As private equity shifts from a financial engineering to an operational model, M&A conducted a roundtable with top “operators” in the business who shared their best practices.
Roundtable

THE NEW PRIVATE EQUITY TOOLBELT

As the asset class shifts from a financial engineering to an operational model, top “operators” in the business share their best practices.
Whether dealing in boom times or a downturn, most private equity investors realize that future returns won’t be solely a result of “buying right.” Multiple expansion, in recent years, has often been factored out of the investment calculus, and the pressure is on sponsors to bring about operational improvements in the businesses they control. In September, *Mergers & Acquisitions* brought together a number of proven operators to discuss best practices in driving positive change.

**Mergers & Acquisitions:** Looking around, it’s fairly obvious that everyone here has already seen the light as far as investing with an operations mindset. Let’s go around the table and discuss the various methods through which you each try to do this.

**Alvarez:** Well, I think we need to break that up between pre-acquisition work and post-acquisition work. On the pre-acquisition work, we’re seeing a lot more firms do operational diligence upfront; and whether it’s hiring outfits like us to help or having operating partners involved, such as a CEO type, I think all of the above are good approaches.

**Psaros:** I think we’re a little unique, given that our operating focus is quite literally the only thing that we look at. We’re not a leveraged buyout fund. I don’t know what my leverage multiple is in any of our portfolio companies. I don’t know what my weighted-average cost of capital is. You could jack our rates up by 500 basis points and it doesn’t move the needle in our returns. We buy underperforming, distressed businesses — businesses operating in bankruptcy and in default of their obligations to creditors. These companies often don’t have a management team intact or a business plan. So the only thing that matters to us is how to take something that’s Ebitda negative and turn it into a viable and profitable going concern.

Usually we rely on the experience of our own partners and our own internal resources, augmented, in some cases, by industry experts.

When you go out and fundraise, you’re often asked: “Who are your operating partners?” It’s become such a standard question, and we’ve always had the impression that it’s just pure marketing shuck. My response is: If you want me to hire 20 guys who have all worked at GE at some point in their career, I can do that. But we’ve been able to do what we’ve done internally and with the experience of our existing partners.

**Feldman:** I would say we’re about 180 degrees from what KPS does. But I think most of the people around this table, in one form or another, would consider themselves to be value investors. And everything stems from that mind-set. We’re looking for situations that represent value in a market in which value has become pretty difficult to find. So we typically look at companies that need work in some form or another.

Unlike KPS, we won’t do turnarounds on purpose — only by necessity. But we definitely agree with their philosophy on operating partners. We’re generalists, and if you have operating partners and you’re not specializing in a specific area, it can be very difficult. Those guys are constantly bringing in deals that, frankly, can be a waste of time. And you may end up doing deals that you probably shouldn’t because you end up getting tired of saying “no.”

"I can’t believe the companies that I have seen refinanced in seriatim over the last three to four years.”

Michael Psaros
Managing Partner
KPS Capital Partners
But you can find talent pretty easily today. And everybody knows what private equity is, whereas 15 years ago they didn’t. So it’s pretty easy to find good talent. The trick, though, is finding the right guy for the right situation.

Mergers & Acquisitions: Mike raised a good point. If you talk to recruiters, the trend du jour in private equity has been to stock up on operating partners, and then declare yourself as a firm focused on operations. But obviously there’s more to it than that. As proven operators, how do you guys differentiate yourselves from everyone else out there that claims to have the same capabilities?

Almeida: We, unlike some of the other firms here, invest in just two industries. So the operating partners — we call them our resources group — is effectively 10 people made up of a combination of true operating executives from large companies, as well as other folks, who probably held more of an M&A or development role at one point in their careers. These are folks who’ve lived in the industries that we’re investing in, so their role is really multi-faceted: It’s about finding deals that we might not otherwise see through the more traditional networks; it’s assisting with the due diligence; it’s helping to locate, recruit and retain the best managers in a particular industry; and, finally, we have people in our operating resources group who are true operators that are working on strategy and other operational issues across our portfolio.

