Q3 2017

Privcap/ Report

Includes a bonus interview with

Terrence Mullen

Partner,
Arsenal Capital Partners

Dealmaker Roundup

Featured Topics

Where Were the Big Deals? In Asia

Deals in Review

Where Are the Banks?

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About This Report

This publication is a companion to Privcap's Dealmaker Roundup, a quarterly video program on the latest trends in private equity dealmaking.

Click to watch the full program

About the Experts

Michael Fanelli is a partner in the Transaction Advisory Services practice at RSM US LLP, focusing on retail and consumer products and business and professional services. He performs transaction advisory services on both buy-side and sell-side transactions, assisting both financial and strategic buyers. Prior to his transaction advisory experience, Fanelli worked as a controller of a middle-market company and as an auditor at a Big Four accounting firm.

Learn more about **RSM here.**

Ryan Flanders is the head of Private Debt Products at Preqin and leads all efforts within the private credit asset class. This includes direct lending, mezzanine, distressed debt, venture debt, and special situations. Preqin is the alternative assets industry's leading source of data and intelligence. Flanders has been with Preqin for over five years and is a Chartered Alternative Investment Analyst (CAIA).

Learn more about **Preqin here.**

Giles Tucker has more than 20 years of investment banking and investment management experience. He was with Harris Williams & Co. for 13 years, during which time he served as a managing director and as co-head of the Energy & Power Group. Tucker co-founded investment management firm Blue Edge Capital, LLC, before returning to Harris Williams & Co.

Learn more about **Harris Williams & Co here.**

David Snows is CEO and co-founder of Privcap Media, the leading channel for thought leadership in private capital investment.

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Where Were the Big Deals?
In Asia

A panel of private equity deal experts recently discussed the trends behind the deal statistics of Q3 2017 and found steady activity in the global middle market, a dearth of U.S. mega-deals, but an uptick in public-to-privates, especially in Asia.

Privcap: By way of deal volume, it was a relatively flat quarter. There are still plenty of middle-market to lower-middle-market deals happening, and yet the larger deals were not happening, given how much capital has been raised for mega-deals.

Ryan Flanders, Preqin: I think you hit the nail on the head in terms of volume. If you look at this point last year, we had 61 deals over $1 billion in value. This year, to date, we've had 53 deals over $1 billion, so there's a bit of a gap there in terms of volume at the higher end of the market.

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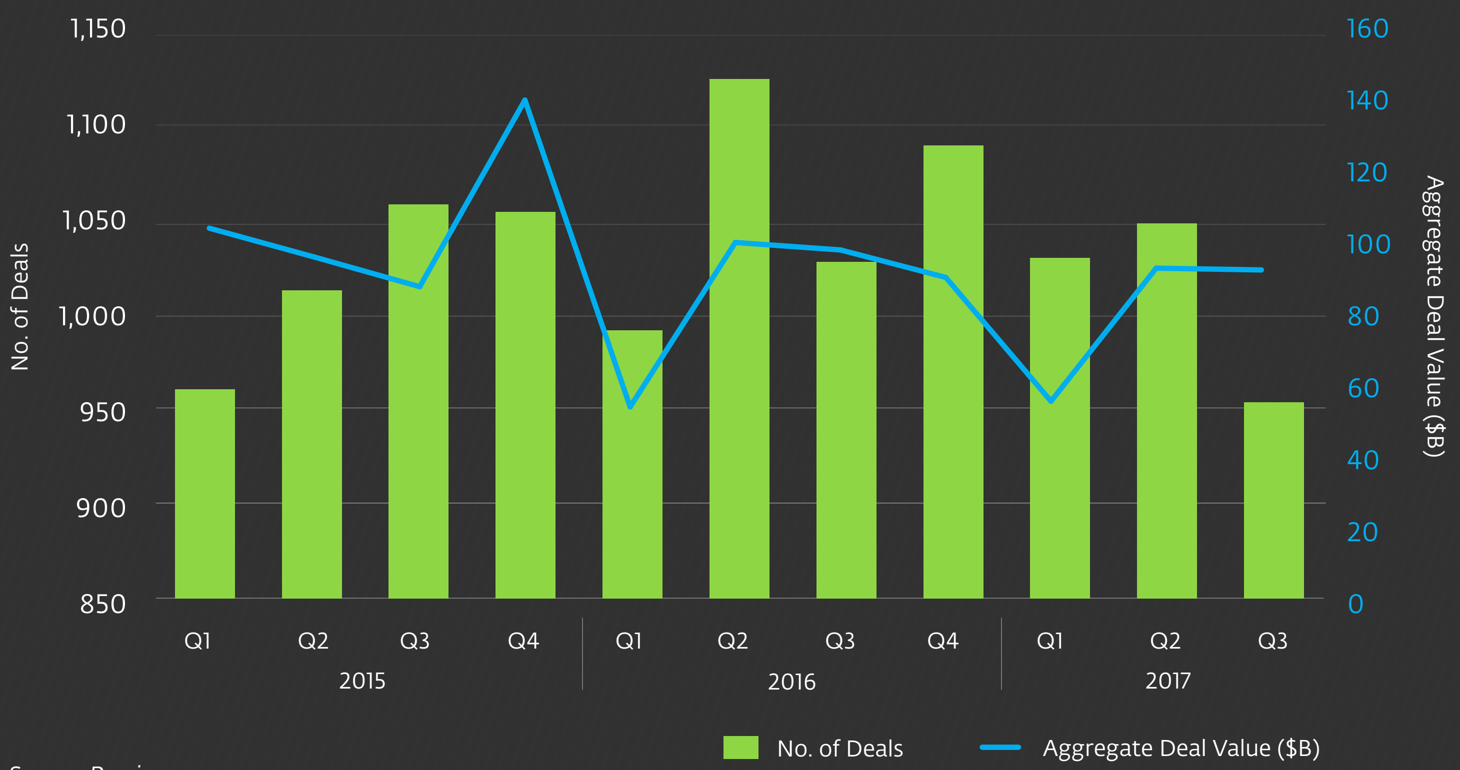
Even Keel: Global Private Equity Deal Volume and Total Value



