INTRODUCTION
Todd: Hello, and welcome to BDO’s Private Equity Perspectives Podcast. I’m Todd Kinney, National Relationship Director in BDO’s Private Equity practice based here in New York City. Today, I’m thrilled to welcome two very special guests who are going to share their insights with us regarding deal sourcing, investment themes to watch, and much more. First, I’d like to welcome to the program Dan Ryan. Dan is a Managing Director and Head of Business Development at MidOcean Partners. It’s great to have you on the podcast, Dan.

Dan: Thanks, Todd. Good to be with you.

Todd: Awesome. Next, I’d like to introduce John Lenahan, who is a partner at Wincove Private Holdings. Thanks for joining us, John.

John: Thanks, Todd. Appreciate the opportunity.

INTRODUCTORY QUESTIONS
Todd: Yeah, you bet. All right, well, let’s jump into it. Dan, as Managing Director and Head of Business Development at MidOcean, can you tell our listeners about the company’s focus and your role?

Dan: Sure, Todd. MidOcean is a mid-market buyout fund, investing in consumer and business services companies. The firm was founded in ’03 after spinning out from Deutsche Bank, and we’re now investing out of our fifth fund, a $1.2 billion committed fund. I joined...
MidOcean earlier this year to help build and run the firm’s business development function. So, I spend most of my time working alongside our deal partners and operating resources to generate new investment opportunities and to manage relationships with our deal referral sources and financing partners.

Todd: Awesome. Well, I talk to you on a regular basis and I know how busy you are. So, I appreciate you joining us again. John, turning to you, as a partner at Wincove Private Holdings, can you tell us a bit more about the firm?

John: Sure. My partner and I started Wincove in 2008. We were an independent sponsor, and in 2015 had a few exits of those independent sponsor deals and formed our current vehicle off of those, which we call Wincove Private Holdings. We call it a permanent capital vehicle, which is essentially a hybrid of a PE fund and a holding company, where we have an indefinite investment horizon. Our focus is really on the lower middle market. For the most part, our transactions are built on a partnership with a business owner who is looking for a recap to take some cash out of the business. But also looking to bring in some support to take some operational weight off of them, while also going for that second bite at the apple. We currently have nine platform companies and have completed 15 add-on acquisitions to those companies since we launched in 2015.

PERMANENT EQUITY APPROACH

Todd: So, probably just as busy as Dan. All right. I appreciate that background, John. I’m going to stay with you for the next question. I did notice, as you alluded to, Wincove is not a traditional investment firm that invests through serial funds, but the holding company has a permanent equity capital base. Maybe you could share more about the uniqueness of that approach with our listeners?

John: Sure. So, in our days before raising a full fund, which we didn’t like not having a fund, but one thing we did like, was, we realized that many small business owners really liked that we weren’t from some big PE firm. Many of them, what we found, were nervous about this three-to-five-year buyer, flipping, that sort of thing that often you read about in the papers, sometimes fairly, sometimes unfairly, about private equity. At the same time, we saw that with small companies it can take a long time to make things work and you really, really need to be patient to realize your investment thesis. So, when we did raise committed capital, we wanted to keep that flexibility for a longer-term hold period and came up with this structure. There are really two main differences with our structure versus the traditional blind pool model. First is, as I said before, we have an indefinite fund life. So, we’ll never be in a position where we’re forced to exit a business because of our fund. And the second is we can recycle capital, including profits, so we don’t have this pressure to put marks on the board to raise the next fund because we can generate that capital internally. It really does stem from what we often found was, we saw in traditional private equity, we often sold the best companies first and we just we thought that that didn’t make sense. We are able to do this because our investor base is individuals and families. The structure would probably have some challenges for a more institutional investor base, but our investors are very committed to this longer-term buy-and-hold kind of a model, so it works.

UPDATE ON M&A DEAL TERMS & STRUCTURES

Todd: Yeah, very interesting. Certainly unique, so I appreciate that insight. Dan, we’ll come back to you. I happen to see that you presented at an ACG webinar this summer. I think the title was “The New Normal in Emerging Deal Terms and Structures,” and from what I remember when I saw the webinar, you were discussing how the disruption to the credit and deal markets due to COVID-19 will really have a deep and lasting impact on how we structure M&A deals for the foreseeable future. So, I am getting to a question here. For our audience perhaps you can share some of the key takeaways from your remarks that our listeners should know about.

