



# PRIVATE EQUITY PERSPECTIVES PODCAST

## EPISODE 2: ARDIAN DIRECTOR'S OUTLOOK FOR INVESTORS' APPETITE FOR U.S. EXPOSURE

INSIGHTS FROM THE BDO PRIVATE EQUITY PRACTICE

**Todd Kinney:** Hello. This is Todd Kinney, National Relationship Director with BDO's private equity practice. I'd like to thank you for tuning in to the second episode of BDO's Private Equity Perspectives podcast. It's a big day today, listeners. I'm proud to say that my good friend and BDO client, Derek Lim, is here with us today. Derek is a director with Ardian's North American Buyouts fund. Derek will be discussing his strategies and experiences, as well as his outlook, for the PE world in 2018. So, Derek, as you know I'm a big fan of the team at Ardian, and it's great to have you here today.

While I know a lot about your strategy and focus, I'd like to start off by having you bring our listeners up to speed regarding Ardian and how the North American Buyouts unit came to be.

**Derek Lim:** Great. Well, thanks for having me today, Todd.

**Kinney:** It's our pleasure.

**Lim:** I really appreciate it. To give listeners a sense of who Ardian is, Ardian is the former AXA Private Equity Group. Some people would better know us as that, but we did a rebranding effort in 2013. We're a Paris-based global investor, and we manage roughly about \$65 billion in assets across numerous asset classes.

The bulk of that is in our Fund of Funds business. We have a very strong Fund of Funds business both in Europe, as well as here in the U.S. Our U.S. presence for Fund of Funds has been here for well over a decade, and we've become one of the market leaders in the secondary space. We raised a very large fund back in 2016 with a primary focus on secondaries. We also manage capital across numerous asset classes. So, we've got a couple pockets of LBO funds over in Europe. We've got a larger cap fund, which focuses on larger scale buyouts. We've got a middle market fund, and then we've got an expansion capital fund, which is looking more for growth equity funds. We also have a real estate fund, an infrastructure fund, and we have a debt fund. So, we truly are a multi-asset manager.

### TOPICS DISCUSSED INCLUDE:

[Opportunities in the Lower Middle Market \(3:47\)](#)

[Increased Appetite for International Expansion \(9:00\)](#)

[How NAFTA renegotiations are influencing investment strategies \(10:51\)](#)

[Outlook for portfolio company leverage rates \(13:37\)](#)

[Predictions for 2018 \(15:27\)](#)

When it came to the U.S. strategy, the team at Ardian had looked to come into the U.S., primarily for two reasons. One, if you look across our capabilities, it was a natural extension. We have been here in the U.S. market on the Fund of Funds and the secondary side for quite some time now. We thought that having a direct fund here in the U.S. made a lot of sense, and it was a natural extension of the capabilities we're already in. And secondly, from our LP base, which is about 550 investors globally, there was a lot of demand for us to come to the United States. We wanted to give those investors access to U.S.-based middle market companies for our direct strategy.

**Kinney: Right. Well, it's truly fantastic, again, to have you here today. Ardian has such a fantastic brand in this space, and BDO has been excited to work with you on some deals in the past year and look forward to expanding the relationship.**

**It is interesting that a large investor like Ardian would be looking for deals in the lower middle market. Maybe you can help listeners understand what the rationale is for seeking acquisitions in that segment.**

### **OPPORTUNITIES IN THE LOWER MIDDLE MARKET (3:47)**

**Lim:** Sure. I think it's a couple of factors. First and foremost, if you look at the middle market, it does tend to be a crowded market today—there are a lot of funds. But it's a very large space, and we will play in the lower end of the middle market, as well as the true traditional middle market. Given that there are a number of companies out there, it's a very dense marketplace for the number of opportunities, both on a proprietary basis or for things that are being auctioned off by an investment banker.

Secondarily, again back to the global demand, our investor base really sees the U.S. as a strong growing market, especially for private equity and just given the number of middle market businesses that are here vis-à-vis other countries. Ardian wanted to plant a flag here to take advantage of that opportunity and to give access to our investors.

We are also believers in the industrial manufacturing space. The strategy here is for us to look at more industrial-focused businesses and industrial services. Our strategy is going to tend to focus on those companies solely in the lower middle market to mid-market. Likewise, is that we're not afraid to roll up our sleeves and really tackle issues that middle market companies tend to have. Whether that's some level of complexity, whether they're at an inflection point in their growth strategy and they just need some outside capital to reach that next growth phase, customer concentration, or other things that we think can add value, both to the middle market companies, and also, more importantly, to our investor base.

