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Berkshire Global Advisors LLP

527 Madison Avenue, 3rd Floor
New York, NY 10022
+1 212 207 1000

One Market Street, Spear Tower, Suite 3600
San Francisco, CA 94105
+1 415 293 8426

999 Eighteenth Street, Suite 3000
Denver, CO 80202
+1 303 893 2899

Berkshire Global Advisors Limited

11 Haymarket
2nd Floor
London, SW1Y 4BP
+44 20 7828 2828

Berkshire Global Advisors Pty Ltd

Level 18, 1 Castlereagh Street
Sydney, NSW, 2000
+61 283 200 841

Berkshire Global Advisors LLP Member, FINRA / SIPC

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As private markets boom, deal-makers follow

Since the financial crisis, the private markets have exploded, driven by institutions and family offices seeking attractive long-term returns as well as portfolio diversification. Last year, AUM in the private markets rose above $5 trillion. Private markets managers also set new records for fundraising in 2017, pulling in a record $748 billion worldwide, according to McKinsey, with North America accounting for 60% and private equity the leading recipient with $397 billion. Closed-end real estate and private debt followed, splitting $219 billion about evenly.

By contrast, initial public offerings worldwide raised one-quarter of the private total, even as the number of IPOs reached the highest level in 10 years, according to EY. The U.S. accounted for just $39 billion by value, behind China ($49 billion) and Europe ($46 billion).

Pension funds, with long time horizons and an often yawning gap between assets and liabilities, have been a major source of funding, believing private market investments can outperform other asset classes, generate income and provide lower volatility. An American Investment Council study of 163 U.S. public pension funds showed that in the 10 years through June 2017 private equity delivered the highest average annual return of any asset class, of 8.6%. That performance was an impressive 2.5 percentage points above second-place public equities.

According to the study, released in May, private equity and real estate comprise nearly 17% of assets on average in those 163 portfolios. Referring to private equity, Michael Bailey, director of private equity at the **Massachusetts Pension Reserves Investment Management Board**, said, "We are in this asset class for the long term, which has given us greater flexibility to partner with industry-leading investment managers to drive performance higher." The $72 billion pension fund has 11% of its assets in private equity, or nearly twice the level in 2008, and the asset class delivered a 13.3% annualized return over the 10-year period studied by AIC. Meanwhile, the nation's largest pension fund, **CalPERS**, is weighing direct investment in privately held firms, joining a small but growing number of institutions reacting to the high fees they pay private equity managers.

To a degree, private markets managers, and their limited partners such as Massachusetts PRIM and CalPERS, are filling a lending gap created by post-financial-crisis constraints on banks in the U.S. and globally. Flush with capital, non-banks can also offer attractive terms, including looser covenants. In reference to private debt funds, which raised $100 billion last year, McKinsey notes that as "access to bank loans and high-yield issuance diminishes, private debt investors step in to fill the void.... Furthermore, many [limited partners] see deteriorating returns in their fixed-income investments, and view private debt as having a similar risk profile with higher yield potential."

In assessing funds across the private market industry, many of the bigger institutions are gravitating toward the larger players that can

continued on next page

put large amounts of capital to work. McKinsey says 15% of total fundraising last year went to U.S. buyout "megafunds" of $5 billion or more. "Before long, [general partners] may find themselves having to choose between two models," the consultant writes. "Managers capable of deploying capital at scale, and specialists operating at a smaller scale."

The numbers are naturally drawing the attention of asset managers seeking to either enter, or expand their presence in, private markets investment. The scores of related deals secured in recent years have spanned private equity, private credit, real estate and infrastructure, and drawn a Who's Who of buyers. Among the highest-profile ones are asset managers that run their own dedicated funds investing in alternatives firms. **Dyal Capital Partners**, a division of **Neuberger Berman**, is the most prominent among them, having assumed minority investments in more than 30 firms worldwide since its formation in 2011. Last year, Dyal closed its third and largest fund to date, with committed capital of $5.3 billion, $2 billion above target. Dyal plans to make 10 to 12 investments in private equity firms diversified by asset class, strategy and geography.

