**TPR**
*Interview*

*After nearly a year and a half on the sidelines,* ***BayStar Capital*** *has come roaring back to the playing field: So far in 2003, the firm is the fourth most active PIPE investor, with more than $66 million invested in 37 deals, according to* PrivateRaise. *BayStar has been lead investor in several of the year's biggest deals, including the $210 million* ***XM Satellite*** *convertible debt offering in January.* TPR *visited with BayStar general partner Larry Goldfarb at the firm's Larkspur, California, office and talked with him about the business—past, present, and future.*

***TPR***: Please give us some background on the founding of BayStar Capital.

**Goldfarb**: The first fund was started in 1998. Steve Lamar and I worked together as placement agents in the business, and we felt we really understood what the buyers were looking for. We decided we'd rather be principals than agents, and an investor we had dealt with gave us money to invest.

Back then there was no such word as "PIPE." It also was viewed as a very sleazy business going back to Reg S, in terms of unregistered off-shore paper. We've watched the business grow geometrically in volume and in the development of sound practices. We've watched the people that were playing the periphery fall out of the business and the bigger players come in and do bigger and more legitimate deals.

I remember when we first started we would mention Reg D and people would say, "Oh, those are those 'death spiral' deals." You hardly hear the term any more; those types of deals just aren't done these days. But it was painful back then. We were working hard to build a fundamental shop, but no matter what we did in the beginning, we were still categorized as Reg D toxic-convert death spiral.

***TPR***: What was the original opportunity as you saw it?

**Goldfarb**: Well, in 20-20 hindsight it's easy to say, but what we saw was the ability to give efficient capital to certain companies that needed it for specific reasons, and we saw enough of those specific reasons to build a business on. Even way back when the Wall Street analysts had so much power and the secondary market was in full bloom, we saw many good companies that had tremendous prospects but where either the cost of capital was cheaper [with a PIPE] or it didn't make sense for them to go the route of filing an S-3 for a syndicated transaction because it was too expensive or time-consuming, or they had been burned by Wall Street before.

***TPR***: Did you do any floorless convertibles back then?

**Goldfarb**: We never did one, but it didn't matter. What people didn't realize was that Reg D is just an exception from the securities registration law. When Warren Buffett buys shares in a private placement at **Berkshire Hathaway**, they're Reg D deals. It's just that Reg D has such a terrible moniker. We never did any of those [toxic convertible] deals. In fact when we saw a lot of toxic converts come down—we were the first call on **eToys**, on **@Home**—we said these deals are going to blow up and land on the front page of the *Wall Street Journal*.

***TPR***: BayStar has been very active in PIPE investments in 2003. What parameters are you using to assess opportunities? What is the overall strategy behind the activity?

**Goldfarb**: I don't like to talk about parameters because I'll do something tomorrow and you'll say "But Larry you said . . ." Regarding terms and size, the terms and the size sort of move with each other. The smaller the deal, the more it begins to look like a venture capital deal, because you don't have a lot of liquidity, and venture terms are tough. As the deals get bigger and the companies get more liquid, the terms ease up. In terms of size, we're not going to do a $200 million deal. Would we put out $100 million? In a heartbeat—for the right deal with the right company.

***TPR***: Recently you've executed some energy deals. Is that a strategic move for BayStar or a more opportunistic situation?

**Goldfarb**: It takes on a life of its own, really. You do one deal, and learn a lot about a business. Someone in the industry hears that you did a deal and sees you as a natural buyer for the next deal. I'm expecting we'll see a lot of energy deals in the fall now, because people are getting comfortable that we understand oil and gas, IPP [independent power producers], power manufacturing equipment, and power generation.

***TPR***: This busy year comes after a 16-month investing hiatus during late 2001 and throughout 2002. Why did you pull out of the market during that period? Were you busy raising money or did you not like what was going on in the market?

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**Goldfarb**: It was a weird time in the capital markets. If you go back, the technology bust had just come and everybody got hit phenomenally hard—yet all the major venture capital funds and the LBO funds were flush with so much cash. Now their job is to put out money. Having just been murdered, they really couldn't go back and put new money in private companies—their investors would have gone nuts. So what they did, much to my chagrin, was they started investing in PIPEs. And what you saw was all the LBO and venture firms doing private investments in public companies.

