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Moderated by
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ROUNDTABLE

DEAL ORIGINATION AND TRANSACTIONS TODAY

Real Deals brings together a group of leading investors and advisers to discuss how GPs are sourcing deals in an uncertain environment, and how advisers are helping them navigate processes.

Photography by **Phil Bourne**

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Jonathan Arrowsmith

It is very clear when a management team has been well prepared and it makes a big difference. This briefing can take a year until they're at that point.

Martim Avillez

With fast-rising interest rates and the highest inflation for decades, what are the best opportunities in today's backdrop?

Chris Price: The fundamentals have not changed, with a focus on revenues still very important, but whereas we used to base this on historical performance, it may no longer be the case. As a result, we're being harder on our origination team now: why has the business grown as it has, and what will it do in the years to come? For example, wealth management is a good sector for us since time has proven that their clients stick with their managers; the drivers are still the same. It gives us conviction on the five-year revenue streams for these companies, so we're more comfortable stepping into the dark over the next 12 months.

Isabelle Pagnotta: We focus on resilient businesses, and this means revenues that are visible and repeatable. You need to have conviction that the business is not only resilient, but also that you can help it to create value with a combination of organic opportunities as well as acquisitions. This way, if the organic growth potential is soft you can complement it with bolt-ons.

Jonathan Arrowsmith: Resilience is definitely key: a mandate we are working on now includes three slides on resilience in the initial deck. Instead of reviewing cost base in the second wave of marketing documents collateral, it's being done upfront as it'll be challenged by the IC at the outset, and they need a thought through viewpoint.

Suzanne Pike: There is a flight now to profitability and cash as well as growth, by both private equity and debt funds who both still have capital to deploy. Competition for businesses that are resilient and growing organically will therefore still be high and they will continue to transact at healthy valuations.

What changes are we seeing in the market as a result of the current backdrop?

Phillip McCreanor: There is currently a lot more liquidity than we had in the GFC, but the threshold to secure lending is very high right now. This is because today we have more than just banks lending on deals – the challenge in today's environment is that pricing is very challenging. What are lenders and GPs signing up to now? You can't look at any numbers with any certainty, and so we'll likely see a pause in terms of deals being done until we get more clarity.

Arrowsmith: The cost of capital has changed. When you get debt now, the all-in cost is much higher and a turn or two lighter than it was a few months ago. Effectively it means you have a very different capital structure, and it will take a lot of working through. There is a risk of a sponsor struggling to get the debt. They can use GP facilities to overcome this in the short-term, but need to ensure they can get it down the line.

Richard Roberts: I think you'll see around two-thirds of business sales recently or currently in process will not occur in the short-term, given both the bid-ask gap and a focus by GPs and LPs on the current vintage to make sure people don't do anything careless. Investment committees should rightly be cautious on terms. The market had no bid/ask in 2008 and for non-trophy assets, we likely have one now.

Stewart Licudi: There is definitely still a gap in expectations between buyers and some sellers, with the latter holding onto unrealistic expectations of value. It means the spread of bids will be wider. We also see some lenders' ICs continuing to transact, but cutting what they are willing to hold, so whereas you may have needed two lenders before, you now need four or five for the same quantum. It means we will see club deals come back.

