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Private Equity Alert

The Beat Goes On

By Doug Warner and Michael Weisser

We wish we could tell you something fascinating about what happened to the private equity industry in 2012. But it was just not that kind of year. Private equity deal volume was flat compared with 2011. New funds continued to be raised at a modest pace. There were no particularly interesting new developments in the deal market.

However, private equity, despite the challenges facing the industry and the harsh spotlight put on it by the presidential campaign, continued to thrive. This article looks back on some of the trends that we saw in the industry in 2012 and some predictions as to what awaits it in 2013 and beyond.

Trends in 2012

Some of the trends that we saw in the private equity industry in 2012 included:

The Tortoise and the Hare – According to Thomson Reuters, worldwide private-equity-backed M&A activity was $321.4 billion in 2012 – flat compared with 2011. However, the year started off slow, with deal volume off significantly in the first two quarters. Volume picked up steam in the third quarter and achieved a blistering pace in December, with many deals closing so that sellers could monetize gains at 2012 tax rates.

Our Slice of the Pie – Private equity's slice of the M&A pie was also flat in 2012 compared with 2011 (12.4% in 2012 compared with 12.7% in 2011 according to Thomson Reuters). This was a far cry from the halcyon days of 2006, when private equity activity represented 21% of the M&A pie but substantially better than the not-so-halcyon days of 2008, when it represented 6% of the pie.

The Loyal and the Faithful – The harsh spotlight put on the private equity industry by the presidential campaign apparently did nothing to shake the loyalty of the LP community. According to Coller Capital, more than three times as many LPs plan to increase their target allocations to private equity funds than expect to reduce them. LPs continue to become more discerning, however. Coller Capital also reported that 47% of LPs intend to reduce the number of their sponsor relationships over the next two years.

AUM and Diversification – A significant focus of alternative asset managers, particularly the ones that are publicly traded, continued to be to grow AUM. This often involved raising credit funds, CLO funds, and other funds that were not focused on buyouts, since buyout funds can take the longest time to raise given the long lock-up periods and significant illiquidity for investors. However, non-publicly traded funds

Weil News

- Weil was ranked #1 in announced global private equity deals for 2012 with approximately 16.3% market share and $67 billion in deal value according to Bloomberg
- Weil was one of only three firms ranked in the top band for private equity in Chambers Global 2012 and one of only three firms ranked in the top band for private equity buyouts in IFLR 2013
- Weil advised Advent International in its acquisition of a majority interest in AOT Bedding Super Holdings, the parent company of National Bedding Company and Simmons Bedding Company
- Weil advised AMC Entertainment Holdings (a portfolio company of Apollo Global Management, Bain Capital, the Carlyle Group, CCMP Capital Advisors, and Spectrum Equity Investors) in connection with its $2.6 billion sale to Dalian Wanda Group
- Weil advised Centerbridge Partners in connection with its $1.1 billion take-private acquisition of P.F. Chang's China Bistro
- Weil advised CVC Capital Partners in connection with its acquisition of majority control of Cunningham Lindsey, a major global loss adjusting and claims management firm
- Weil advised Getty Images (a portfolio company of Hellman & Friedman) in connection with its $3.3 billion sale
- Weil advised Goldman Sachs Capital Partners in connection with the $2.3 billion sale of its portfolio company USI Insurance Services

continued on back page

in many cases also embraced diversification into specialty buyout funds and credit funds.

Trying to Go Public – 2012 was another relatively weak year for IPO exits for private equity sponsors despite the relatively strong returns for public equities. A number of potential IPOs were pulled and others were put on hold.

Getting Your Just Rewards – Dividend recaps, on the other hand, boomed in 2012. This was partly due to accommodative debt markets and partly due to the locomotive of higher taxes in 2013 barreling down the tracks.