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But in order to invest in PIPEs you need hybrid skills. One is you need a skill set where you can fundamentally understand what companies are, what they do, what their balance sheet is, etc. The other is, you need a trading floor. You need both of these things in order to make a PIPE transaction work well for both sides. The venture firms had no real experience with public equities, because whenever they received them they would distribute them to their investors. LBO firms had experience, but trading wasn't their expertise; **KKR** and **Hicks, Muse** [for example] don't have trading floors.

They put all this money to these companies, and you read newspaper article upon newspaper article about each debacle . . . because what they were doing was giving terms that we couldn't ever live with, and they would agree to things such as lock-ups that we just don't do, because we depend on liquidity. And it blew us out of the market. All we saw were deals that didn't make economic sense, and we didn't understand why people were doing them, so we just sat it out.

I have ambivalent feelings about the period because while all these deals blew up, the big names brought credibility to the business. So on the one hand it kept us out of the business, but on the other hand it brought lots of credibility to see names such as **Forstmann**, **Blackstone**, **Apollo**, in what was really *our* business.

***TPR***: Do you see a permanent place in the market for venture capital-style investors?

**Goldfarb**: I like VCs in my deals—when I'm the lead. Then I get to set up the structure the way I want it. But it's not a good fit, really. The venture capital business is built on the premise of odds. That is, you do 20 deals a year, and you write off X number of them. Then two or three are going to be the next Cisco Systems or Ebay, and they make your fund.

In order for our PIPEs business to be profitable, every deal has to work. Well, when you take this lottery mentality [of the VCs] and you combine it with this business, it doesn't fit at all.

Now, if you are already an investor in a company, and you're a venture fund, then I understand it. And that's what I'm seeing now, venture firms that are already on board, already in the company, participating in what is essentially another round of financing. That makes total sense to me. But for a venture firm to say that PIPEs are a natural extension of its business, that I don't get.

***TPR***: BayStar was a primary investor in one of the biggest PIPE deals of the year, XM Satellite. Can you talk about that deal a bit?

**Goldfarb**: One of the things we did when we built BayStar is we brought on very strong, well-known, and respected partners that had tremendous credibility in the marketplace in different areas. Two of the partners we brought on, Steve Hicks from **Capstar** and Tom Hicks from Hicks, Muse, were the original guys who went out and rolled up radio stations, creating AM-FM Capstar and then selling it to Clear Channel Communications. Through Steve and Tom we came to know the radio industry extraordinarily well.

We don't think satellite radio is a gimmick. It's an application that we see going way beyond people listening to music in cars and in places where they couldn't get good reception, or don't want commercials. We think it is a great medium for the eventual dissemination of data, and these companies have the infrastructure in place now.

***TPR***: What's the best deal BayStar has done? Which one stands out as a clear home run?

**Goldfarb**: I think that it is very important to understand [that] that's not how this business works. We're singles hitters. We don't hit home runs. But we hit a hell of a lot of singles. We're like a lead-off batter: We get on base a lot, and we rarely strike out.

***TPR***: What about your worst deal?

**Goldfarb**: Well, I'm not going to name them, but I have done two deals in which, in effect, we were defrauded. The sellers lied about material information. If we had known, we would have never done the deals. If we were a litigious group we would have probably sued them. In these two situations the management had material information that they knew something bad was going to happen; we gave them money and then, right thereafter in both cases, it happened, and we lost our money.

***TPR***: There has been a lot of press about PIPE investors that prey on small companies. But in talking with some of the investors that are parties to lawsuits in which these accusations have been leveled, there's often the charge that there's really two sides to this game, that there is a minority of corporate officers out there that see a PIPE investment as a last opportunity to use their stock as currency to line their own pockets before the company hits the wall.

**Goldfarb**: Yes, but with all due respect to the investors who are claiming that the lawsuits against them are without merit, maybe they should've not invested in those companies in the first place. Maybe they should have known that the use of proceeds wasn't appropriate.

Of course, there are a lot of unfair lawsuits, but there are a lot of fair lawsuits as well, where the investors were not good guys, and they knew what was up, and they were going to make money regardless of whether the stock went up or down. That's not what this business is about. Some of these lawsuits are deservedly so. That doesn't mean that the issuers aren't guilty as hell, but don't think that sometimes investors didn't know about it. If you invest in a shady management team, you should expect that bad things may happen. Sometimes people get what they deserve.