

## HARMAN INTERNATIONAL AND KKR (A)

On the morning of September 21, 2007, Sidney Harman and Henry Kravis sat at a conference table overlooking Central Park in the New York office of Kohlberg Kravis Roberts & Co. L.P. (KKR). The purpose of the meeting was to determine the fate of an \$8 billion private equity transaction between a group led by KKR and the renowned audio-equipment maker Harman International Industries, Inc. (Harman International). It had been 10 months since Kravis first approached Harman about acquiring Harman International. Kravis, cofounder of one of the world's leading private equity firms, had made the first direct pitch to Harman in his Washington, DC, office. Kravis strongly believed the time was right for Harman International to go private.

Harman was initially reluctant to sell because Harman International was experiencing robust times, as exemplified by its recent financial performance, and he enjoyed being at the helm of the company as executive chairman. "This is how I define myself. This is my life," he said.<sup>1</sup> Yet there were compelling reasons for him to consider Kravis's offer. Although vigorous at heart, Harman was 88 years old. He also recalled the difficult time replacing former CEO Bernie Girod. Girod, after more than 20 years with the company, had recently retired, but his successor had lasted only a few months. Harman also knew he would receive a financial windfall from the sale: He owned approximately 5% of the company's common stock, and the value offered by KKR and its partners would provide more than \$400 million in financial security for him, his wife (U.S. Congresswoman Jane Harman of California), their extended families, and their many philanthropic interests.

### Harman International

Harman and Bernard Kardon founded Harman International in 1953. At the time, the two men were engineers working for a company that produced amplifiers for television sets. Their collaboration produced the world's first stereo receiver in 1958, but for personal reasons, Kardon

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<sup>1</sup> Carol J. Loomis, "An Old Hand in a Strange New World," *Fortune*, January 23, 2008.

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This case was prepared by Daren Dickerson (MBA '09) and Paul J. Simko, Associate Professor of Business Administration and Associate Dean, MBA for Executives. It was written as a basis for class discussion rather than to illustrate effective or ineffective handling of an administrative situation. Copyright © 2010 by the University of Virginia Darden School Foundation, Charlottesville, VA. All rights reserved. To order copies, send an e-mail to [sales@dardenbusinesspublishing.com](mailto:sales@dardenbusinesspublishing.com). No part of this publication may be reproduced, stored in a retrieval system, used in a spreadsheet, or transmitted in any form or by any means—electronic, mechanical, photocopying, recording, or otherwise—without the permission of the Darden School Foundation. ◇

left the company a few years later. Harman went on to become a pioneer in the audio industry in a journey that was anything but routine.

Early in his career, Harman had served as president of Friends World College, an experimental Quaker school for higher education, located in Long Island, New York. He later earned a PhD in social psychology, adding an academic touch to his executive management style. In 1976, President Jimmy Carter appointed him deputy secretary of commerce. The potential conflict of interest associated with running a successful technology company mandated that Harman relinquish control of Harman International to accept the government position, so he sold his company to Beatrice Foods (Beatrice) in 1976 for \$98 million.

Beatrice was a multinational conglomerate with approximately 200 subsidiaries that served a variety of markets. The company became a leader in the food-processing industry during the 1950s and then leveraged its distribution network to acquire other food companies. Eventually, Beatrice broadened its product base integrating such firms as Avis Rent A Car and Playtex. But the company's acclaimed distribution network did not fit in a burgeoning audio industry typified by audiophiles who had launched their companies in small specialty shops.

Because Beatrice had little success running Harman International, after completing his government appointment four years later, Harman repurchased what remained of his company. The rest had been liquidated. He would later state that two of his finest business decisions were first to sell his company to Beatrice and then later to buy his company back from Beatrice.<sup>2</sup>

Harman International was now the leader in designing, manufacturing, and marketing high-quality, high-fidelity audio products and electronics systems for the automotive, consumer, and professional markets. The company's later success was largely due to the development, both internally and through a series of strategic acquisitions, of a broad range of product offerings sold under renowned brands. These brands included legendary names in the audio field such as Harman/Kardon, JBL, Infinity, Mark Levinson, and Becker (**Exhibit 1**).

The company was organized into three divisions based on end user markets: automotive, consumer, and professional. Automotive designed, manufactured, and marketed audio, electronic, and infotainment systems for vehicle applications. Infotainment systems were a combination of information and entertainment components that included or controlled GPS navigation, traffic information, voice-activated telephone and climate control, rear-seat entertainment, wireless Internet, hard-disk recording, MP3 playback, and a premium branded audio system. Major automotive customers included Mercedes-Benz, BMW, Audi, Porsche, Land Rover, Toyota, and Chrysler.

The consumer division designed, manufactured, and marketed audio, video, and electronic systems for multimedia, home, and mobile applications. These applications included

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<sup>2</sup> Ironically, KKR later acquired Beatrice in 1986 for \$8.7 billion, which was the largest leveraged buyout in history at that time.

home theatres and accessories for portable electronic devices including music-enabled cell phones such as the iPhone and MP3 players including the iPod.

The professional division focused on loudspeakers and electronic systems used by audio professionals in concert halls, stadiums, airports, houses of worship, and other public spaces. (**Exhibit 2** provides a summary of financial information about the company's three divisions.)

### **KKR and Partners**

KKR was a private equity firm founded in 1976 by Jerome Kohlberg, Henry Kravis, and George Roberts, all former colleagues at Bear Stearns. The three men were credited with being pioneers of the leveraged buyout (LBO) industry, and in 1989, their firm gained worldwide notoriety with its LBO of RJR Nabisco. This specific transaction later was the inspiration for the book *Barbarians at the Gate*, and the firm's panache remained vibrant many years after that legendary transaction. During the first five months of 2006, KKR announced deals to acquire all or parts of 30 companies for a total of \$215 billion. For all of 2006, the firm had 36 companies in its portfolio generating more than \$107 billion in revenues. (**Exhibit 3** provides a geographic summary.) Since its founding, KKR had completed approximately 150 transactions with an aggregate value of more than \$279 billion.

Private equity firms often partnered with investment banks when conducting large transactions in order to share equity financing. In fact, the Goldman Sachs Group, Inc., (Goldman) acted as a strategic partner with KKR to take Harman International private. KKR and Goldman together committed approximately \$3.5 billion of equity financing for the acquisition.

### **Private Equity**

Private equity, by definition, referred to equity securities that were not publicly traded on an exchange. The source for private equity capital was typically institutional investors or investment funds that specifically targeted undervalued or distressed companies. These investments often required long holding periods in order for the target company to undergo a restructuring to restore value in the company. The goal of private equity investors was to eventually sell their shares in the now more profitable company. Other than Goldman and KKR, there were many other notable firms in the private equity industry that competed for undervalued companies. Among the largest and most active KKR competitors were Blackstone Group L.P., Carlyle Group, and TPG Capital. (**Exhibit 4** illustrates the role of private equity firms and the private equity funds that made investments in target companies.)

In a typical LBO transaction, private equity firms set up *Parent* and *Merger Sub* entities for the sole purpose of conducting the transaction. The Parent was controlled by the private equity fund, which was affiliated with the private equity firm. The Merger Sub was the vehicle that sought debt-financing commitments from investment banks. Once the Merger Sub had the