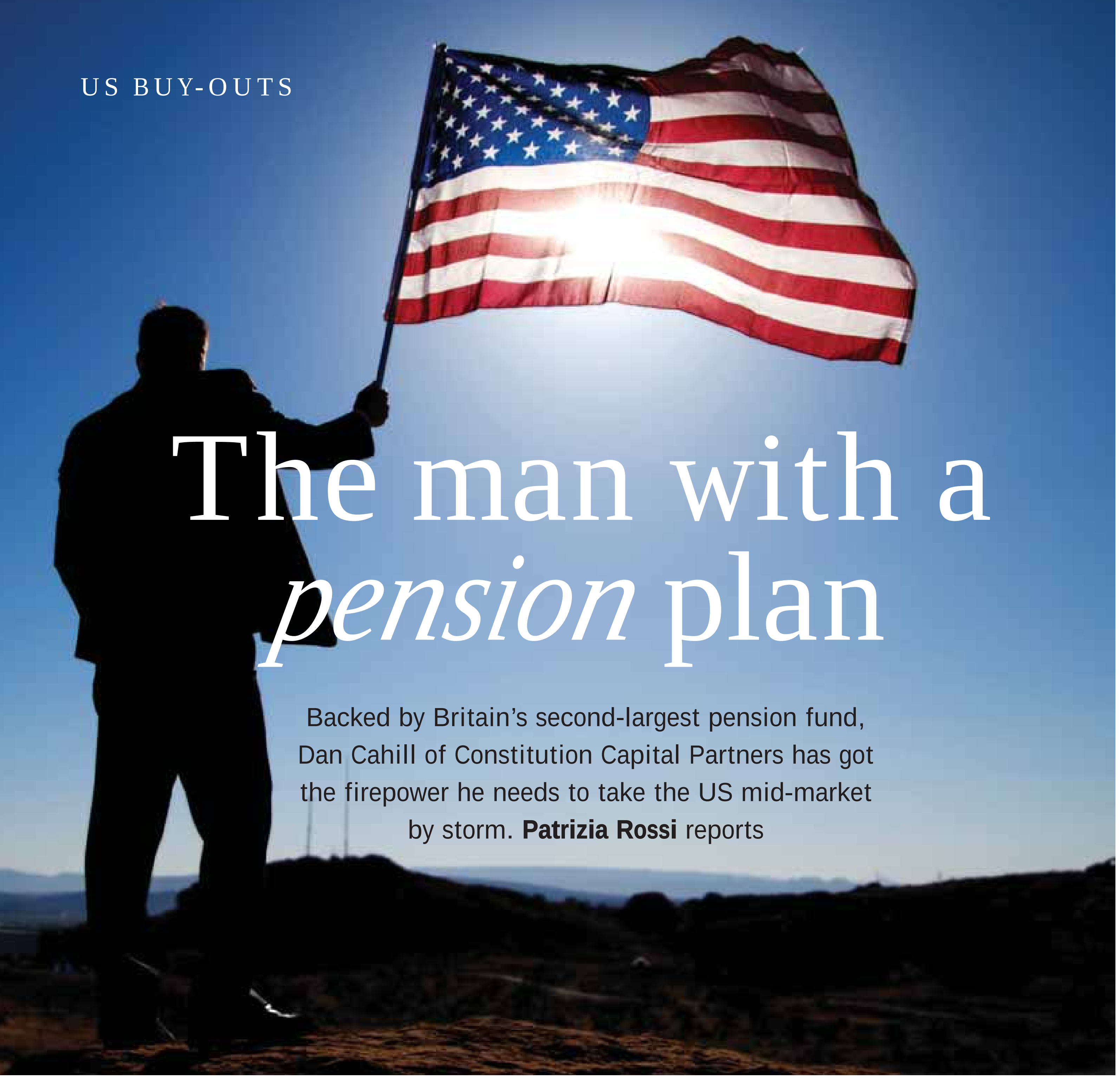

The man with a *pension* plan

Backed by Britain's second-largest pension fund, Dan Cahill of Constitution Capital Partners has got the firepower he needs to take the US mid-market by storm. **Patrizia Rossi** reports

It was a fairly gutsy move. As the number of global leveraged buy-outs (LBOs) took a hammering, Dan Cahill decided to part ways with Standard Life Investments Private Equity USA in October and start a new venture – Constitution Capital Partners (CCP), a Boston-based private equity firm focused on US mid-market buy-outs.

Faced with an 86 per cent drop in US private equity deals compared with the same period last year, according to Thomson Reuters – just $42 billion (£21 billion) in the first six months of the year – Cahill is more confident than one might expect.