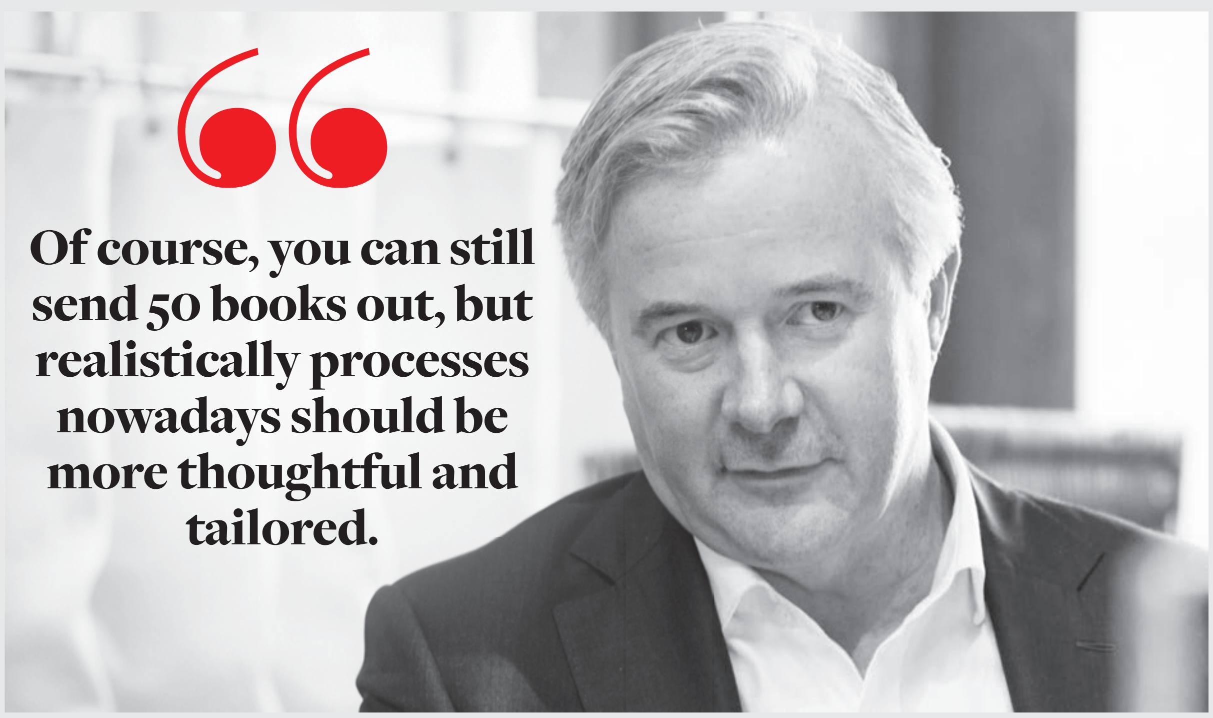
Pagnotta: We work closely with credit funds, so we can continue to invest. Debt margins are higher now so for a private equity buyer it may be more expensive – but on the other hand, we expect valuations to revert to healthier levels (for the buyer).

Price: In 2008 there was a pricing crunch, but now we have liquidity alongside inflation, and we don't know what impact that will have on businesses. So people may sit on their hands as investors until they understand what it will all mean.

Rudi Pattni: This market will create a number of opportunities from a special situations perspective, that we are already starting to see. For example, carve-outs of non-core positions, rescue financings, debt for equity swaps, family-owned businesses that need investment, and opportunities to buy stakes when a fund is at the end of its fund life.

With so many firms chasing the best assets, how can you differentiate yourself as a buyer to maximise your success?

Stewart Licudi



Phillip McCreanor

deals were done 20 years ago and reusing some of those tools.

Pattni: As a special situations investor, we are about speed, flexibility and structure. We aim to provide stakeholders with a creative solution which allows other parties to exit neatly, and they typically seek a quick solution.

How can sellers make the best impression to find the right partner for their next stage of growth?

McCreanor: The importance of management is paramount. Good businesses are typically run by fantastic management teams, but making sure they're properly briefed ahead of engaging with investors or debt providers is really important in uncertain times. Of course, you can still send 50 books out, but realistically processes nowadays should be more thoughtful and tailored. Getting that engagement with potential investors is really key to success in today's environment.

Martim Avillez: It is very clear when a management team has been well prepared and it makes a big difference. This briefing can take a year until they're at that point. You can also see when you acquire from a private equity firm rather than a founder, with the former typically better prepared at coaching management teams in engaging with prospective partners. Getting creative with structures to appeal to the involved parties and ensuring it works for them is important, too.

Arrowsmith: There is a real premium on relationships and trust in this market. It's partly innovation and creativity, but as an adviser, you need to get really tight with the sellers as well as the buyers. You must treat both parties well since you don't want to hear 'why did you put them in front of me?' Some private equity houses can come in poorly prepared and it reflects badly.

Adam Philippsohn: It's important to get to the management team early to build a relationship, understand what the management team have achieved, and what drives their appetite to grow the business so that you can understand their aspirations ahead of a transaction. All this helps us build conviction ahead of time and therefore deliverability. Effective mapping in our areas of focus as well as our regional networks enable us to build long-term relationships locally with entrepreneurs. We only do minority investing from an evergreen balance sheet; this gives us the ability to follow our money and we are not reliant on fund lifecycles.

Pagnotta: Time is very important to successful partnerships. It's about stepping back to determine what the 10 deals are that you want to do over the next two years, and then actively pursuing them by tracking them in a very disciplined way, rather than waiting for them to come to market. It starts with identifying targets in certain key verticals, tracking them, building relationships with the management teams you are impressed by and building your conviction from there. It takes time to do this.

Pike: The three keys to winning are price, deliverability and management relationships. You have to get all three right every time. Subsector expertise and direct early access to management give you the building blocks to get there. You may pay a full price, but you'll have conviction in that price.