Source: Preqin

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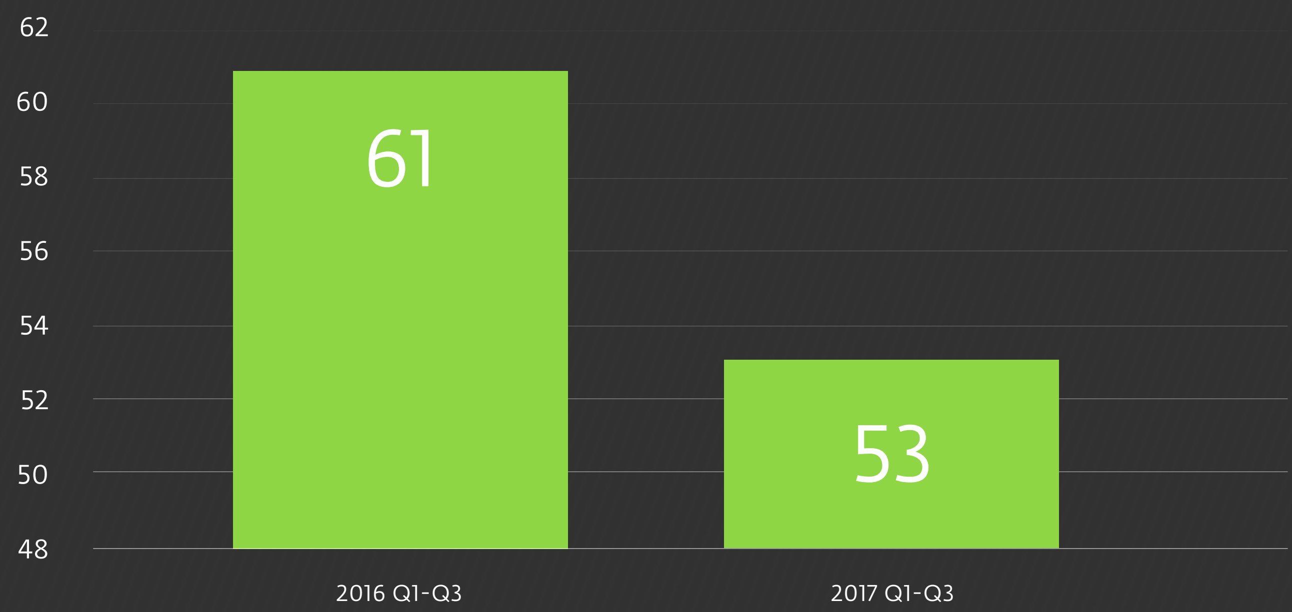
Mega-Decline: Number of $1B+ Deals Globally



Giles Tucker, Harris Williams: I just don't think one quarter really makes a trend. If you think about the key pillars you need to have a strong M&A market, they're all here. You've got ample liquidity in the form of private equity capital overhang; you have record levels of cash on corporate balance sheets of corporations. You back that up with increased confidence in the boardroom amongst management teams. For the first time in a number of years, most global economies are in growth mode right now. The global central banks have got everybody in sync. We're in a golden age of private equity buyouts right now.

Michael Fanelli, RSM: We're very busy in the middle market, especially with the private equity. The market is going through a transition right now where we think tax reform is going to happen. Some of the larger investors might be holding back a little. Warren Buffett came out and said, "Why would I sell something this year and pay $350 million in taxes when I could sell it next year and pay $250 million in taxes?"

