

Buyouts

Unprecedented Heights: Deal Volume Continues Ascent

By Kenneth MacFadyen

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The dealmakers have done their part to live up to the hype. They've taken the record levels of funds raised over the past couple of years, and plowed it right back into the market, resulting in another \$50 billion-plus quarter of deal volume.

The half-year sum of disclosed completed deals represents a roughly 39% gain over the same period last year, itself a record-breaking 12 months. Broken up by quarter, U.S. private equity investors completed more than \$59 billion worth of deals in the second quarter, following up on a three-month span that saw almost \$51 billion in disclosed transactions.

Considering some of the deals currently pending—the \$12.3 billion Univision buyout, the \$14 billion takeover of GM's GMAC financing unit and the \$22 billion Kinder Morgan take private—2006 will very likely surpass last year's record sum with ease. And according to deal pros, there is nothing on the immediate horizon that can stop the momentum.

“If you step back a bit, the capital hangover going into 2005 stood at about \$125 billion of dry powder. Add another \$200 billion or so since then, and that represents over \$1 trillion of buying power in the hands of private equity buyers,” Morgenthaler General Partner Daniel Farrar tells *Buyouts*.

To be sure, there is more to today's robust market than available capital. It's the availability of debt that is truly driving investment.

When **Clayton Dubilier & Rice**, **The Carlyle Group** and **Merrill Lynch Private Equity** acquired Ford Motor's Hertz rental car unit last December, the buyers' only had to commit \$2.3 billion of equity to the \$14 billion purchase price. At the end of June, just about six months after the buyout, the investors were able to recapitalize the business and take roughly \$1 billion of the equity back in the form of a dividend, demonstrating that lender appetite remains strong.

With record fundraising and fluid debt markets fueling the market, it has pushed purchase prices notably higher. That, in turn, has brought sellers out of the woodwork. As Farrar puts it, “There are more deals coming to us than we could possibly chase.”

It's a market most dealmakers dream of, but the exuberance has many asking if there is an end in sight.

Even as deal volume continues reaching unprecedented highs, there's a growing population of investors waiting for the other shoe to drop. The word “bubble” has increasingly been heard at

industry conferences and it has become a recurring theme for many in the mainstream press. While nearly all dealmakers know the current environment won't last forever, there's a split as to whether it will be a soft landing or an all out implosion.

"It's palpable," says **AIG Global Investment Group's Steve Costabile**, a managing director in the firm's Private Equity Funds Group. "The key has been the debt markets. They're so liberal and so open, that it's almost a cliché now. But for lenders, it's good up until it's not good anymore. We're entering a less certain economic environment, and we're eventually going to hit that inflection point."

As far as lenders are concerned, the market today is indeed still good. However, that's not to say that the debt providers aren't taking precautions. **Winthrop Minot**, a partner at law firm **Ropes & Gray**, cites, "It's still an extremely active [debt] market among private equity groups, although people aren't too sure about how high rates are going or even when the markets will soften, so we're starting to see a lot of market-flex language being built into the [debt] deals."

Even if debt does get more expensive, that won't necessarily stop the parade. **William Matthes**, a managing partner at **Behrman Capital**, notes, "In our market, the interest rates are less important than the leverage multiples... as long as lenders stay aggressive, I wouldn't expect a dramatic change to come from rates rising."

At this point, the only thing that has curbed buyout activity has been the buyout firms themselves. Even as there are numerous instances of deals being made with double-digit purchase price multiples, increasingly financial buyers have shown a tendency to walk when the bidding gets out of control, or at the very least hold firm in the face seller demands.

The auction for Univision Communications serves as the most recent example of buyer restraint. When Univision put itself on the block, the Spanish-language media giant was reportedly seeking as much as \$40 a share. A consortium led by Haim Saban proposed \$35.50, and was rejected. The rival consortium, led by strategic bidder Grupo Televisa, answered with a \$35.75 per-share bid, and there was ensuing speculation that the auction would bust. The initial bidders, however, sweetened their proposal slightly to \$36.25 a share and a deal was made. **Texas Pacific Group**, **Thomas H. Lee Partners**, **Madison Dearborn** and **Providence Equity Partners** took part in the winning proposal.

The lackluster bidding and the fact that the Televisa consortium suffered price-related defections from initial backers **Blackstone Group**, The Carlyle Group and **Kohlberg Kravis Roberts & Co.** signals that buyout firms are indeed cognizant of price.

A permanent shift?

While many of the old investing principles continue to hold weight, there are those that have seen a material shift in the industry itself. This change, if permanent, would mean that buyout groups aren't necessarily engulfed in a terrific upcycle, but rather taking part in what is the new norm as it relates to putting capital to work.

Kevin Landry, the CEO of **TA Associates**, told *Buyouts* in June, "Private equity firms have transformed—especially at the large end—from looking for a few good deals to becoming asset managers."

Whether this transformation is permanent, however, remains to be seen. For now, while most investors are anticipating the current environment will eventually give way, there still is no end in sight, and buyout pros will gladly embrace the status quo.