It’s not a model that we ever force on our portfolio companies. And, I guess the one addendum I’d probably make to the approach is that roughly 40% of our current C-level executives are people whom we’ve worked with before. So you can talk about outsourcing these issues, bringing in operating partners, etcetera, but there’s nothing better than working with people you know. And working with proven managers is usually the best way to assure operational excellence.

Arenz: For years, at Harvest, we’ve felt that we could bring more to a portfolio company if we had somebody inside the firm with operating experience who could be dropped into a business when it needed help. From time to time a portfolio company may encounter a specific problem and it is very valuable to have a guy on staff that can be adaptable. We have one person that fits this mold, and we’ve worked with him for about five years. We’ve dropped him into a couple situations and had him work on specific issues. It could be a manufacturing issue or it could be that inventories are out of control, and for whatever reason, the C-level executives at the company can’t figure it out, but our guy can come in and help them sort things out.

Mergers & Acquisitions: Just going back to Greg’s point, are these guys performing deal sourcing on top of their portfolio oversight functions or are they strictly operations?

Heidecorn: For us, it’s not a sourcing role. At Catterton, since we are an industry-focused group [specializing in the consumer space], it’s really important to have a stable of people that we already know — people who seek us out and want to work with us because they like the industries in which we play. But we’re very specific as to who we want to work with. The trick, though, is matching the timing of the deal with the people available. And that’s always a challenge.

In terms of our usage of the operating partner model, though, we’re a bit of a hybrid, quite candidly. Many of the partners at Catterton have been operators in a past life. What we try to do is get our operating partners involved early on in the deal process. A question we run into is how do you manage these resources correctly when you run into a speed-bump situation? To warehouse a whole staff of operating partners can be a little upside down and, I think, very frustrating. So at Catterton, we’ll augment the operators we have in house with outside resources.

Perlman: Since we’re specialists as well, all we do is invest in consumer retail businesses. So we pride ourselves on having a deep and extensive network in the industry. And when we went out to raise our fund, we ended up raising over $30 million from around 60 consumer retail executives. In addition to those executives, two of my partners have operating backgrounds; one was the former president and a co-founder of Staples [Henry Nasella], and the other is the former CEO of Phillips-Van Heusen [Bruce Klatsky]. They’re not “operating partners,” but rather true partners who are in the office every day.

So our approach is that whatever issue our portfolio companies may come across, we can put the management in touch with two or three other CEOs who have been
there and done that. And, to be clear, we would never tell our portfolio company CEO what the right answer is. But we feel that by giving them access to smart, experienced individuals, they can figure it out, and we can help them improve operations that way.

**Mergers & Acquisitions:** When it comes to sourcing deals, what kind of advantages would you say someone like Mr. Klatsky or Mr. Nasella provide, as former operators?

**Perlman:** Bruce Klatsky, of course, ran Phillips-Van Hausen. So we might get a heads-up on deals in the apparel industry that maybe only a handful of others would know about. And he helps us get to the right questions very quickly during due diligence. When there’s so much money out there chasing deals, that focus helps us compete with speed and certainty, which is very important.

And, just as important, that experience adds value when we invest in a company.

**Mergers & Acquisitions:** I imagine there are some intricacies to recruiting pros with a focus on operations. What would you say are some of the key attributes that you look for when it comes to hiring these folks?

**Smart:** At Fenway, we have a separate box off to the side called Fenway Resources. And it’s designed to be a flex box. Currently, we have four executives in there, and all four are executives that we’ve worked with successfully in the past. And I think that is an important criterion. We want to put talent inside that box that we have confidence in, and since there’s that familiarity, we will know where and how to use that talent.

On one hand, the experience of our Fenway Resources group is fairly broad based, but on the other, we have a couple of guys whose skills are fairly specific. That determines how we use them, whether it’s on a project basis or working directly with our deal team.

**Mergers & Acquisitions:** Does there need to be experience with private equity firms or at least experience working in highly leveraged situations?