Dan: Yeah, happy to. First, that was my first time presenting on a virtual panel. I realize that’s not an easy thing to do when you can’t read the audience at all. It’s like, you can see the number of people in the room, but you are kind of talking to yourself and the three people on the panel with us. So, it was tricky, but we actually had a really good discussion. That was early June and the market has changed dramatically since then. I remember just trying to staff the panel. It was very difficult to find a lender who was willing to join because a lot of the lenders then didn’t have much to talk about, obviously, in terms of new deal activity. They were focused on portfolio management and weren’t comfortable representing their firm’s appetite for risk because no one really knew what to expect from the market. I think today you’d probably have a difficult time staffing a panel of lenders because they’re so busy. So, the market really has changed dramatically, but I think there are a couple of key takeaways from that event in June that still apply today, and those are speed and sector expertise. I don’t think it’s ever been more important than it is today for investors and advisors and lenders to really understand the industry segment and the business model that they’re looking at and to be able to move quickly. That was certainly the case then, in a very uncertain volatile environment and it is so still so today as the market comes back, snaps back pretty quickly from those days. And it’s a wildly competitive market that, for example, we’ve seen sell processes launched over the last couple of weeks where buyers are hoping to transact by year-end for tax purposes. So, you have to know what you’re looking at and you have to be able to move quickly.
**FUND-LEVEL MANAGEMENT PLAYBOOK**

**Todd:** Yeah. Good takeaways. Thanks for sharing those. Speaking of the deal environment we’re in, John, turning to you. Maybe you could share some of the fund-level adjustments you’ve considered since the onset of the coronavirus recession.

**John:** Sure. I would say overall there hasn’t been a huge shift overall where we’re staying the course, and I wouldn’t say we’ve fundamentally changed any of our long-term goals. There’s definitely been more of a focus on the portfolio for 2020 which isn’t necessarily a bad thing. I will say COVID has probably pushed back some exits we might have been considering in the next 12 to 18 months, though I agree with Dan. You definitely feel a shift, where I think two months ago you probably wouldn’t have thought about—it would have been a very special circumstance to consider bringing a company to market, and you see more and more activity. But we are thinking a little more proactively about growing our investor base just because we think there are going to be a lot of opportunities out there as the dust starts to settle, and we want to be well positioned to go after them.

**COFFEE BREAK WITH BDO**

**Todd:** Yeah. Makes a lot of sense. Appreciate that, John. Next, I’d like to turn it over to our Coffee Break guest, Michael Lee, Principal at BDO Digital. Let’s hear what Michael has to say.

**Michael:** Hello, everyone. This is Michael Lee from BDO Digital. I would like to share with you today why data-driven portfolio visibility is an essential part of private equity digital strategy. Accurate and timely insight is important for any business but even moreso for private equity funds that are managing multiple portfolio companies and new investment targets. The actionable insights from data can help a fund decide where to focus their dry powder, to find new and different ways to exploit the market, or to quickly identify trouble spots in their portfolio. PE firms typically have an established process for receiving reports from their portfolio on a regular basis. In many organizations, we typically see three types of challenges in the reporting process.

First, the process is largely manual, typically relying on complex homegrown spreadsheets and other means that are just not conducive for collaboration, automation, or for real-time analysis. Such process, at best, provides lagging indicators about the business.

Second, because the process is so manual, and by the time the reports are generated, they’re often stale, and the market may have already shifted in significant ways, not to mention the burden on the people creating the reports and those who need to digest them for actionable insight.

Third, because each portfolio company has their own set of systems and sources of data, it is difficult to standardize reporting at the fund level.

So what do leading firms do? They first create a single source of truth by extracting and decoupling the data from underlying systems so that, regardless of where all the raw data live, they’re able to collect and analyze information. Leading PEs also invest in the right technology, starting with a solid data strategy on architecture, automation, and artificial intelligence that can provide leading indicators for predictive and prescriptive insights. BDO’s 2020 Digital Transformation Survey found that among the companies which rated their digital initiatives as successful, 86% reported net profitability increases.