**Kinney: Sure. Well, I think the team at BDO is, alongside you, very bullish about the lower middle market, middle market, and industrial manufacturing segments. So, we assume you're going to have a lot of success. Pretty frothy markets out there.**

**Now, despite being formed in 2016, your team has already done several deals. Perhaps it'd be helpful for our listeners if you could share if you've come across any kind of unique financing arrangements or deal structures that might be a good story or two.**

### **UNIQUE FINANCING ARRANGEMENTS AND DEAL STRUCTURES (6:16)**

**Lim:** Sure. We closed one deal in the summer. And we announced, a couple of weeks ago, our second platform in the plastic injection molding space, which we're hoping to close imminently. In terms of financing arrangements, one of the things that has been a little bit surprising to me—but also a great opportunity—is we've seen a lot of activity from the commercial banking side to get into leveraged loans. Ten years ago, when I was in this business, that wasn't necessarily the case. For our deals, we have seen some of the active middle market banks, or even larger-scale banks, that are trying to come down market to play in the middle market. And I think that speaks to the number and the breadth of opportunities that we spoke about earlier.

In terms of deal structures, I'd say it really runs the gamut. The first buyout we did happened to be a company that had significant revenue over here in North America. There was a cross-border element to that as well, and that provided a unique deal structure that we had to structure around. Going to the banking community to get that financing done was certainly nice.

More importantly, as I talked about our ability to look at more complex deals, that naturally will lend itself to more unique financing arrangements. I can't necessarily get into specifics, but there are opportunities for seller-related financing. And we have seen a really strong appetite, not only from the commercial banks, but also more importantly, from the international investor base. We've seen a lot of appetite from some Asian and European banks to come play in the middle market here in the U.S.

**Kinney: Right. Well, I think that was a fair response without giving away some of the secret sauce. I'm sure your team will appreciate that. On the international cross-border front, with Ardian being a European-based investor, I would think that this provides an edge to your North America fund as you explore cross-border growth opportunities both at the fund and portfolio level. I certainly know at BDO that our global footprint is something that we really highlight in most pursuits as a competitive advantage. It can really separate us from some of the second-tier firms that try and compete**

with us here in North America, but really just can't match us globally. Would it be safe to say that Ardian would follow a somewhat similar strategy?

## INCREASED APPETITE FOR INTERNATIONAL EXPANSION (9:00)

**Lim:** I'd say over the last couple of years, when we're going to management meetings or we're meeting with CEOs or leaders of businesses, more and more, the need for international expansion has become more prominent in their near-term goals.

And what I'd say about Ardian, taking a step back and looking at us, we are a global investor. We do have a very strong direct-buyout platform over in Europe, and with that comes a large number of portfolio companies over in Europe. So, I would say that the U.S. companies that we're meeting with do have international expansion opportunities and what we bring to the table is a pretty unique bridge. And I think that is certainly how we can differentiate ourselves from our peers here in the middle market. There's not a lot of peers of ours that can say that they're a truly global firm. We can take advantage of the Ardian network, whether that's talking to other executives in the same space over in Europe, or it's using the knowledge base that exists at Ardian to help strategize and game plan for our international expansion plans for our portfolio companies here in North America.

**Kinney: Right. Well, I couldn't agree more. You guys are certainly a unique brand, and I think that global footprint is only going to help you guys going forward.**

**On a similar international note, the Trump administration has been trying to renegotiate NAFTA and is leaning toward protectionism. How do you see this affecting company's plans for cross-border expansion?**

## HOW NAFTA RENEGOTIATIONS ARE INFLUENCING INVESTMENT STRATEGIES (10:51)

**Lim:** Given any changes to NAFTA, I think a lot of companies now are going to start to look at the potential pros and cons. We own businesses in our portfolio that have U.S.-based production facilities. And we also have some that are in Canada and Mexico. For the most part—and again, the devil's in the details—as you're looking for expansion and whether it's moving facilities offshore or potentially coming back on shore, that's certainly going to drive a lot of decision-making. If you're a middle-market investor, and you're looking at a U.S.-based manufacturer, and part of your investment thesis is to move manufacturing offshore, you've got to stop and take a breath here and really think twice about that strategy because, if NAFTA is changed, obviously you've lost a large potential of your upside.