**Feldman:** Not necessarily. I would say just the opposite. I don’t think the leverage issue, when you’re trying to buy companies for five and six times Ebitda, is a real issue in any of our companies — unless, of course, they stumble, and then we’ve got other problems.

I would say the hungriest people we’ve found have been the people who haven’t been in private equity before. There have been a lot of situations where we brought someone in, and they made lots of money. It is great advertising and they’ll want to work with us again, but we’ve found that the first time out, they’re hungry and focused.

**Psaros:** None of our executives have had experience with private equity firms or leverage situations before. And we are just now starting to recycle CEOs. We did that last week, actually, so perhaps my story will change, but I tend to agree with Greg.

**Heidecorn:** We’re not a leverage shop, so for us, we’re looking at things where we’re actually driving earnings backwards because we’re investing in growth — that’s just our focus. With that in mind, we want to make sure people are comfortable with that. We have to make sure right out of the box that we have that alignment and it can be tough, because initially, everyone is in deal heat and feeling good, but some guys just don’t make it.

**Feldman:** We’ve learned to act a lot faster than we used to when it comes to making a change [in personnel]. If we’re wrong the first time, we won’t show any hesitation trying somebody else.

**Almeida:** I would just add one comment: We’ve found that executives who are not experienced working with private equity firms are often not used to the kind of accountability we typically demand — the monthly operating reports, the monthly operating reviews, seeing the budget before the board meeting, etcetera. And those things happen quickly or they don’t happen at all.

**Mergers & Acquisitions:** What do you guys think about the star CEOs? As the industry has grown up, it seems like a lot of names, whether it’s Jack Welch or John Browne, have jumped into the asset class. Are they really adding value in an operating sense or is it more about their Rolodex and ability to open doors?

**Roundtable**

“Our initiatives are really focused around trying to get that cash flow to materially move higher.”

Gregg Smart
Senior Managing Director and COO
Fenway Partners
Perlman: In general, I’m very wary of that approach. We certainly have our fair share of star CEOs who are friends of the firm, but oftentimes, when we’re dealing with a rapidly growing middle-market company, a star CEO may not appreciate the issues they’re facing and it may not represent the right cultural dynamic.

And when you’re trying to make that connection, you want to make sure that the personalities and the culture fit, otherwise you’ll just create a dysfunctional relationship. So some of the CEOs mentioned are obviously great and if they wanted to help us out at LNK, we’d be happy to take them in. But finding a good match is not about the resume but rather the personalities and finding people who have specific experience with a particular issue that a portfolio company may be facing.

Heidecorn: It really comes back to the question: What is the construct of your partnership? Is there one strong individual who is effectively the person making the call? I think then you might encounter those kinds of challenges. If it’s a partnership — a true partnership with a capital “P” — then it should be strong enough to take in all the differing views. I think it takes time, though, and you have to create the right balances and have the right forums to deal with certain conflicts, which can be healthy.

Mergers & Acquisitions: Let’s go back a bit. How have you seen this “operations” trend evolve? People have been talking about this migration away from financial engineering for years, but when did it really start to percolate?

Feldman: We used to all be operators in the 80’s, because you had to be. Of course, we were all financial guys, but we thought we were operators and that got us into trouble. I think the world has changed, though. Today, you have to distinguish yourself in this market, whereas back then — since it wasn’t as competitive — you didn’t. Now, as some have said, private equity is in danger of becoming commoditized. So you have to do something that the other guy isn’t and a lot of people look at operating skills as a way to do that.

It also probably enlarges the scope of dealflow. Firms like Welsh Carson, who have experience in healthcare, can go after deals in that sector. We, on the other hand, can’t because we wouldn’t know what to do. You can’t just dabble in healthcare.

Alvarez: One of the things we’re trying to do with regards to our operating platform is actually assist where we can in certain industries to help generalist firms to have that operating skillset. In fact, we actually have a healthcare group and we try to provide that operating talent, more on a broad-bench perspective.