Although the importance of data-driven portfolio visibility is nothing new, the extraordinary set of market challenges that we have seen in 2020 have highlighted the urgency for action. For example, how do you know which portco is experiencing operational issues in what specific ways, and what can you do about those problems in a timely manner? Wrong decisions can be costly, but having the right data-driven strategy can make all the difference.

Data is the currency of the digital economy. And as we anticipate a macro-economic recovery, we believe that data-driven portfolio visibility that provides PE funds the leading indicators, rather than lagging indicators, is an essential, if not a critical, part of private equity digital strategy. Now back over to you, Todd.

**Todd:** Thanks, Michael. Now, let’s return to our conversation with John Lenahan and Dan Ryan.

**ANATOMY OF DEAL SOURCING**

**Todd:** I’m going to throw the next topic out to both of you. I’m curious what are some of the shifts in approach to sourcing deals that you’ve seen since the pandemic started. Dan, maybe you weigh in first, and then we’ll hear from John.

**Dan:** Yeah, sure. So, at the start of the pandemic, I’d spent nearly all of my time reaching out to restructuring advisors like Pat Fodale with BDO and direct lenders and attorneys and other sponsors to make sure that MidOcean was in front of all the special situation investment opportunities that we expected to see. As it turned out, that wave of opportunities never really materialized in the middle market for a variety of reasons we can talk about. But I think that was a good healthy phase for MidOcean. I think we really forged the new channel of non-traditional deal flow which I think will work to our benefit going forward as our fund mandate allows us to invest in non-control situations outside of the restructuring market outreach. In terms of new tactics around deal sourcing, I’ve become a big fan of...
the virtual banker-hosted industry conference. I’ve attended a number of them over the last several months, and I think it’s a highly efficient way for my deal partners and I to get in front of management team executives. You can cover a lot more ground when you do that virtually. There’s a quick meeting, so you never really made a deep personal connection in the past. And so, you get that face-to-face, and it’s very effective, highly efficient.

Todd: Yeah. I like it. John, what are you seeing?

John: So, COVID-19 has definitely shifted more of a focus to add-ons for us. We know those markets a lot better, and to the extent that there are questions about where earnings are in a company, that and valuation is a little less important because there’s other ways for us to create and to drive value with those acquisitions. We’ve continued to pursue add-ons throughout this. I think my sense is that there’s a limited supply of good companies out there. I don’t know if that’s necessarily so much because of performance as it might be because of logistics. But my sense is that for good companies that are being brought to market, there are still very, very robust levels of activity. So, we’re not really chasing those. But that has been a surprise. I like the virtual aspect of things to a degree because you can see a lot more companies, you can meet a lot more people. But I still think, ultimately, if you’re going to pursue something, you’ve got to kick the tires, you’ve got to shake their hands. It is nice to be able to get things a little bit further along before you do that.

INVESTMENT THEMES

Todd: Sure. Well, on the BDO front, we’re trying to be creative and host a lot of virtual events that we used to do in person. Good to get both of your perspectives. So, let’s shift gears again, and Dan, I’ll come to you. I’ve read about the key investment themes being at the core of MidOcean Partners’ investment approach. Maybe you can tell our listeners a little bit more about that.

Dan: Yeah, I’d love to. MidOcean Partners has had a thesis-driven investment focus since the outset of the firm with proprietary executive resources being a core component to the model throughout our history really. Today, whether it’s managed service provider businesses or the behavioral health space or direct-to-consumer models, food and beverage, information services and data. Each of our deal-team leads is working one to three live investment themes on any given day. Around each of those, we have a white paper with multiple operating partners. We have real conviction across the firm in the investment committee. And back to my earlier point around speed, that helps us move a little more assertively in the market. And we can be a provider of a real kind of strategic value-added capital, thanks to the work that goes into these investment themes upfront.

PRIVATE CAPITAL PULSE ANALYSIS

Todd: Well, sounds like a solid approach, Dan. Thanks for sharing. We’re actually going to transition to our last topic. I know you guys are having a ton of fun and it’s going quick, but let’s jump into it. I’d like to give a plug to BDO’s recently released Private Capital Pulse Survey. The survey actually found that three-quarters of fund managers expect the economy to perform better in 2021. Yet, over half are conducting business continuity risk assessments in preparation for a second wave of COVID-19. So again, I’ll start with Dan, and then hear from John. Does this surprise you in any way and would you have responded the same or differently?