But, depending on what end markets you're at, there is a lot of talent pool here in the U.S., and especially for manufacturing-oriented companies. And we're seeing it. We're playing more in the end markets of the manufacturing space that are more technical, more highly engineered in nature. For those types of opportunities, in terms of if there's a need for human capital, I still think the U.S. is one of the best places to find that type of human capital. But that's a long-winded way of saying that we're fully aware of it. It does play into our investment strategy and how we think about expansion. But for the most part, I think we're kind of in a wait-and-see mode before we make any type of arrangements.

**Kinney: Right. Well, we certainly appreciate that insight. I understand we're asking you to speculate a little bit, but I think your professional opinion of what you're doing and seeing helps quite a bit.**

**On the topic of the debt markets, certainly we're seeing many highly-leveraged companies get a lot of media attention these days. Perhaps I can ask you what your thoughts are on the high leverage rates on portfolio companies, and what we should expect. Are we going to see a rise in defaults, or do you think the fundamentals are still pretty strong?**

## OUTLOOK FOR PORTFOLIO COMPANY LEVERAGE RATES (13:37)

**Lim:** As I look across our portfolio, the fundamentals are all showing signs of continued strength, especially when we're talking to companies that are out for sale. And we're talking to bankers. We're talking to executives. For the most part, the economy is still very strong. We're at low unemployment. From a fundamental standpoint, they're showing some strength that is going into 2018.

On the debt market in general, there is a lot of capital out there. On almost every call that we have with bankers, we always ask for an existing current leverage read of the business in terms of how many debt providers they've gone out to. And consistently I'm hearing that number rise more and more. Maybe a year ago, it was four to five times. Now in the middle market, I'm hearing five to six times for businesses that maybe you're a GDP, GDP-plus type grower but have good cash flow dynamics.

So, I don't see any pullback in the fundamentals. And for highly leveraged companies, again, saving tax reform for a second, I still think there's a lot of appetite from the debt providers out there to provide as much capital as is appropriate for existing and new portfolio companies for investors.

**Kinney: Yeah. Well, this is the time in the conversation when I ask you to bring out your crystal ball. Let's talk about 2018. What is your personal outlook—maybe Ardian's outlook—on PE deal making in 2018? Should we expect to see high**

valuations and further intense competition that we've seen in the last couple years?

## PREDICTIONS FOR 2018 (15:27)

**Lim:** Fundamentals are strong, especially in all aspects of our business. There's a lot of dry powder out there on the investing side. The number of deals, if I look at December in our business, tends to be a little bit slower. We're pretty busy right now. I've talked to other peers who are extremely busy. I've talked to a lot of our vendors, so there is a lot of activity. And I think the backdrop to that and the driving force behind that is that the dry powder is still there from the investor base. The debt capital markets are still very strong and liquid. There's a lot of demand. We've been seeing some larger players try to come into the middle market debt space providing more and more capital that tends to push leverage levels up more and more.

And then you've got a strong economy. We still have a very strong economy. Again, back to unemployment levels being very low. And, obviously, there's tax reform out there, and again, talking about the pros and cons. But fundamentally, I don't see anything on the horizon that would lead me to believe that 2018 is not going to be at least as good of a year as 2017. I would hope for some kind of correction so we can get some of our deals a little bit cheaper, obviously, but in general speaking terms for the middle market, it's very strong. Probably one of the strongest markets I've seen since I've been in the business.

**Kinney:** Wow, a strong statement. Well, Derek, we really have to thank you for joining us today. I personally know how busy you and the team are and how you accommodated us in your busy calendar. So, thank you very much. I'm glad our listeners got the opportunity to learn more about your fund strategy and what you think the future holds for the industry.

**Lim:** Todd, thanks for the opportunity, and I certainly look forward to working with you and BDO in 2018 and beyond.

**Kinney:** Awesome. Much appreciated.

Listeners, before we wrap, we want to invite you to read [BDO's Industry 4.0 report](#) where we explore how PE firms can help manufacturing companies harness digital innovation.

I'd also like to mention that BDO's PE practice is about to launch its Ninth Annual Private Equity PERSpective Survey. For that study, we surveyed hundreds of PE funds managers for their thoughts on various industry trends, as well as their business opportunities and challenges. A lot of this year's data is particularly valuable, so we'll be sure to let listeners know when it publishes. Again, thanks for tuning in.

Thank you for listening to the Private Equity Perspectives podcast. For more information on how BDO supports private equity sponsors, funds, and their portfolio companies with a full spectrum of accounting, tax, and advisory services, please visit us at [BDO.com](#).

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