

## Private Equity

# Opportunities – And Risks – For A Private Equity Practice

The Editor interviews **Michael J. Cochran**, Partner, McKenna Long & Aldridge LLP.

**Editor:** Mr. Cochran, would you tell our readers something about your professional experience?

**Cochran:** Since graduating from the University of Chicago Law School in 1989, my legal practice has focused on corporate finance with a specialty in private equity. I have been resident in Atlanta, London and New York and recently became a partner at McKenna Long & Aldridge in Atlanta. For a number of years, when I was not practicing law, I was a principal of a small private equity firm called Equity Capital Partners, which was focused on control acquisitions of smaller middle market companies. My career in private equity really started when I joined Fried Frank in New York. In the late 1980's private equity had yet to be recognized as an industry class. I had the good fortune to work with Forstmann Little & Co. and a series of other financial investors at the forefront in the development of private equity. Indeed, the very first deal that I ever worked on was Forstmann Little's acquisition of Gulfstream Aerospace. It was a great introduction to buyouts.

**Editor:** How did you come to McKenna Long? What were the things that attracted you to the firm?

**Cochran:** McKenna Long has a national platform, which is focused on expanding its corporate finance practice throughout its markets. I was in a position to discuss with the firm's leadership the institutionalization of the private equity end of the practice. This represented, for me, an opportunity to assist in taking a practice from its Southeastern focus and onto a national platform with a global reach.

**Editor:** Please tell us about your practice. How has it evolved over the course of your career?

**Cochran:** Well, what I have witnessed is the increasing sophistication of limited partners and the development and professionalization of a well-defined market. Today that market includes over a hundred hedge funds with more than a billion dollars under management in the United States alone, and by the end of 2005, private equity firms were capable of raising in excess of \$10 billion for their mega funds. Such is the institutionalization of these private equity concerns that they look like well funded merchant banks.

**Editor:** Would you share with us your definition of private equity?

**Cochran:** Private equity is one of these financial terms that is often misused. In the broadest sense, I think the term describes investment vehicles that are pooled sources of capital for investment in a variety of areas. At times, private equity may refer to what otherwise might be described as leveraged buyout funds or to control investments, as distinguished from venture capital funds, which traditionally take minority equity positions in growth-oriented companies. It depends on the context.



Michael J. Cochran

**Editor:** And the firm's venture capital and private equity practice. How is that positioned within the firm?

**Cochran:** One of the really great things about private equity from a law firm standpoint is that the private equity investor seeking control of an enterprise needs the full array of expertise that only a large firm offers. In addition to deal work, the investor requires employment lawyers, tax lawyers, ERISA lawyers, environmental lawyers, and so on. Even specialized litigators. At McKenna Long, we have developed a whole range of cross-specialties with expertise in dealing with private equity professionals and their portfolio companies.

**Editor:** What kinds of background do the attorneys in this practice possess?

**Cochran:** Their backgrounds are pretty diverse, but they all must possess a solid grounding in corporate finance. That entails some expertise in mergers and acquisitions and an understanding of leveraged finance. You have to be sensitive to the public equity markets, particularly with respect to venture capital clients and middle market private equity firms. So long as the public markets serve as an exit opportunity, you must also possess public equity expertise. Finally, in light of Sarbanes-Oxley, you must know a considerable amount about corporate governance and the fiduciary obligations of corporate insiders.

**Editor:** How do you go about staffing your projects?

**Cochran:** The longer you work with private equity clients the more you realize that they want a continuity of staffing, both at the partner and associate level. To that end, we maintain a small set of lawyers who are familiar with the particular needs of these clients. A very common client complaint – and one that, in all probability, is not limited to this practice area – is the amount of time necessary to educate a new team of lawyers on the client's business needs with each new deal. A smart professional services firm is going to address this complaint by providing as much continuity as possible. We do.

**Editor:** You have been engaged in providing legal services to private equity, venture capital and hedge funds for a

considerable time. What are the key issues today?

