Churchill Spotlight

This week we speak with David Wachter, Founding Partner & Managing Director, W Capital Partners

W Capital Partners is a private equity firm that acquires non-control, direct PE investments and portfolios of investments in the secondary market.

On The Left: David, just to clarify what W is all about, you don't trade LP investments.

David Wachter: That's right. We're not a Lexington or Coller, for example. We buy ownership interests in companies. Our clients are private equity sponsors who are low on realizations. They want to receive a gain or sell a percent of the business but keep control and the existing cap structure intact. We don't believe anyone else in the U.S. does this exclusively, or at our size.

OTL: Where do your opportunities come from?

DW: We're always discussing deals with GPs, mezz funds, insurance companies, and banks – anyone who takes an equity position.

OTL: Could you give us examples of different structures you'll consider?

DW: Sure, it's pretty simple. There are three types of investments we make. We can make an equity investment in one single portfolio company. Or we can invest in several portfolio companies. Or we can make partial investments where the GP sponsor keeps control but sells down a minority stake. Every GP we deal with has their own specific needs which we can tailor solutions to match.

OTL: Do you only look at buying at significant discounts?

DW: No. We're not vulture investors. Our valuation is not based on discounts, but on a fair value bottoms-up approach. We price for long term IRR and multiples based upon the stages and risk of investments, not discounts. Our valuation typically establishes an unbiased third-party valuation for the equity investors in that company.

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OTL: How big are the companies you invest in?

DW: More than 75% of the sixty companies in our portfolio have Ebitda over $25 million.

OTL: How about sectors?

DW: Sectors we focus on include financial services, business services, technology, media, consumer, industrial and healthcare.

OTL: Do you distinguish between growth equity situations and typical LBOs?

DW: We make a market in a spectrum of opportunities. From late-stage venture, to growth equity, to growth buyouts, including co-investments, as long as it's a non-control situation.

OTL: I can imagine sponsor exits have not been robust over the past few years.

DW: A key metric for GPs is DPI, or distributions to paid-in capital. That's been a very lean number with 2005-08 vintage funds. Those funds are becoming fully drawn and fully reserved.

Take for instance a distressed fund that built a portfolio through the credit crunch. Some investments were grand slams – when companies were bought out of bankruptcy but not yet exited. We can buy an ownership strip, which provides a high realized multiple on part of the investment and also provides a valid third-party valuation. It also lets the sponsor ride the good deals for a few more years.

OTL: Isn't liquidity to provide sponsors with realizations returning to these markets?

DW: There is liquidity for full company sales but if a GP wants several more years with an investment and doesn't want to re-leverage up through a dividend, then a partial sale makes sense.

OTL: What's your capacity?

David Wachter: We'll put anywhere from $5 to $50 million to work per investment. So as an example, we can do five investments of up to $50 million each with one GP and that gives a fund $250 million in liquidity.

OTL: Can you give us an example of a restructuring you've been involved with?

DW: A good one is World Kitchen. When that kitchen supplies company filed Chapter 11, a major sponsor held the largest share of debt which became the largest share of equity. We got a call from a distressed debt investment bank that was looking to find a buyer for five-percent of the equity. We bought it, then pretty quickly we got calls from the other minority shareholders, ultimately ten in all. And we ended up buying all ten positions! But it was the first purchase that got the ball rolling.

OTL: Is that typical, to have a number of minority investors?

DW: Yes, many deals have several investors and one that wants partial or full liquidity. But deals where there's a sole control-sponsor that wants partial liquidity are becoming a larger part of our business.

OTL: How about another example?

DW: We have an investment in a company that uses technology for traffic enforcement. The original investors had sold a stake to a major PE firm about three years ago, but several years later wanted partial liquidity. The sponsor referred the investors to us and we came in and met their needs.

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OTL: Ok, so one more case study.

DW: We were approached by a private equity sponsor in a large third-party administrator of health plans. The sponsor had sold control but kept 25% ownership in the deal. Two years later, they wanted liquidity for their remaining 25%. So we bought their position and came in alongside the lead. We stepped into the existing cap structure as is and took one board seat.

OTL: It seems as if current technicals are very favorable for your business model.

DW: You recently published one of our charts (On the Left, May 2, 2011) depicting this, but think about the numbers: PE firms do about 2000 deals annually, but there are only about 400 exits each year. So that creates quite a bottleneck. In 2004, there was a universe of about 2300 portfolio companies held by the entire US PE industry. That grew to almost 6000 companies last year. Again, with only 400 exits per year, it'll take a long time to realize all those investments.

OTL: And that's where W Capital comes in.

DW: Exactly. You could say we are a liquidity management tool for private equity.

OTL: Nice. So why aren't there dozens of W Capitals running around?

DW: You can't just do one-offs. It takes years to develop strong relationships and a robust pipeline. After all, it took us ten years to build our portfolio of sixty-plus companies and gain trust with the PE community.

OTL: Are there lessons learned as you look at your history of investing?

DW: GPs motivations for selling are only relevant to the GP, and prices as a percentage of NAV don't matter. What matters is finding win-win transactions with attractive investments. Pricing-wise, the seller is satisfied and we can get a return too.

OTL: What do you anticipate the future to look like for buying secondary PE positions?

DW: Most of our sellers are thriving, growing GPs. But as we just said, there's a universe of sponsors out looking to realize their investments and show appropriate returns to their LPs. That's where we see the opportunity.