table in the working class suburb of Independence, he looks a decade older than his 64 years.

At its peak in 1970, the Kansas City plant, then owned by Armco Steel Corp, employed 4,500 people. Poor market conditions forced a wave of layoffs in the early 1980s and led the company to prune its product line. By the early 1990s, the plant focused on two items: wire for products such as mattress springs and tires; and high-carbon balls and rods used by the mining industry to pulverize rocks.

It was around that time that the mill workers started noticing the kids in suits.

Armco wanted to sell its Kansas City plant to concentrate on other aspects of its business. Jack Stutz and a few of the other Armco managers were looking for backers to help them buy it. They spoke to GE Capital, which, in turn, contacted Bain Capital because it had earned a sterling reputation for turning companies around.

The risks were obvious. The mill's equipment was out of date and it faced stiff competition from Nucor Corp, which also made grinding balls.

Nevertheless, Bain and its partners decided to buy the mill for \$75 million. Bain put up about \$8 million to gain majority control of the company, renamed GS Technologies Inc. GE Capital, former Armco executives and Leggett & Platt, a major customer for the mill's wire rods, chipped in the rest of the equity.

As part of the deal, Armco agreed to cover employee pension obligations if the plant closed within five years -- a \$120

million liability, according to the Kansas City Business Journal.

## THE BIG DIVIDEND

Bain got its money back quickly. The new company issued \$125 million in bonds and paid Bain a \$36.1 million dividend in 1994.

"Paying distributions with debt is not uncommon," said Campbell Harvey, a finance professor at Duke University. "The only thing that strikes me as a bit unusual is the size of the dividend. There would be logic in them saving some cash for a downturn."

Looking back on the dividend payout, Stutz and another former GS Technologies officer, Mario Concha, believe it weakened the mill's financial position.

"At the time they paid that dividend, they felt that the financials justified it," Stutz said.

GS announced plans for a \$98 million plant modernization and Kansas City officials agreed to a tax break worth about \$3 million, according to press accounts.

In 1995 Bain merged GS with another wire rod maker in Georgetown, South Carolina, to form one of the largest mini-mill steel producers in the U.S. The new company issued another \$125 million in bonds to pay for the merger. Bain doubled down, reinvesting \$16.5 million of its earlier dividend.

The new company, dubbed GS Industries Inc., would have annual revenues of \$1 billion and employ 3,800 people.

Already, though, there were warning signs that the company was not on a sustainable course. Concerned about the level of debt, which totaled \$378 million in 1995 on operating income less than a tenth of that amount, the merged company's new CEO, Roger Regelbrugge, negotiated a clause in his contract that would allow him to retire at the end of 1997.

Regelbrugge said he was concerned that the company would have to go through a painful restructuring if it had not sold shares through an initial public offering by then.

Regelbrugge had done one restructuring in the 1980s at the South Carolina mill, laying off workers and haggling with creditors. He did not want to go through that painful process again.

"Unless we had plans to go public at that time, I did not want to carry that debt load ad infinitum," he said.

Over the next two years, GS Industries completed its upgrade of the Kansas City plant and laid the groundwork for an IPO to pay down some of the debt.

Meanwhile, managers struggled to forge a cohesive whole from two companies that made similar products but had different corporate cultures, different manufacturing processes and different labor contracts.

"I guess the two cultures never really got together," Stutz said.

## ON STRIKE

In 1997, with Armco's pension guarantees set to expire in one year, the United Steelworkers local at the Kansas City plant was worried that GS was not setting aside enough money to cover pension obligations and other benefits in the event of a shutdown.

David Foster, the negotiator for the union, said labor talks were typically more tense at companies owned by private equity firms because the high level of debt left managers with less flexibility.

Contract talks foundered and the union went on strike in April 1997. The first standoff since 1959 quickly turned nasty. Workers shot bottle rockets at security guards, tossed nails in the roadways to flatten the tires of nonunion trucks and pounded on the windows of vehicles as they left the plant.

After 10 weeks, the two sides reached a deal that boosted pensions and ensured that workers would get health and life insurance in the event of a shutdown.

The workers put down their picket signs, but the equipment upgrades weren't delivering productivity gains as quickly as hoped. At the end of 1997, Regelbrugge decided to retire rather than stick around for an IPO that wasn't going to materialize.

Shortly after that, an industry competitor offered "a whole lot of money" to buy GS, according to Regelbrugge, but Bain turned it down. A company insider said the suitor was the global behemoth Mittal Steel Company, but added that no formal offer was ever made.

As GS Industries sought to cut costs, it hired line managers with no experience in the steel industry, workers said. One had worked at Walmart; many others came straight out of the military.

"He would come up with some of the stupidest damn ideas that you ever seen," the former steelworker Linson said of one supervisor, a retired Air Force colonel.

Paperwork proliferated. Cost-cutting efforts backfired. Managers skimped on purchases of everything from earplugs to spare motors and scaled back routine maintenance. Machines began to break down more often, and with parts no longer in stock a replacement could take days to arrive.

Labor costs spiked as managers revamped work schedules with little understanding of how the plant actually operated. Linson says he picked up an entire shift of overtime each week because his managers didn't realize that a furnace needed a full eight hours to heat up to operating temperature.