For Dyal and other large best-in-class investors such as **Blackstone Group**'s (NYSE: BX) Blackstone Strategic Capital Holdings fund and **Goldman Sachs**' (NYSE: GS) **Petershill**, those minority investments deliver a percentage of their partners' attractive earnings as well as the potential for gains on an exit. For private equity and other alternatives managers, investors like Dyal offer a source of permanent capital as they seek financing for new and often larger funds as well as other strategic purposes.

In May, Dyal joined in a unique partnership approach with Petershill, which this year closed a new $2.5 billion fund, and **Landmark Partners** to assume a minority stake in **Clearlake Capital Group**. Clearlake, founded in 2006 and based in Santa Monica, Calif., focuses on the industrial, energy, consumer and technology sectors. In discussing the deal with *Pensions & Investments*, Clearlake co-founder and Managing Partner Jose Feliciano said the three investors bring different areas of expertise, adding, "Dyal has an extensive business services platform with an a la carte menu where we can focus on fundraising or the human capital end of our business." In the first quarter of this year, Clearlake closed the largest fund in its history, "substantially oversubscribed" at $3.6 billion. Dyal also invested in **Bridgepoint**, a European investor with £18 billion ($20.5 billion) in AUM, and **Vector Capital**, a San Francisco technology investor with $3.8 billion in AUM, among others.

In a second joint deal this year, Blackstone and Goldman acquired a minority stake of around 20% in **Francisco Partners**, a technology specialist in San Francisco that has raised more than $14 billion and invested in 200 tech companies during its 18-year history. "Long term, we want to be one of the preeminent brands in our industry, and having preeminent partners will continue to help us get there," Francisco CEO Dipanjan Deb told Bloomberg. Francisco said it will use the capital to develop its platform and increase commitments to its own funds, "strengthening alignment with limited partners."

Deal-makers have also been busy in the credit marketplace. A significant European transaction announced in January involved **Natixis Investment Managers**' acquisition **MV Credit**, an established pan-European credit specialist based in London that has invested more than €5 billion ($5.8 billion) in 500 debt financing solutions. Natixis, which employs a multi-boutique model, said the deal "marks another important step in the development" of its "European real assets range." As is the case with many smaller to mid-size private markets firms that tie up with large, diversified asset managers, MV Credit said it was drawn by its new parent's scale as well as the ability to retain "our full autonomy."

New York Life Insurance is another global asset manager with a boutique structure that has been expanding its private markets capabilities via acquisition, including a 2017 transaction for a majority stake in **Credit Value Partners**, an opportunistic, distressed and high-yield credit manager with $2.5 billion in AUM at the time of the deal. CVP's portfolio includes collateralized loan obligations, which was the hottest part of the credit M&A market after the financial crisis. The pace of acquisitions for such managers or portfolios has slowed of late, reflecting in part the limited number of remaining players looking to cash out. But the asset class itself remains active: **Wells Fargo** (NYSE: WFC) predicts record CLO issuance this year of $150 billion in the dominant U.S. market.

In discussing CVP, New York Life said the firm's investments "align with the income-generation needs and total return profile of our investor base." Meanwhile, two of the insurer's private markets affiliates closed funds this year: **GoldPoint Partners**, which raised $850 million for a co-investment fund supporting middle-market U.S. and European companies; and **Private Advisors**, which raised $275 million for small market transactions of less than $25 million.

In February, New York Life's European subsidiary, **Candriam Investors Group**, gained entry to the pan-European real estate advisory business by assuming a 40% stake in **Tristan Capital Partners**, a London firm with €9.1 billion in AUM in a variety of property funds. Candriam said the deal adds real estate to its portfolio, "a major asset class which continues to attract strong institutional investor demand." TCP, which defines its philosophy as assuming "as little risk as possible in the pursuit of targeted returns," said the partnership provides it with a "leading global investment platform."