I’d also be interested to hear from a post-acquisition standpoint. Once a portfolio company is in place, do you find that more firms put together a 100-day plan versus what it was like in the eighties?

Heidecorn: When we finalize a transaction, everyone, with all good intentions, puts together their 100-day plan. Everyone feels good, the PowerPoint looks great and everything’s wonderful, but once the deal closes, it’s off to the races and off to the next transaction. The trick is to make sure that those pieces get nailed, and get nailed in the right time frame. Nick and I have had some good conversations about how to monitor it, because once you start getting off track on a few things, it generally doesn’t get better.

Almeida: And CEOs, by their very nature, don’t want...
to have an equity investor force resources on them immediately post-acquisition. But they’ll realize at the end of the process that it’s been well worth the time, effort and money.

Generally, we like to bring in an outside resource to monitor the integration and make sure the company is hitting the benchmarks. And if they’re not going to do use this resource, there needs to be a reason why, as opposed to us justifying why we’re bringing these resources in.

**Feldman:** I agree with everything you just said, and I also agree with what David said, because the deal team, whether they admit it or not, will always move on to something else. These young guys don’t really like doing day plans; they like doing deals. So we brought in a guy who has experience in managing processes. I wouldn’t call him an operating partner, but he’s a six sigma, black belt to the tenth degree, whatever it is, and he’s good at evaluating talent but he’s also good at monitoring things.

**Perlman:** Our approach is slightly different. Even though we have all these executives and resources at our disposal, we only invest in premium companies with strong management teams. We don’t do underperforming. A lot of times our involvement is to help the companies go from good to great, and, frankly, a lot of times we won’t even involve ourselves at all. If we find that the management team is working well and the company is performing, then we’re happy to not get involved.

It’s much more of a pull from the management teams rather than a push on our part. What we’ve found, typically, is that for the first 180 days or so, we probably won’t be involved. But once the companies realize the access and the relationships we have, then they ask for a couple of favors here or there. And when they want something, we’re there to help no matter what they want.

**Psaros:** See, the nature of our transactions as a turnaround investor is completely different. Forget about pulling. We’re more like the naval cannon going off contemporaneous with the close. The vendors expect change, the customers expect change, the employees expect change — basically, everybody expects change. We won’t make the investment unless we have a fully articulated turnaround plan going into the close, and on the day of the close it starts.

We made an acquisition about four or five months ago of a corporate carveout. Literally, the day we closed, we reduced the work force by 25 percent. So I would characterize us as a push investor as opposed to a pull investor. You have to be to work in our space.

**Perlman:** I’d also add that our goal is to back management’s plan. And our operational experience helps us to decide which plans to back. It gives us insight into which plans to believe and which ones are too aggressive. So our approach is very different.

**Smart:** I’d say that our strategy sits halfway in between.
and requirements of SarbOx that aren’t very productive. So there’s not any less pressure, but there may be less focus on things that don’t really matter. And I think that’s the difference between the two.

Feldman: By the way, if you’ve got public debt, a lot of us have to deal with SarbOx as private companies, and it tends to be more of a distraction than anything else.

Mergers & Acquisitions: Let’s talk a bit about returns. Obviously everyone here’s an operator, but how much of your fund performance can still be attributed to “financial engineering?”

Heidecorn: We don’t take on very much leverage. We generally invest more money into sales and marketing, and will actually drive earnings backwards to a certain extent. It’s an interesting model and it works for us, so long as you know where you are on the “J curve” it can be effective. And then, when we get some level of comfort with our cash flows, that’s when we’ll take on some incremental leverage, but it’s not financial engineering.

Perlman: We’re the same way. We bet on growth and it’s more about improving operations and growing Ebitda. I was looking at our numbers before this roundtable, and the average Ebitda growth across all of the companies that we’ve ever invested in, over the lifetime of our investment, has been over 300%, representing an annual CAGR of 26% per year. So we’re much more about driving growth than looking for returns through financial engineering.