We have a middle-market business index, in which we survey 700 middle-market executives. That barometer actually declined for the first time in Q3. I think it might be due to, again, regulatory and tax uncertainty, and a little bit of geo-political uncertainty.

Tucker: I would add that these are pretty unprecedented times in terms of purchase multiples that are being paid in the market. You have to go all the way back to 2007, which people widely regard as one of the best M&A markets ever, to see multiples similar to what private equity groups are having to pay today. So people may be hesitating to jump into such a frothy market. We're seeing those multiples at that level across all 10 of our industry groups.

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Asia Harbinger

There were a few pretty notable large deals that were announced in Q3. All of them were public-to-privates, which may be a harbinger for what is to come. What's very interesting is that the two largest deals announced in Q3 2017 are both in Asia. Let's talk about the proposed buyout of the memory chip division of Toshiba.

Tucker: Capital is going to flow to where the best opportunities are, and that's just the way that the private equity industry works. I think you're seeing greater opportunities in Asia, perhaps at a little bit better values than you are here in the U.S.

The other thing that you're seeing is a proliferation of deals going on in the chip and semiconductor space. Historically this has been viewed as a very cyclical business. I think people are beginning to view that industry a little bit differently, given the tailwinds that are behind it. It's almost a derivative play, right? Chips are going into everything from refrigerators to smartphones to your car. Private equity is anticipating the Internet of Things, this growth that's happening.

Flanders: If you look at the cash that sits on balance sheets for some of these companies, them partnering up with larger private equity shops and finding opportunity to put that capital to work in may be more efficient than leaving it on the balance sheet.

Fanelli: The most interesting thing about that deal is you have a large private equity firm teaming up with other corporates to do a very large transaction and an international nature. This might be the tip of the spear of things to come in the next few years.

It's amazing that this is in Japan, which is one of the largest economies in the world, has some of the largest companies in the world, and yet has been almost a zero as far as private equity spinout activity. So here's a large corporate division from a major company in Japan ridding itself of one of its divisions, partnering with private equity. If this is the beginning of a trend, it could be a pretty big trend.

Singapore Logistics

The next Asia deal I want to talk about is Global Logistics Properties. What's notable is that there are no Western private equity firms that are part of this transaction. It is led by a couple of very large Chinese private equity firms, which points to the ascendancy of Asian private equity as a global force.

Tucker: Asian private equity groups, in particular those based in China, are very active across a number of our industry groups looking at a number of strategic assets. They're typically looking for businesses and industries where they can gain some kind of advantage from a technology standpoint.

Flanders: What we're seeing is corporates in Asia providing capital, partnering with U.S.-based PE firms that in some cases are fundless PE firms, but partnering with them to provide them set amounts of capital.

> "You have a large private equity firm teaming up with corporates to do a very large transaction. This might be the tip of the spear of things to come."
>
> –Michael Fanelli, RSM US LLP

Power to Canada

The third-largest announced private equity deal in Q3 was Calpine Corp., a power company. It's a deal that includes a private equity firm called Energy Capital Partners, as well as CPP Investment Board, a large Canadian pension.

One interesting trend that we're seeing is these pension funds doing direct co-invests with U.S. private equity firms, so they're also invested in the funds, but they want to do the direct investments alongside them for certain direct deals, so that they're removing some of the two-and-20 financials dynamics from just being invested in the fund.

Tucker: When pension funds go direct, they have a lower return threshold than your typical private equity group. They're trying to match their obligations with their investments, and if they can achieve a net 11 percent to 12 percent IRR on their investment and they have a 7 percent to 8 percent corresponding long-term liability on the other side of the balance sheet, that works for them, so they can get really aggressive in some of these deals.

Where Are the Banks?

Ryan, you oversee private debt products at Preqin. There is indeed a large appetite for providers in debt finance to the right private equity deals, correct?

Flanders: Absolutely. You see more and more private financing. That's a trend that we'll continue to see as some of the leveraged loan markets become overheated.

Fanelli: It's a very competitive marketplace right now, and the whole key is non-bank lenders. I don't recall seeing an actual bank lender on a deal in the past 12 months. Every single deal, the PE firms bring in five or six non-bank lenders, sometimes a lot more. And they're at the table they're competing. ■

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POWER HOUSES
IN PRIVATE EQUITY

Terrence Mullen

Insights from the world's leading investors and dealmakers

Terrence Mullen
Partner,
Arsenal Capital Partners

A SLEEPER HIT

You have a big presence in specialty chemicals. What opportunities are you seeing today?

The abundance of natural gas, oil, and cheap feed stocks, combined with a tremendous amount of technology and innovation in material science, is creating much exciting growth opportunities. Last year, we combined four businesses to build what is the world leader in the next generation of polyurethane bedding. They supply the "bed-in-a-box" phenomenon from companies like Casper, Tuft and Needle. That business is growing at huge rates because of a superior science and innovation and a great consumer product. ■

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