**Cochran:** In a relatively crowded marketplace it is important for professionals to be able to distinguish themselves. By the same token, on the fund raising side there is a need for clients to be able to demonstrate why they, in particular, should be able to attract limited partner capital. In light of the wide range of opportunities available to investors today, these clients must demonstrate strong investment performance or a particularized expertise that matches with an industry sector. An area of particular interest today revolves around the sale of portfolio companies by one fund to another. One of the two may be wrong about the company, and the bet is on whether it is absolutely the right time to sell or the right time to buy. Such transactions always generate an interesting set of questions.

Another challenging area has to do with the venture capital community, where, for a long time, transactions have been structured to permit a syndicate of venture capital funds to come together to finance a particular growth equity round. More recently, private equity funds have begun to do what is called "club deals" to deploy money in ever increasing amounts. This is the result, I think, of a market characterized by the need to achieve investment returns and growth through longer hold periods. Club deals involve investors used to controlling their investments – and in this arrangement no one of them is in control – which is fine in an economic environment that has been relatively calm. When the economy turns, these deals are going to be subject to stress and may become difficult to manage.

Finally, I would say that a wave of restructuring activity is in the process of hitting the market, and that this trend is very probably going to hit its peak in the latter part of 2006 and early 2007.

**Editor:** Is there any particular type of transaction that McKenna Long has handled recently?

**Cochran:** In the last year, we have been very active in fund formation activities. We have seen a number of first-time funds, in addition to existing ones working aggressively in a fund raising environment that has been particularly active in the Southeast and elsewhere. Our private equity clients have been very active on the M&A front. One of the most interesting aspects of the firm's practice in this area revolves around the reemergence of our venture capital clients. In addition, the volume of work with respect to technology and medical device deals has been growing, as has our hedge fund practice, where we represent funds participating in the mezzanine financing market.

**Editor:** You mentioned Sarbanes-Oxley. How has the scrutiny on corporate governance affected your practice?

**Cochran:** It has had a couple of very significant impacts. First, there is a heightened level of due diligence in the area of internal controls in any transaction that involves a public company or one with the potential to be a public company. The need to be Sarbanes-compliant is clearly recognized, and this has had the effect of driving

up the cost of due diligence, on both the accounting and the legal sides.

During the 1990s there was a great deal of activity in the public small cap marketplace. In recent years, the ability of a small cap company to go public – as a consequence of the cost of compliance with the new rules – has decreased. This means that there are fewer investment opportunities to be realized through a public market exit today. We are moving through a period in which certain enterprises are reluctant to go public or, if they are already public, to remain so. The focus on corporate governance has made for interesting times.

**Editor:** How about the international aspect of your practice?

**Cochran:** We are experiencing the impact of China, India and a number of particular industries – outsourcing and the ability to take manufacturing off-shore – in our private equity practice. This translates into an impact on even relatively modest Southeastern middle market transactions, through real or perceived concerns about the trends underway in the international marketplace. Trending in the other direction, we are beginning to see non-U.S. capital appear in our markets again and play a more active role in investing. Large Chinese enterprises are beginning to have sufficient capital to consider investing in the U.S., and I think this is going to be an accelerating development over the next five years.

**Editor:** What about the future? Where would you like this practice to be in, say, five years?

**Cochran:** I hope to see a very healthy and vibrant domestic economy and a public market that will continue to fuel solid growth. That is what permits good transactions to be done. I believe that there is going to be a relatively large shakeout in the industry over the next few years, and it will be interesting to see who adapts to a market that is somewhat distress driven and who does not. Our practice is poised to move in a number of directions in response to this development.

**Editor:** Is there anything you would like to add?

**Cochran:** Corporate executives, including general counsel, are interested in how they can effectively compete for acquisitions against private equity buyers. I believe that companies with a streamlined decision-making process and a thoughtful plan for growth through acquisitions are in a far better position to compete against financial buyers. Companies which are heavily bureaucratic in their decision-making or lack a clear acquisition program will not be in position to take advantage of opportunities as they develop. With respect to acquisitions, many corporate buyers have an opportunity to compete against private equity firms because the latter have a short-term investment mentality – they approach every acquisition with a seller's mentality – while the corporate buyer approaches the acquisition with a long-term and much more all-encompassing perspective. That can be very attractive to a seller.

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