Smart: I looked at our track record, and if I were to break down the return equation into three buckets, it would be: multiple in, multiple out; debt pay down; and the third would use Ebitda as a proxy for cash flow. In our case, it was around 65% Ebitda growth, with some of that coming organically and some acquired. I’d say there’s a bit of a fuzziness around that, but all in all our initiatives are really focused around trying to get that cash flow to materially move higher and how we can help the management team to do that.

Feldman: And that will drive your exit multiple higher. Starting with operational improvement will make everything better. It will increase the debt pay down, obviously, and provide a better exit multiple. And that’s been our model — to focus on driving Ebitda improvements.

Mergers & Acquisitions: Given that where purchase prices are today, or maybe I should say three months ago, could you still even factor multiple expansion into the equation?

Almeida: I think the world has changed so quickly that we’re all trying to assess exactly what this means for asset valuations, but our base case financial models always assumed some sort of multiple contraction up until about three months ago.

The thinking used to be that you could pursue more buy and builds and use acquisitions to move up in size to create multiple expansion. Those are the situations where you could drive margin improvement and growth and you’d expect to see multiple expansion over time. But clearly we don’t count on that any longer. We probably never should have counted on that to begin with, but we certainly don’t count on it anymore.

Feldman: We won’t buy companies assuming multiple expansion will happen. It has to work at the same entry multiple. But when you make four times your money, it’s because you’re getting multiple expansion.

Mergers & Acquisitions: John mentioned add-ons, which brings up a separate, but interesting point. How does an operational focus help as far as finding and integrating new deals for a platform?

Almeida: It’s a sine qua non. If you don’t know how to operate businesses, you really can’t do deals, because that’s the quickest way to screw up a situation, period. Anyone can assemble spreadsheets to make deals look good, but actually putting the businesses together and creating the right strategy, that’s how you create value through buy and builds.

Psaros: We’ve had a lot of success doing that. I step back sometimes and am surprised by how much value is unlocked across the tube when you nail it.
Heidecorn: Bolt-ons can work perfectly. If you believe in your management team and they know what they’re doing, those deals are generally a pretty low beta. But it can be difficult when you try to take two cultures and combine them after you’ve been with your management team for a couple years. The question becomes, “Who’s got their hands on the steering wheel.” You can lose time, and time is our biggest enemy.

Mergers & Acquisitions: Switching gears a little bit, how does a company’s size impact operational initiatives? Is it easier to instill change in a small- or mid-market company than say a two-billion-plus large cap?

Alvarez: I think the big difference is just the level of management and the number of people needed to do the work. In a lot of the mid-cap companies that we have worked with, you’ll have an entrepreneurial type, who’s really had his hands on the expenses. In other cases, where we’ve worked on carveouts or integrations, we’ve beefed up certain overhead functions such as IT or finance. On the larger companies, we typically find more fat. There’ll be too much overhead compared to too little.

Feldman: The bigger the better. I’ve learned the hard way.

Psaros: I agree with that. There’s nothing harder than trying to turn around a lemonade stand.

Feldman: With larger companies, you can also make mistakes and live to see another day.

Heidecorn: That’s funny. There was a bolt-on that we had been working on for six months or so, and the performance had just deteriorated. The seller couldn’t understand why we wouldn’t just reprice the deal, and use a lower multiple. It’s because the company has turned into that lemonade stand. It’s not worth spending time on anymore because the odds on making it work are too low, so you’ve just got to move on.

Mergers & Acquisitions: Tell me about globalization. I imagine this trend often overlaps with the general “operational” movement going on in the asset class?

Psaros: China has been the best thing that has happened to our firm. To me, we’re primarily a manufacturing/industrial fund, and there’s this mythology out there that America doesn’t make anything anymore. Our GDP doubled in the last six years. Manufacturing has remained at 14% or 15 percent. So if you do the math, we’re manufacturing in dollar values twice as much as we did in the earlier part of the decade. But a lot of these businesses in the middle market that we invest in have been 100% pure play U.S. and Canadian businesses, and to work with them and to morph them into a globally thinking, export-driven enterprises has been a lot of fun.