Price: We've seen a return to practices we've not used in deal structures for a while, such as ratchets to help vendors feel they are still achieving the price they had 12 months ago. We build in protection so the buy-side can be at the table in a tricky situation. We are dusting off textbooks about how

Isabelle Pagnotta

Licudi: Doing deals is complicated, but people who haven't been in the business for long aren't aware of this since the last few years have given this illusion that it is really easy. It's not about putting a "For Sale" sign up and having a quick feeding frenzy; it's about differentiation and that is about devising a sophisticated approach and structure to a deal. ICs have different risk appetites, GPs are all at different timings of fund deployment – it all makes a difference and so pitches need to be tailored to cater for the requirements of the audience.

How has origination evolved? Is tech playing a bigger role?

Philippsohn: There are lots of tools we use to access high-quality information, and we combine them to do effective market mapping and enhance our own analytics. It's about doing the research thoroughly and using the tools and software at our disposal which have developed a long way in the last four years. We then approach companies directly. We get lots of meetings off the back of this process, then it's about shadowing those companies. We also use the experience of our talent network when considering whether to pursue a deal. It's a very powerful differentiator that helps us get up to speed on an opportunity quickly.

Pike: We typically see businesses 4.5 years ahead of a transaction. We have an AI platform in-house called Amplifind that has been trained using proprietary Salesforce data based on our 20-year origination function and 30 years of our own CRM data. Amplifind helps us find the hidden gems sooner and with far less resources to get there. The hit rate of businesses reviewed to qualified leads added to Salesforce has improved 8-fold since we launched the platform. The use of tech and tools after that is about the conversion machine helping focus the investment team's time and energy on the next most powerful actions in our pipeline. The goal with tech & systems is to minimise time spent on activities that can be automated or are lower value, cutting through the noise so we can maximise attention on those businesses we want to get into our portfolio.

Pagnotta: We firstly brainstorm as a team about the end-markets we want to be in, and we draw on our network of industry experts to share views. Once we map out what the interesting themes will be over the next five to 10 years, we try to identify businesses in those areas. Digital helps this process but we start with human input and overlay the tech to progress it.

Avillez: Our team of in-house operating partners are sector aligned and we use them for origination on top of their roles with our portfolio companies. Their networks and knowledge bring real credibility to our relationships with management teams. After we highlight potential opportunities, they will be hugely valuable in assessing them, with their input on top-level drivers really crucial.

Price: We operate at the smaller end and so rely differently on tech, since businesses only tend to get captured once they reach a later stage of development. For this reason, we need to rely more on people to track businesses sooner.

Pattni: We typically work with our network of operating partners in Europe, who help us find off-market opportunities. We also look at certain thematics. For example during Covid, we looked at hospitality, particularly hotels and pubs, so we got to know the relevant advisers and operators within that space and we found interesting deals that way. For us, it's more about finding a thematic to focus on and then connecting with people who are close to that space.

How can advisers add value, and what role can tech play in this?

Pattni: We don't normally participate in auctions, we source 80% of our opportunities off-market. But now we're getting advisers approaching us directly and quietly, as formal processes break down.

McCreanor: We run our entire practice along sector teams who in turn use various tech platforms to assess which businesses are on the move within individual sub-sectors. We overlay this with our global footprint to help GPs, and it works well. For example, my sector teams in the US are very important as they identify bolt-ons as potential for future growth and can help with introductions. This helps to plug gaps in domestic GPs' reach and knowledge when they go cross-border.

Roberts: It's very important that advisers tailor their efforts in the current market. I'm still surprised on the GP side when an adviser comes through with a thick book of deals and they've not filtered it; it is very inefficient.

Arrowsmith: We offer advisory as well banking and so lots of relationships within that, including lots of private companies we have relationships with. Many are too small for private equity now, but will grow and we've created an AI database for this. We shape and filter it as a clever source of origination, with tech really enhancing the process.

Pike: The role of adviser in origination is absolutely still crucial. We look at businesses earlier, but advisors are doing the same, it's proper deal craft where we unlock opportunities together. If we are shown something of interest to us by an advisor that we hadn't already identified ourselves though, we do an internal autopsy to understand how we'd missed it.

Pagnotta: We're expecting more quality now and interesting ideas from advisers, rather than logos and decks.

Avillez: We look to buy-and-build as a growth strategy and so it's not just about knowing the market but actually having access. A strong adviser can bring you credibility to a process or with a team.

Licudi: We use AI to show people their behaviour over time in

Rudi Pattni

Adam Philippsohn

processes. It's helpful for them to look at where they won and lost in deals to help them understand where they've possibly taken a misstep (for example, establishing a great relationship with management but being way off on pricing). You need to have a long relationship with them and have worked together on a number of deals to get quality data but that is the case for many of our repeat PE clients. To help clients understand this, we've brought together lots of data and information and digitised it so we can layer in the AI over the top. It can reveal where funds fall down – for example where they've not bid up and then with the benefit of hindsight realise they should have.