"That didn't work to their advantage," he said. "I made a lot of money."

Daily life at the plant was also growing more dangerous. Veteran crane operator Ed Mossman says he was ordered to pick up a load of steel that was 50 percent above the recommended weight limit - a prospect that could have toppled the crane and sent Mossman plunging to his death. When he refused, he says, he was fired after putting in 29 years at the mill.

"The first 15 years, I had the best job in the United States, as far as I was concerned," Mossman said. "The last five years down there got to be pure hell."

Meanwhile, a wave of cheap imports from Asia drove steel prices down sharply, while costs for natural gas and electricity rose. The Asian financial crisis lowered demand for mined metals, which hit the company's grinding-ball business.

The company, along with other steelmakers, successfully petitioned the U.S. International Trade Commission for tariff rate quotas on imported wire rods and also entered the federal loan guarantee program for troubled steel companies -- two remedies at odds with a free-market stance. Romney now says it was a mistake for the government to try to protect the steel industry.

Nevertheless, net losses at the company grew to \$52.9 million in 1999 from \$16.1 million in 1997, while operating income dropped to \$9.6 million from \$37.9 million over the same period -- not enough to sustain the firm's debt and obligations for long.

#### THE BLAME GAME

Charles Bradford, an analyst at Bradford Research, blames the union, in part, for the failure of GS Industries to survive in the new global marketplace.

"If you look at the steel companies that went under at the time, all of them were unionized," he said. "I'm not saying this was the only factor -- these firms faced other headwinds such as cheap labor and a strong dollar ... but the unions held them back."

Union officials blame the Bain managers for saddling the company with too much debt for a capital-intensive, cyclical industry such as steel. "They look at ways to try to leverage the financial resources of the company during an uptick in the markets, stream money out of it and leave wreckage behind them," said the union's Foster.

Regelbrugge blames his successor, Mark Essig, for installing senior managers who did not know the business. "I have no question that the company would have survived under different management," he said. Essig did not return calls seeking comment.

A spokesman for Bain Capital said: "Over \$100 million and many thousands of hours were invested in GSI to upgrade its facilities and make the company more competitive during a 7-year period when the industry came under enormous pressure and 44 U.S. steel companies went into bankruptcy. In the same period, we worked to turn around GSI, we helped launch and grow an innovative business called Steel Dynamics that is today a \$6 billion global leader.... Our focus remains on building great companies and improving their operations."

GS Industries declared bankruptcy on February 7, 2001, and said it would shut down the Kansas City plant, eliminating 750 jobs. In a press release, the company said the bankruptcy was triggered in part by "the critical need to restructure the

company's liabilities."

Workers soon found out what that meant. In April, GS said it was shedding the guarantees it had promised its workers in the event of a plant closure - the severance pay, health insurance, life insurance and pension supplements that had been negotiated during the 1997 strike.

Workers could buy health insurance through the company's plan, but the company would no longer share its costs. For many who were struggling with asbestosis or other ailments contracted during their years of work, the cost was prohibitive.

"The wife and I, we just held our breath and prayed a lot," said Stanger, the ex-millworker. He was quoted a price of \$1,800 per month - more than his pension payment.

#### FEDERAL AID

The U.S. Pension Benefit Guaranty Corp, which insures company retirement plans, determined in 2002 that GS had underfunded its pension by \$44 million. The federal agency, funded by corporate levies, stepped in to cover the basic pension payments, but not the supplement the union had negotiated as a hedge against the plant's closure.

For Joe Soptic, who worked at the plant for 28 years, that meant a loss of \$283 per month, about 22 percent of his pension. Others lost up to \$400 per month, according to documents supplied by the union.

Comparatively, the GS bailout was one of the pension guarantor's smaller hits. The federal fund swung from a \$7.7 billion surplus to a \$3.6 billion deficit that year as it struggled to cover bankruptcies in the steel and transportation industries. The failure of LTV Steel, for example, cost the agency \$1.9 billion.

The agency's woes prompted Congress in 2006 to require companies to contribute more toward their pensions. Press accounts said this change accelerated the shift away from pension plans toward 401(k)s and other defined-contribution retirement plans that offer less security for workers.

Many of the older workers at the Kansas City mill were just a few years away from Social Security and Medicare, but younger workers didn't have that safety net. Even with \$600,000 earmarked by the U.S. Labor Department for job retraining, many had trouble finding work.

"They give you a year's worth of training, you're 50-something years old, nobody wants to hire you," said Steve Morrow, who retrained in the field of heating and air conditioning.

After nearly 30 years as a steelworker, Joe Soptic found a job as a school custodian. The \$24,000 salary was roughly one-third of his former pay, and the health plan did not cover his wife, Ranae.

When Ranae started losing weight, "I tried to get her to the doctor and she wouldn't go," Soptic said. She ended up in the county hospital with pneumonia, where doctors discovered her advanced lung cancer. She died two weeks later.

Soptic was left with nearly \$30,000 in medical bills. He drained a \$12,000 savings account and the hospital wrote off the balance.

"I worked hard all my life and played by the rules, and they allowed this to happen," Soptic said.

(Additional reporting by Tom Hals; Editing by Lee Aitken)