We sold a company last Monday [Genesis Worldwide II]. When we created it, buying the assets out of bankruptcy, it was a 100% U.S. company. By the time we sold the business, it had over 50% of its revenues coming from exports to greater East Asia, primarily China. We’ve also done joint ventures in Asia, in Europe, etcetera. So it’s not just export. I don’t want to limit it to that. But globalization, overall, has been extremely important.

Mergers & Acquisitions: Again, switching gears a little bit, groups like the SEIU have come down on the industry in recent years, and I’m sure everyone here knows all too well about the debate going on in Washington. Everyone here can point to a company that grew under your stewardship or a company that you actually saved and added jobs. Are the social aspects of being operators an added benefit?

Psaros: That’s why we refer to ourselves as “constructive investors in special situations.” I would say that about a third of our dealflow comes straight from the big unions and I don’t think we could have turned around 90% of the businesses that we have without the affirmative engagement with labor.

“...what people don’t necessarily understand about this business is how firms make money.”
Tom Arenz
Senior Managing Director
Harvest Partners
We’re very hardcore turnaround investors. We close plants; we lay off people; we bring in new management; we do all this stuff. But before we do any of it, the union has the playbook. They have every single analysis and every single consultant study that we’ve done. We’ve just found that transparency has really worked for us, along with the dialogue. If you remove the surprise, it can go a long way toward the industry building a bridge to labor.

Arenz: What people don’t necessarily understand about this business is how firms make money. Well, they make money ideally by making a company a bigger, faster growing and more profitable business, which truly aligns what we’re trying to do with labor, frankly. And to leave a company weaker so that jobs in the future are going to be lost doesn’t serve anybody. There are the fancy birthday parties and the big names with billion dollar net worths, but that’s not really what’s going on throughout most of the industry.

Smart: And the subtle irony perhaps is that, for many of us in this room, we’re investing money on behalf of retirees, many of whom were union members, state or corporate.

Mergers & Acquisitions: When you guys acquire a company, how do you try to educate the employees about what it means? I think there’s a misconception out there among the general public that an LBO translates into cost cuts and lost jobs. How do you impart to employees that that’s not necessarily the case?

Almeida: We expect the CEO and the senior leadership to ultimately be responsible and accountable for putting the employees at ease. On occasions we’ll make presentations, but it can blur the distinction between who you’re empowering to make the decisions and who the employees believe is running the company. And that’s a distinction we never want to blur. We’re on the boards. We try to be value added. But if we have to run companies, at least in my firm, it means that we’ve made mistakes along the way.

Feldman: I would say it’s important to impart to employees that by improving the growth prospects of the business, you’re improving the business for them. In a lot of cases, such as retail for example, it creates a lot more opportunity for people to move up. If you can communicate that, you can actually get people very excited.

Alvarez: The important thing is communication. We’ve worked in carveout situations where we have an HR group within the company communicate the opportunities that new ownership will bring in. Even in distress situations when there may be layoffs, the important thing is getting the communication out there.

Mergers & Acquisitions: Let’s discuss the current environment. If you believe all the stories out there, the economy seems as if it’s headed for a downturn. Does such a scenario underscore why it’s so important to have an operational focus?

Arenz: If you go back to the early 90’s when the economy did slow, you had basically good companies with balance sheets that needed to be fixed. There was an operating element to survival, but it mostly had to do with fixing the balance sheets. Having just gone through a period where asset values rose, high prices were paid, and a lot of leverage was put on the balance sheets, we’ll really have to wait and see what happens to the economy. Will it be that businesses are over-levered but are fundamentally still growing, albeit at slower rates, or will it be worse than that?

“On the pre-acquisition work, we’re seeing a lot more [PE] firms do operational diligence upfront.”

Nick Alvarez
Managing Director and National Practice Leader
Alvarez & Marsal Transaction Advisory Group
Feldman: And do those companies have covenants?