Dan: Not really surprised to see it honestly, Todd. This is kind of cautious optimism in my mind. I do think that there are certain areas of our market, like in travel and hospitality and some of the areas in the service economy, that will continue to feel the effects of the pandemic for some time. But I think what we’ve seen in the middle market is that there’s just a ton of liquidity out there to support companies in a market that will kind of help drive growth. As John mentioned earlier, focus on add-on acquisitions, you’re going to see a lot of inorganic growth, a lot of capital going into organic growth initiatives as well. So, I think that’s kind of why you’re seeing some of the optimism around economic performance growth next year.

Todd: Right. Sounds good. John, what’s your take?

John: Yeah, I agree with everything Dan said. I think cautious optimism is definitely the operative phrase that we see. I think for industries that didn’t have a direct hit from the pandemic, we see within our management teams they’re very excited to get back out there, to start meeting with customers, start going after growth opportunities. At the same time they want to be ready for anything, whether it’s cases in their own facilities or second wave or whatever and so we’ll see. But I think cautious optimism is definitely the words of the day.

Todd: Let me ask you this one last point. The survey also found that directing capital toward applying equity relief to portfolio companies is down 15% compared to last year. Why do you think that is, and where do you see capital going instead? Again, Dan, we’ll start with you and then go to John.

Dan: So, this is a surprising stat for me, Todd, when you think about year-over-year comparison. Defensive capital deployment being down year-over-year as we deal with this economic uncertainty. I think the number may be very different if you take the survey at the end of the year. My view is that there are a lot of companies and sponsors and lenders that have been in “kick the can down the road mode,” for the last three-to-six months.
And so, companies have been really good about freeing up capital, freeing up cash through cost-cutting measures, through improved working capital management. Sponsors have been—I know our guys were working day and night with our management teams to help in that regard and to work with our lenders and leverage situations. Lenders I think have been pretty cooperative and flexible where companies are in compliance on the principal and interest side. So, that flexibility, that improved management around working capital and cash management is great. Probably can’t keep that up forever so, I think if you think about the defensive capital deployment in our market, through 2020 on the whole, if you take the survey at the end of the year or in the first quarter as a look back, I think that number may be different and I find it hard to believe that it would be down year-over-year, personally.

Todd: Okay, I appreciate that. John, what do you think?

John: I agree. I was surprised it was down, or it was going to be down. I thought maybe there was some concern about throwing good money after bad, and if you did have some of these companies in retail or restaurants or hospitality, that maybe some companies or maybe some investment firms were just pulling the plug on it. But I would still think that there would be equity relief going in in a number of situations. We have seen lenders be quite patient, but I think that I agree with Dan, I think that we can definitely expect that to change and evolve in the next few months here. I think part of it could be a matter of perspective, too. There are situations where we’re looking at putting capital in a company. We really see it more to facilitate growth, but at the same time, it’s such that the balance sheet isn’t constrained as the company looks to fund growth. So, I don’t know if we necessarily think of it as equity relief as so much as facilitating growth.

Dan: I think that’s a really interesting point, John. You hit on again a good nuance there and it comes down to how people may define defensive capital differently. So, you talk about growth investments, you can think about it on the M&A side, too. If you have a company that may need an infusion maybe you’d turn that into an offensive infusion through an add-on acquisition or two.

John: Private equity has been known to spin their performance every now and then.

Todd: We’ll definitely have to see how this all plays out. Listen, I appreciate you both taking time to join the PEspectives podcast. Again, John Lenahan with Wincove Private Holdings and Dan Ryan with MidOcean Partners, I appreciate my personal relationship with both of you and certainly the relationships that BDO has with both of your firms. So, thank you very much. I know you’re both busy guys. I appreciate you being on with me today. Hope you had a good time.

Dan: Absolutely. Yeah.

John: Thanks, Todd.

Dan: Good to have been with you.

Todd: Thanks, again. To our listeners, thanks so much for tuning in. If you haven’t already, we’d love for you to subscribe, rate, and leave a review of the show on iTunes. Until next time, this is BDO’s Private Equity PEspectives.
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