The Debt Machine Keeps Humming Along – Leveraged finance markets continued to be strong in 2012. Both leveraged loan and high-yield-bond issuance were up significantly over 2011. Leverage ratios continued to climb, although not to 2007 levels, and covenant-lite loans were common. One innovation in the leveraged loan market that may become more common is the "pre-cap," where the loan is structured so that a buyer of the company can step into the shoes of the seller on the loan assuming certain conditions are met.

Predictions for 2013

Some of our predictions for the industry in 2013 include:

The Beat Goes On – We expect deal volume to be slow in the early months of 2013 as significant activity was accelerated in 2012 to beat the uncertainty surrounding the fiscal cliff. However, the macro environment for private equity continues to be strong. Debt markets remain accommodative to buyouts, and many sponsors are facing the reality that their 2005, 2006, and 2007 vintage funds are winding down and they will have to hit the fundraising trail soon if they have not already done so. Sponsors will be more motivated than ever to sell some of their aging inventory of portfolio companies to enhance their fundraising story, so it should be a good year for secondary LBOs. Sponsors will also be motivated to utilize their "dry powder" to do deals before the commitment periods on those funds expire. According to the Private Equity Growth Council, buyout funds had $372 billion of dry powder at the end of the second quarter of 2012.

Try Aisle 6 – We expect continued diversification by sponsors, with certain sponsors providing "one-stop" alternative asset shopping to the LP community. While some sponsors are rapidly becoming alternative asset supermarkets, others are dipping their toes into the pool of diversification by expanding into credit and other funds.

Passing the Baton – As the industry matures (and its founders continue to age), succession issues will continue to be a major focus of sponsors as well as the LP community. According to Coller Capital, 73% of LPs are focused on succession issues at the sponsors where they invest.

Continuing Need for Private Equity – We expect the private equity industry to continue to survive

- Weil advised Lion Capital in connection with its €1.2 billion sale of a 60% interest in Weetabix Food Co. to China's Bright Food Group
- Weil advised Ontario Teachers' Pension Plan (through its private equity group, Teachers' Private Capital) in connection with its acquisition of a majority interest in Heartland Dental Care
- Weil advised Providence Equity Partners in connection with the C$1.1 billion acquisition of Canadian data center operator Q9 Networks by an investor group comprising Providence, Ontario Teachers' Pension Plan, Madison Dearborn Partners, and BCE
- Weil advised Providence Equity Partners in connection with the acquisition by News Corporation of a 49% equity state in the YES Network
- Weil advised Silver Lake Partners and Partners Group in connection with their €1 billion acquisition of Global Blue
- Weil advised Thomas H. Lee Partners in connection with its acquisition of a majority stake in Party City Holdings in a recapitalization transaction valued at $2.7 billion

and thrive because investors are rational and over time private equity has provided superior risk-adjusted returns. Investors who are starved for returns to meet their obligations to retirees and to fund universities and other worthy causes will maintain their confidence in private equity. According to the Private Equity Capital Growth Council (admittedly not an unbiased source), pension fund investment returns from private equity over the last 10 years exceeded their returns on public equities by over 5%.

Happy New Year to all of our clients and friends.

If you would like more information about the contents of this issue, or about Weil's Private Equity practice, please speak to your regular contact at Weil or to the editors.

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The Private Equity Group's practice includes the formation of private equity funds and the execution of domestic and cross-border acquisition and investment transactions. Our fund formation practice includes the representation of private equity fund sponsors in organizing a wide variety of private equity funds, including buyout, venture capital, distressed debt and real estate opportunity funds, and the representation of large institutional investors making investments in those funds. Our transaction execution practice includes the representation of private equity fund sponsors and their portfolio companies in a broad range of transactions, including leveraged buyouts, merger and acquisition transactions, strategic investments, recapitalizations, minority equity investments, distressed investments, venture capital investments and restructurings.

Editors:

Doug Warner (founding editor)	doug.warner@weil.com	+ 1 212 310 8751
Michael Weisser	michael.weisser@weil.com	+ 1 212 310 8249

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