

How To Navigate PE Clients Through Uncertain Markets

By **Benjamin Horney**

Law360 (March 23, 2018, 2:32 PM EDT) -- As the private equity industry's pile of dry powder continues to swell and cost-effective deals become harder to find, fund managers will need attorneys who understand the issues that plague PE players and who can help them find and land attractive assets in an environment fraught with uncertainty.

Private equity professionals face a challenging marketplace at the moment, and even fund managers flush with cash are finding it difficult to deploy capital because a congested market for traditional PE transactions has sent valuations through the roof. Meanwhile, there is uncertainty by the barrelful because of issues including U.S. tax reform, rising interest rates and global geopolitics.

The headaches are plentiful, and the pressure from investors to generate strong returns is intense, but fund managers must also be careful not to repeat the same mistakes that they made ahead of the global financial crisis in 2008.

"I think hard lessons have been learned, and while some may repeat the mistakes of the past, most won't," said Eric Schwartzman, a partner in the private equity practice of Cooley LLP. "Instead, I think people will seek to spend their money more broadly."

Those seeking to learn from the past should focus on spending their money wisely, and in a marketplace filled to the brim with potential stumbling blocks, the need for knowledgeable legal counsel with their finger on the pulse of the industry is as great as it's ever been.

To help PE clients prosper, lawyers should ensure that they have a thorough knowledge of the issues that have been or could soon cause difficulties in the deals market. For instance, U.S. tax reform has curtailed leverage when it comes to dealmaking while also providing competing buyers — namely large corporations — with more cash on hand because of repatriation provisions that allow them to bring money that had been stashed offshore back to the U.S.

"The strategics now have not only more cash, but they've got the currency of their shares, which they can use for deals," said Brian F. Richards, a Paul Hastings LLP partner who chairs the firm's global private equity practice and Chicago corporate department.

Rising interest rates also have the potential to make it more difficult for PE players to use leverage for a deal in the same ways they are used to.

“Interest rate hikes are going to have a huge impact on PE in the future,” said Nick Tsafos, a partner at accounting firm EisnerAmper LLP whose practice focuses on hedge funds and private equity funds.

Meanwhile, the current U.S. administration has brought with it geopolitical uncertainty galore, so smart lawyers will be keeping clients abreast of any situations that could have an impact on the dealmaking market.

“Geopolitical risk seems to vary by the day,” said Mark S. Solomon, managing partner of Katten Muchin Rosenman LLP’s Dallas office.

For example, there may be fund managers out there right now with portfolio companies that could be significantly affected by the impending steel and aluminum tariffs that President Donald Trump has been bloviating about.

Besides being able to provide clients with a wealth of knowledge related to why the deals market is becoming more difficult, attorneys should be offering counsel on the ways in which private equity still has a leg up in certain situations.

For instance, Tsafos noted that companies that in the past may have already gone public seem to be staying private longer, which in turn means that those companies are instead raising further rounds of funding. Thus, private equity firms have more opportunity to take stakes in companies that have yet to tap the public markets.

“Some companies are taking a lot longer to go public, and are instead doing more rounds of private equity investment,” Tsafos said. “This is where PE is making its money.”

Attorneys can be helpful in ways aside from simply providing information, however, and the most successful lawyers will be those who are truly proactive in steering their clients toward continued success.

Case in point: At Cooley, lawyers are encouraged to introduce clients to management teams and leadership of companies that might be a good fit for a deal of some kind down the road, according to Schwartzman.

“I think that’s one of the areas where lawyers can really help,” Schwartzman said. “Making introductions early so we can help our clients minimize the number of times they have to compete in an auction.”

The actual introduction can take place in any form, from a simple email to a lunch or meeting that is meant to break the ice and connect two sides that might be a good fit for each other.

“That’s something PE funds will be looking for,” Schwartzman said.

Pushing clients toward potential deals is something that attorneys at Paul Hastings also consider to be a unique value add, Richards said. Additionally, the firm has placed an increased emphasis on being able to rapidly move through the deals process, which can make it less likely that a third-party bidder jumps into the fray. Deals that previously may have taken up to 90 days are now being done in as little 30 days or, in some cases, a single week, according to Richards.

“In order to do that you have to not only be able to deploy a lot of resources, but also be very judicious in prioritizing where the risks are, because we’re not going to get to turn over every stone,” Richards said. “You have to determine which stones you absolutely have to turn over.”

Lawyers can also help nudge private equity fund managers into the future. The lines between venture capital and private equity are rapidly blurring, and while a PE fund may not want to invest \$10 million in an innovative tech company, the fund could be interested in buying a majority stake in such a business far sooner than it would have in the past.

“I think we’ll continue to see a convergence among PE, growth equity and venture capital,” Schwartzman said. “You’ll start to see deals of all shapes and sizes. As a lawyer, you have to be nimble. You need to start thinking and acting a lot like your clients and their target companies.”

--Editing by Rebecca Flanagan and Edrienne Su.

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