A second and major cross border real estate deal this year took place in North America, where **Colliers International Group** (TSX: CIGI) of Toronto paid $450 million for 75% of Chicago's **Harrison Street Real Estate Capital** (AUM: $14.6 billion). Harrison, where executives retain the rest of equity, is a "demographic-based" investor focused on senior and student housing, medical offices and storage, primarily in the U.S. but with a presence in Europe. Colliers, a real estate services firm that operates in 69 markets, said the addition of Harrison makes it "one of the major players in global real

estate investment management." During a second-quarter conference call, Colliers Chairman and CEO Jay Hennick said "the appetite for what Harrison does and its chosen areas of focus is massive." Colliers, which expects Harrison to generate between $100 million and $115 million in annual run-rate management fees, could tack another $100 million to its payment by 2022 based on performance.

There was one notable real estate cross border deal in 2017 involving **Mitsui & Co.**'s entrance into the U.S. market through the purchase of a 20% stake in **CIM Group** of Los Angeles. CIM is a North American urban real estate fund manager with $29 billion in assets in a broad portfolio ranging from opportunistic and core/stabilized to debt, as well as infrastructure. Mitsui, whose total investment will be $450 million to $550 million including interests in several CIM funds, said at the time that CIM will be "positioned at the core of [our] international asset management strategy." CIM expressed a hope it would be positioned as "the first choice for Japanese investors interested in real estate and infrastructure investments in North America." Earlier this year, Mitsui launched its first private institutional REIT in Japan, with assets expected to reach nearly $300 million.

In a domestic U.S. deal from 2017 that closed in the first quarter, **Morgan Stanley** (NYSE: MS) took a different approach, targeting the credit piece of the market in acquiring **Mesa West Capital**, a commercial real estate credit platform with $5 billion in AUM. Morgan Stanley, which said it is "dedicated to providing clients with differentiated investment solutions," managed $48 billion in real assets prior to the closing. Mesa West primarily originates transitional first mortgages to "strong sponsors" in core and secondary markets in the U.S. "When we launched our first fund in 2005, there weren't many institutions beyond insurance companies in this space," co-founder Jeff Friedman told *Institutional Investor* in 2017. "But we've seen more institutions, and pensions specifically, come around to the asset class."

Asset managers handling infrastructure have represented a small part of private markets M&A activity, though the sector looms large as an investment opportunity. The McKinsey Global Institute figures there's an $800 billion gap between what the world spends annually on infrastructure ($2.5 trillion) and what's required to support current economic growth. Numerous asset managers are engaged in the market, including Blackstone, which in October launched a company to develop, finance, construct and operate energy-related projects — primarily thermal and renewable — in the Middle East, North Africa and neighboring regions. The private equity industry itself raised $68 billion for infrastructure projects in the first three quarters, 18% above the same period in 2017 and more than the total raised in all of 2016, according to the Preqin.

In March, **Northill Capital** completed the acquisition from **Westpac Banking Corp.** (ASX:WBC) of a majority of Hastings Management, an established global debt and equity infrastructure specialist. Based in London, Hastings subsequently rebranded as **Vantage Infrastructure**; it has $3 billion invested in assets in Australia, Europe and North America. In a recent action, Vantage announced it will provide asset management services for two Chinese investors related to a 33% stake they acquired in Redexis Gas, a developer and operator of natural gas transportation and distribution in Spain. Founded in 2010 with backing from the billionaire Bertarelli family in Europe, Northill has acquired five diverse asset managers since, including Vantage, which represents its entry into infrastructure. "It's hard to become an infrastructure specialist from scratch if you don't have the expertise," Jonathan Little, a Northill partner, told *Financial News* last year, adding, "Most pension funds and large investors are underinvested in the asset class. Governments are also saying they will sell off or privatize more assets. For us, it is the perfect storm."

In another infrastructure deal, Goldman Sachs, through its Petershill unit, last year joined the Kuwaiti-owned **Wafra Investment Advisory Group** in acquiring a minority stake in **ArcLight Capital Partners** of Boston. ArcLight is an energy infrastructure specialist that has invested $21 billion in more than 100 transactions since its founding in 2001. In January, for example, the firm took a minority interest in a Gulf of Mexico deepwater production facility operated by Shell Offshore. Separate from Petershill, Goldman has since 2006 raised more than $10 billion for direct infrastructure investments. ▲