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Private Equity Sitting On Powder Keg But Not For Long

By **Pete Brush**

Law360, New York (November 14, 2011, 8:39 PM ET) -- With recent research indicating that $937 billion in private equity cash is sitting on the sidelines worldwide, huge mergers involving private equity are on the horizon as general partners face more and more pressure to invest their so-called dry powder, attorneys say.

The research, published by London-based alternative assets research firm Preqin last month, says billions of dollars' worth of unspent capital, including $91 billion raised during 2008 alone, must be spent soon, returned to investors or extended.

“Dry powder is at relatively unprecedented levels. Some of it may lapse because of an inability to invest in accordance with fund terms but much of it will be invested,” said Larry Bronska, a Chicago-based private equity partner with McDermott Will & Emery LLP. “Eventually it will find a home, which means that lawyers will be active supporting their clients' efforts in deploying capital.”

According to the Preqin report, some so-called megabuyout funds, geared toward control investments in multibillion-dollar companies, have been slow to deploy. Some of these massive funds, as large as $16 billion, closed back in 2008 yet waited until this year to make investments.

That data bolsters the notion that huge mergers involving private equity — the likes which have been relatively rare in recent years — are on the horizon, attorneys say.

“Whenever you have a weaker period of deal flow … there ends up being a buildup in private equity fund dry powder that is available to be put to work,” New York-based Weil Gotshal & Manges LLP private equity partner Michael Weisser said. “Deal lawyers are very used to cyclicality. When things turn, as they always do, we expect we're going to be off-the-charts busy.”

In order for such deals to happen though, an improved debt financing market to acquire portfolio companies will be the key going forward for private equity, according to Weisser.

Certain strategic buyers with healthy balance sheets currently have the upper hand in terms of finding debt financing terms to help acquire companies, he said, which could help grease the wheels.

“When the debt financing markets and macroeconomic conditions improve, we could see mergers and acquisitions activity explode, fed by interest on the part of strategic buyers as well as private equity on both on the buy side and sell side,” Weisser said.

While that process has already begun behind the scenes, caution still abounds right now in the M&A and private equity world, according to Weisser.

“Deals are simply being put on hold and bankers aren't forcing bid deadlines until the environment normalizes,” he said, which translates to “pent-up demand.”

But not everyone is convinced that the report's numbers add up to a greater number of private equity megadeals in the near future.

“It's going to be great work for the firms who get those deals but there's not going to be a flood because, by their nature, only a certain number of funds qualify for deals of that size,” Blayne Grady of Akin Gump Strauss Hauer & Feld LLP said. “And they're only going to happen if the general partner likes the opportunity.”

While certainly a factor, the vintage of funds by itself will not push general partners into making these decisions, according to Grady.

“Fund performance remains the primary driver,” he said.

Still, experts say the sheer volume of dry powder will mean general partners will be required in some cases to ask their limited partners for an extension since they will not be able to invest it all in the required time frame.

That, according to Locke Lord LLP partner Billie J. Ellis Jr., will have them looking back at the terms coded into their fund agreements as they determine how to proceed.

Typically, according to Ellis, fund documents will either allow an automatic fund extension, under certain circumstances, or will require a percentage of limited partners agreeing to an extension.

“Lawyers try to create the most liberal avenue for the general partner to extend,” Ellis said. “But that's driven by what the market will allow.”

Extensions might be a hassle, according to experts like Ellis and Grady, but they are a better alternative to what could await.

“The primary concern continues to be the performance of the fund,” Grady said. “Nobody wants to go back to investors for an extension. But that's an easier conversation to have than explaining why a mad rush to make deals has created a fund that isn't performing well.”

--Editing by Christie Smythe and Andrew Park.