Blackstone, Carlyle Consider Takeover Deals Outside Their Existing Funds

Move Would Signal a Major Shift for Private-Equity Industry

By
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Blackstone Group LP and Carlyle Group LP are exploring new ways to buy global companies in partnership with major investors, including potentially making acquisitions outside their existing funds, according to people familiar with the firms' thinking.

Carlyle co-founder David Rubenstein, pictured in July, has said the impact of sovereign-wealth funds as big institutional investor clients "is hard to overstate." *Matthew Staver/Bloomberg News*

The strategy would take aim at very large companies with global brands, one person familiar with Blackstone's thinking said. "It has to be the sun and the moon and the stars aligning."

The potential new approach would mark a major shift in the private-equity industry.

Typically, private-equity firms raise 10-year funds from investors that they combine with bank loans and bonds to acquire companies. They aim to improve the performance of the companies they buy and then sell them within five years, targeting rates of return of at least

20%. The biggest international takeovers, though, can take longer to pay off than traditional leveraged buyouts and earn lower returns, so don't conform to the norms of private-equity investing.

But senior executives at both firms are thinking about the change in response to the demands of some of their biggest institutional clients for steady returns as interest rates remain persistently low, the people said.

Investors "are increasingly looking to deploy more money directly and looking for low volatility," one person said. The private-equity funds are trying to figure out how to satisfy their investors' needs "but not have our basic private-equity funds be compromised and have lower returns," the person said.

Rather than just invest in private-equity funds, major investors such as Singapore's sovereign-wealth vehicle GIC Pte.Ltd. and large pension funds such as Canada Pension Plan Investment Board have recruited bankers and private-equity executives in recent years to make direct investments in companies and infrastructure projects.

"More and more, the big sovereign-wealth funds prefer to do the investing themselves," Nuno Fernandes, a professor at Switzerland's IMD business school, said in an interview. "Many have hired talented teams and are now much more concerned with the cost of active asset managers such as private-equity firms, which take a significant percentage of returns as fees and carry."

Carlyle co-founder David Rubenstein said on a conference call for analysts in July that the impact of the growth of sovereign-wealth funds from the Middle East to China and Southeast Asia "is hard to overstate."

"Everybody is looking for something that somebody else doesn't have," Mr. Rubenstein said. "High rates of return are less important to some investors than the steadiness of rates of return."

It is unclear whether Blackstone and Carlyle have specific plans for any such deals on the table right now. Funding for the deals could come from a combination of the private-equity firms' own balance sheets, debt financing, and the co-investment partners.

A possible model for the new approach is last year's $23 billion purchase of H.J. Heinz Co. by 3G Capital and Warren Buffett 's Berkshire Hathaway Inc., the people familiar with the private-equity firms' thinking said. 3G didn't use a fund to invest and invited Mr. Buffett to participate in the takeover. 3G and Berkshire Hathaway aren't under pressure to sell Heinz within a set time period to earn a return.

George Anson, a managing director at HarbourVest Partners LLC, a Boston-based investor in private-equity funds, said he would consider investing in such deals, depending on their risk-return profile.

"I can only assume that the investment profile of the deals they would consider doing in this way aren't applicable to the investment mandates of their existing funds," Mr. Anson said.

Blackstone manages $279 billion of private-equity, real estate, credit and hedge funds. It is currently raising a new $16 billion buyout fund. Carlyle manages $203 billion. It typically charge investors an annual fee of between 1% and 2% and keeps 20% of the profit from deals.

The scale of acquisitions by private-equity firms peaked in 2007, when KKR & Co. and TPG teamed up with other investors to buy Dallas-based energy company TXU Corp. for $43.8 billion. Since then, investment companies have completed two deals valued at more than $20 billion, including Heinz, according to Dealogic data. That is in spite of the $1.19 trillion of cash they have to spend globally, according to Preqin data.

Some private-equity firms are moving in the direction of offering lower risk, lower return and longer-term investments, said Adam Hain, a banker at Macquarie Group Ltd. who advises funds that make investments of as much as $1 billion at a time.

“There continues to be a zone of investment which is missing, in between infrastructure and private-equity,” Mr. Hain said. “In broad terms, parties looking to invest in infrastructure target 8% to 12% and private-equity is 20% plus—they are asking what can we target that is between 12% and 20%?”

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