Are advisers' schedules still very busy and thus impacting timeframes?
Price: The messaging has changed a bit recently. At the beginning of the year, I had a bunch of 'no, we're booked through the summer' but now there is more capacity and people are taking work where they can get it.

Roberts: There is a wave of deals coming and it remains to be seen whether they have the capacity and specialist skillsets to manage it.

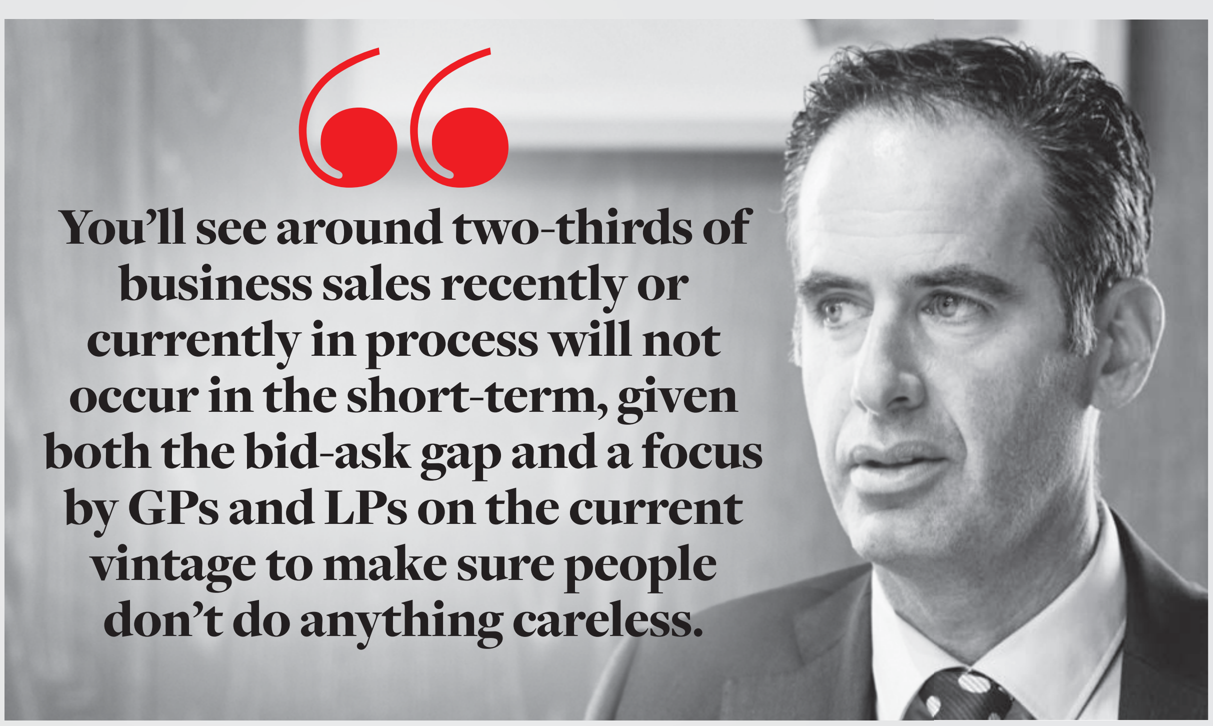
And finally, what is your take on how lenders are behaving in the market in this new environment?
Arrowsmith: If you went back 20 years, banks were there immediately if something went wrong. Now there are more creative ways where lenders can extend the credit. They're less quick to restructure and more about collaboration. Direct lenders were set up to be light-touch with borrowers; they have very limited covenants and are often much closer to the equity, but they are not natural owners of businesses.

Pattni: Financing documents are loose with cov-lite, meaning defaults will take longer, so it'll be more about running out of cash. Banks have been forbearing and the excuse has been Covid. Now it's a true recession but with inflation on top. It will be very difficult, and they don't have the tools of 10 years ago like debt-for-equity swaps, amend-and-extend, etc. Banks are better capitalised this time around, unlike last time when they were balance-sheet insolvent, so they can now offload loans much faster. I'm less sure about direct lenders – since they've been going since 2010, they've never navigated such a difficult market. The advisers are doing contingency planning as they await a wave of defaults.

McCreanor: There are more debt funds, but most are yet to be tested through a crisis. They may look at alternatives, for example we may see direct lenders start pushing assets into continuation funds, the way we're seeing GPs do this.

Suzanne Pike

Chris Price



Richard Roberts