NEW YORK (Dow Jones)--The Blackstone Group's decision to sell a piece of itself to the public is generating lots of talk about its ultimate game plan.

The private-equity giant will use some of its expected $4 billion from its initial public offering to buy out founding partner Peter Peterson and some to fuel its principal asset-management businesses. But it also may be planning for a time when the rich fields of private equity dry up.

Its preliminary prospectus filed two weeks ago offers some hints of how it could use its new capital to compete with Goldman Sachs Group (GS), Morgan Stanley (MS), Merrill Lynch & Co. (MER) and other firms that count it as one of their best clients. (Blackstone paid Wall Street $620 million of investment-banking fees last year, according to Dealogic, more than any of its rivals. Private-equity firms together larded Wall Street with $14 billion.)

"We may also consider pursuing strategic acquisitions ...that will either be complementary or additive to our existing businesses," the prospectus says.

Blackstone mints its money ($2.3 billion of profit over the last four years) from asset management, not investment banking. But it has a small unit that books fees from advising the very companies it buys and sells, and its preliminary prospectus implicitly sassed some of its Wall Street competitors.

"We are not engaged in securities underwriting, research or other similar activities that might conflict with our role as a trusted financial advisor," it said. "We believe that this makes us particularly well-suited to represent boards and special committees in the increasing number of situations where they are looking to retain a financial advisor who is devoid of such conflicts."

That paragraph could have come straight from the brochures of Greenhill & Co. (GHL) or Perella Weinberg Partners, whose namesake founders boast of advice untainted by the banking, proprietary trading and investing activities of the full-service banks where they made their fortunes.

Wall Street is returning the favor by raising its own private-equity funds that invest with, and at other times compete with, private-equity clients. In a reminder of his firm's clout, Goldman Sachs Chief Executive Lloyd Blankfein last week said it will raise up to $20 billion, "maybe a little bit less, maybe more," for a private-equity fund. Blackstone, which didn't include Goldman in the team of six firms leading its IPO and boasted in its prospectus that as of early March it had raised more than $18.1 billion for its latest effort, the "largest fund of its kind ever raised."

Competition Cuts Both Ways

When Wall Street isn't competing with private-equity firms, it's steering them to acquisition candidates, helping them raise debt to buy the firms and booking more fees by selling or taking public the companies it helped them buy. Blackstone could seek more of that action - it already gets fees for giving banking advice to its portfolio companies - but many observers are skeptical.
"Wall Street has little to fear from the private-equity firms," says Colin Blaydon, director of the Center for Private Equity and Entrepreneurship at Dartmouth College's Tuck School of Business. "It's probably the other way around. The major investment banks, with their substantial capital resources and their very sophisticated staff, may become very successful merchant banks. They could be the dominant players in both spaces."

Goldman already is. Wall Street's top merger advisor ended its fiscal year last November with $10 billion of principal investments from its funds and its investments in Sumitomo Mitsui Financial Group (8136.TO) and Industrial and Commercial Bank of China (0349.HK). Its private-equity fund performance bested even Blackstone with an internal rate of return before fees of 42%, according to The Wall Street Journal. It also had $3.7 billion of private equity and restricted public equity securities on its books.

Blackstone knows Wall Street well. It was founded by Lehman Brothers (LEH) alumni Peterson and Stephen Schwarzman, and many of its employees have deep Street backgrounds.

Only too aware that the private-equity juggernaut will come to a heart-dropping halt if low interest rates that finance their buyouts suddenly rise or equities markets that underlie their cashout strategies collapse, they could be eager to diversify.

Glenn Hubbard, former head of President Bush's Council of Economic Advisors and now dean of Columbia University's Graduate School of Business, last week forecast that higher interest rates on junk bonds will make private-equity deals "more costly and less attractive" while increasing competition among the firms will drive up acquisition prices. "We won't necessarily see very high returns in private equity as far as the eye can see," he said on a National Public Radio broadcast.

Richard Bove, a brokerage firm analyst at Punk Ziegel with a gloomy view of the economy, says he is hearing that private-equity firms are plummeting to low single-digit levels on returns that are "totally unacceptable."

In a piquant paragraph in its preliminary prospectus, Blackstone says it plans to eventually borrow three to four times its stockholders' equity in an attempt to increase returns. That could mean borrowing as much as $16 billion, based on expectations it will raise $4 billion in the IPO.

Could Blackstone use the money to invade Wall Street with a bang, by merging with a willing equal partner? The company's valuation of $40 billion - if it sells 10% for $4 billion - could make it larger than the market capitalization of the slightly smaller Lehman and much smaller Bear Stearns Cos. (BSC).

"Given that Schwarzman came from Lehman, everyone finds that most titillating," says the Tuck School's Blaydon. "It's unlikely but certainly possible they would decide to use this capital and these public securities to build a major new financial institution and compete with Goldman and Morgan Stanley and Merrill."

A spokeswoman at Lehman, which is leading the Blackstone underwriting with Morgan Stanley, declined to comment.