



Phil Canfield of GTCR on Fund Expiration Dates and the Coming M&A Influx

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I recently spoke with Philip Canfield, a principal at GTCR, on M&A bullishness, GTCR's pipeline, why the fundraising market isn't so bad for everyone, GTCR's next fund equity checks on its recent deals, and the healthcare reform bill.

What's your outlook for M&A in 2010?

We think the year will be robust for M&A activity. It will be fueled by a few things. Number one: a rebound in valuations. A year ago all the buyers wanted to buy cheap, but no sellers were willing to sell. Now it's an environment where buyers think prices are reasonable and sellers agree and there's a crossroad to transact. Number two, you have a fair bit of liquidity in the market. On the financing side, starting early last summer you saw a big rebound in high yield markets. That has continued and led to a rebound in other credit markets, like the bank loan and CLO markets. The other component is that you have a trillion dollars of cash on the balance sheets of S&P 500 companies, and in private equity, you have half a trillion of committed but uncalled capital. That money starts going away by next year and is gone by 2013–

Can you clarify that?

It expires. Most funds have a five year commitment period for new investments, and much of that half a trillion of committed, uncalled capital was raised in '06 and '07. So once you get out to 2014, that money will have to be invested or sent back to investors. There's a tremendous incentive for private equity firms to do deals.

I don't imagine many buyout firms will willingly give back their hard-fought capital. Neither do I.

What fund is GTCR investing from?

Fund nine. It's a \$2.75 billion fund and it's probably around 2/3 of the way deployed. We also have a very robust pipeline coming up.

You've been busy doing a lot of add-on deals lately. The firm acquired BIT Systems as an add-on to Six3 Systems, as well as NYFIX as an add-on to ConvergEx. Would you say you've been doing more add-on deals as a result of the deal environment?

It's been independent of that. We wouldn't call anything we do a "roll-up." We think a lot about transformation. One element of that transformation is to bring services or products into the base business that are highly complimentary or that change the profile—in a good way—of the businesses we have. It has been the case that we've done a fair bit of (add-on deals) over the last couple of years. It's not any more than we did before, but it is the case that (add-on) deals, over the last two years, have been marginally easier to do than a stand-alone, brand new LBO. That's because often times our portfolio companies can finance the deal out of their existing balance sheets or credit facilities.

So, based on your earlier comments, it sounds like you're saying standalone deals are now easier to do than they have been over the past couple of years?

There's no question it's easier to do standalones now.

You mentioned a robust pipeline. How many deals should we expect from GTCR in the coming quarter or two?

Well, we did one deal in Q1 and we have another one pending that will likely get done in the first quarter yet. Both of those have sizable equity investments and enterprise values. They're between \$400 million and \$500 million in value. We have a couple more of similar size that could happen in the second quarter.

That's a lot of money being put to work. Is it safe to say that would wipe your fund out?

We would have room for two or three more investments. But yes, if those deals all went through it would get us moving rapidly toward thinking about our next fund.

And if you're lucky, the fundraising environment will improve in the same way that the M&A market has by the time you come to market.

I don't think the fundraising environment is as bad as people say it is. I think it depends on your LP base. If it's made up solely of endowments and universities, it will be tough to raise your fund. But if its made up of public pension fund money, it won't be as difficult.

And who are GTCR's LPs?

The latter.

Lets talk about the healthcare reform bill. What does this mean for investing in the sector going forward?

The big take-away is that there will be a lot more people who weren't insurable before who are going to get insurance. It's something like 25 million to 30 million newly insured people. We think that's a good thing for the entities serving them, such as hospitals and nursing homes and rehabilitation and physical therapy centers.