Managing partners Cahill and John Guinee, also formerly of Standard Life, have sized up a number of mid-market deals since February, concentrating on $10 million to $45 million investments in companies worth $100 million to $1 billion, alongside commitments in funds ranging in size from $200 million to $5 billion.

"We were starting from scratch, but felt comfortable and confident that we would be able to raise capital," says Cahill. "Sometimes, talking to private equity groups and conducting due diligence was challenging as they would say, 'Where is the capital coming from, Dan?' and I would say, 'Don't worry, it's coming.'"

We continued to operate as if we had capital and were up and running – we just weren't getting a pay cheque, which wasn't fun," he notes.

OLD-SCHOOL FUNDING

After four months of talks, the Universities Superannuation Scheme (USS), the main pension scheme of Britain's universities and academic institutions, with some 250,000 members, took a ten per cent stake in the Boston buy-out house as well as backing CCP with a $750 million strategic partnership.

"When you take a diversified approach and have relationships with the better fund managers, you can weather the storm and come out with the wind at your back" Dan Cahill

The deal was the pension fund's second investment in a private equity firm this year, coming on the back of the £56 million acquisition of a majority interest in the London-based investment management group Climate Change Capital in May. The deal was backed by USS and a consortium of investors, and marked a further investment for USS, which had already committed €35 million to a fundraising by Climate Change in July last year.

Mike Powell, head of alternative assets at USS, has since told the press that the fund aims to "look for the most effective way to increase our investments in North American middle-market private equity".

The CCP deal is also in line with the pension fund's strategy of investing larger amounts with fewer firms in order to pay lower fees to private equity managers – a strategy that has been followed by other US and Canadian pension funds.

"Private equity is a relatively expensive class, and one of our objectives is to reduce our fees, as long as it is not at the expense of quality and returns," says Powell.

Cahill adds: "When you get a call from a large, sophisticated pension plan like USS, it's exciting. They were looking for a private equity group with expertise in the mid-market space.

"They flew over and did extensive due diligence on us – much more than I would have anticipated – and this is why we are happy with them as partners and as a funding source. We view them as a very sophisticated, savvy investor."

STORM IN A TEA CUP

Despite the $750 million burning a hole in Cahill's pockets, writing deals and lining up senior debt funding could well be problematic. Thomson Reuters' M&A 2008 analysis shows that North American deal-making has been hit hard. However, Cahill insists that mid-market deals are still coming through and that he is seeing companies that are better capitalised and better set to weather the storm.

He also observes that buying opportunities have improved as sellers have adjusted their price expectations compared with a year or two ago, with purchase price multiples coming down dramatically.

"We find that some of the more seasoned investors look at the current climate as an opportunity to outperform. When you look at the last two recessions in the US, the vintage year performance numbers are much stronger when investing in a down-cycle. And some of the more sophisticated investors understand that in periods of 'dislocation' there is opportunity as long as you are with the best groups."

ON THE RADAR

CCP is taking a diversified approach, with plans for five direct investments in companies in the healthcare, financial services, logistics, media and construction sectors over the next 60 days. It also plans to make six commitments to private equity funds during this time.

Cahill says: "This month, we made our first investment, a $40 million commitment with Nautic Partners, a fund manager that focuses on the mid-market space. It's a group we did a lot of due diligence for when we were with Standard Life. We stayed in touch and we came in at the final closing – in fact, we were the last investor in."

In addition to Nautic Partners, Cahill says he is looking to make a string of commitments in buy-out funds over the next 30 to 60 days. Other fund managers CCP intends to commit capital to in the near future include Towerbrook Capital Partners, Avista Capital Partners, American Securities, SunTx and Windpoint Partners.

TOUGH TIMES AHEAD

Despite talk of expanding into Europe with a London office over the next two years, Cahill says he will have his work cut out for him this year: "These are certainly challenging times in terms of deal flow and activity, which has dropped dramatically.

"When you take a diversified approach within the mid-market buy-out space and have relationships with the better fund managers, you can weather the storm and come out with the wind at your back. In times of 'dislocation', the better fund managers have the ability to find deals and structure them correctly. They are certainly putting in more equity today than they normally would – capitalising the companies for future growth. I think the next 12 to 18 months will certainly be challenging." ■

DEAL AT A GLANCE:

COMPANY: CONSTITUTION CAPITAL PARTNERS (CCP)

INVESTOR: UNIVERSITIES SUPERANNUATION SCHEME (USS)

DEAL: $750 MILLION

USS ASSETS: £30 BILLION

SECTOR: US BUY-OUT MARKET

ADVISERS: ROPES AND GRAY LLP PROVIDED LEGAL SERVICES TO CCP. PROSKAUR ROSE LLP ACTED AS LEGAL COUNSEL TO USS

DATE: JUNE 2008