Almeida: Good investors have to make money, no matter which method they use. In the last three or four years, I’m sure we’ve all made some money using financial engineering. I don’t apologize for that at all. Our LPs would be upset if we didn’t. But we’re going into a period where the credit markets are going to be very different and access to capital is going to be more difficult, so there has to be a different model in order to generate outsized returns. And if you don’t put an operational focus on it, my sense is the financial engineering opportunity will diminish.

Psaros: I think most of the people around this table are of the age where we have seen probably four cycles or more, and I agree that there will be — or at least I hope there will be — a credit contraction over the next 12 to 24 months, maybe longer. But as soon as the spigot gets turned on again and liquidity flows back into the market, then financial engineering will be back. It’s cyclical.

Feldman: For sure.

Mergers & Acquisitions: As a final question here, I’d like to go around the table and have each one of you make a prediction. It doesn’t even have to follow this operational theme. It can be of the economic variety or whether or not the Yankees will win the World Series. Completely your call.

Psaros: Well, if you look back over the last three or four years, there is an enormous amount of companies that would have either filed for bankruptcy or entered into a formal restructuring process in or out of court. I believe that given what’s happened in the markets over the last 30 to 60 days that the perpetual refinancing of companies with serious operating problems is going to stop, and when it does, you’re going to see defaults rise. I think you’re going to see a lot of reorganizations in and out of court, with much more probably happening out of court.

I can’t believe the companies that I have seen refinanced in seri-atum over the last three to four years. At the firm, we refer to this as the “perpetual daisy chain” of bail out and Band-Aid financings. It’s never happened before in my career, and I just don’t think that it can continue if markets are rational.

Feldman: My concern is the mega funds and what they are going to do with all the capital that’s been raised. I know they have spent a lot of it over the past few years, but there’s a huge overhang of equity in our business, and it seems fairly clear that there won’t be these huge take-private deals available in the near future. So where is all that capital going to go? I’m concerned that it might come back down to the middle market and start competing with us. I think it already has to some extent.

Heidecorn: I think the biggest unknown — assuming there are difficult times ahead — is who controls the debt and have they been through these cycles before. If it’s the hedge funds, they’re different players than the old school, traditional banks. And unlike the banks, you can’t predict how they will act through different cycles.

Mergers & Acquisitions: If you had to guess, how do think they will act?

Heidecorn: They’re half our age, so I really have no idea. It’s too tough.

Smart: From the limited partner side, we’ve really seen a rush into mega funds over the last two and a half years. My prediction is that the trend is probably playing itself out. It doesn’t mean new vehicles won’t open up, but the enthusiasm for putting money behind a few large-market names will probably be viewed as just one chapter in the book.

Perlman: I would probably echo Michael’s and David’s concern over the credit market. It will continue to be tight and some of these hedge funds who have been major players haven’t been through cycles before. They were opportunistic in getting in, but they may not have the mind-set to work it out. So it’s going to be interesting. And I’ll go with the Yanks in six for the series.

Arenz: I think one of the topics that we’ve certainly discussed internally, and it’s been discussed in the industry, is: Can you survive as a middle-market firm? Do you need to become a multi-billion dollar, multi-asset class investment firm? And I think the answer is that there’s always going to be a place for the $500 million to $1.5 billion firms that can really help mid-sized companies grow.

The other thing that I expect to happen — even though there might be a little retrenchment in the near term — is that we’re going to continue to see states and other institutional investors continue to open their investment programs up to private equity. And they’ll find places in the middle market where they’ll still see returns that are either 500 or 1,000 basis points over what they’d find in the public market.

Almeida: We get paid to be skeptical, so it’s tough to look at the next handful of years and say that it’s going to be easier than the last few. That having been said, I still fundamentally believe this credit retrenchment is fundamentally a positive thing for our part of the industry. What will happen, I think, is that some of the firms that have the “me too” type of strategies, those firms will have a harder time creating value for their limited partners over time. But if you’re specialized, and if you have different operating strategies, I think that’s the way you can continue to separate yourself from other firms in the industry.