In Chapter 7, TA’s European boss, Ajit Nedungadi, observed that ‘When there’s less of one form of capital in any market, there’s more opportunity for the other forms of capital.’ With debt very much less available than it used to be, particularly in developed markets, there’s no doubt that some growing businesses that might previously have funded expansion by borrowing are instead teaming up with growth private equity firms, such as those featured in the previous three chapters.

There is another option open to certain types of high-growth business, and it is also one that is forming an increasingly large proportion of the funding structure of many buyout transactions. I’m talking here about the various ways of funding a company that sit on the spectrum between conventional senior debt and ordinary equity.

In particular, since 2008, there has been a growth in instruments that blur the distinction between equity and debt: mezzanine debt with options attached and preferred stock that does not carry a current yield (i.e., where the yield is rolled up and paid on exit, albeit that it is technically a form of income rather than a capital gain). Some call this intermediate capital, a term that brings to mind the UK-based, publicly quoted finance provider, Intermediate Capital Group (ICG). In fact, ICG provides a much wider range of instruments, including senior debt and high-yield bonds, and its structure does not really lend itself to being regarded as a private equity firm, so I have instead focused on one of its competitors, Hutton Collins, which specialises in this middle ground between debt and equity, has no debt in its own structure and is set up in the conventional, GP/LP private equity mould.

Hutton Collins was established in 2002 by Graham Hutton and Matthew Collins, who had previously worked together in Morgan Grenfell’s London-based structured finance team. Their firm is also based in London. It currently manages around €600 million of committed capital, typically investing between €35 million and €100 million in firms valued between €100 million
and €500 million. As you would expect from the preceding series of Euro signs, it is focused on the European market, driven by an identification of an opportunity to offer the more sophisticated range of funding instruments long available in the USA to firms on the other side of the Atlantic.

Hutton Collins is fascinating because it is both a supplier or partner and a competitor to conventional private equity houses. On the one hand, it participates in the funding structures of other PE firms’ transactions, enabling them to close deals when the metrics would not permit the use of more senior debt or ordinary equity; on the other, it raises capital from the same pool of limited partners as any other GP and it does primary deals with managements that might otherwise have sold equity to growth private equity firms.

This last point merits a little clarification. If you’ve read the past three chapters, you will know that the ideal transaction for most growth PE firms is to acquire existing equity in an asset-light business that requires minimal capital expenditure. The reasons are obvious: such a firm can be scaled with less investment and can start to repay the acquisition capital sooner through dividend flow, resulting in a higher internal rate of return – the primary measure on which LPs judge GPs, and the crucial figure on which GPs’ carried interest is calculated.

Preferred capital – Hutton Collins’s favoured term for its specialism – is, in effect, a mix of debt and equity, often provided in situations in which lenders consider the risk profile too high for senior debt but management does not want to be diluted as much as would be the case in an all-equity deal; therefore the mitigation of risk is critical. Preferred capital is thus more likely to be an attractive option for growth companies that want to put cash onto their balance sheets in order that they can spend it on the acquisition of tangible assets or bolt-on businesses that will contribute to their future expansion, and which represent security for the finance provider. But the instruments can also be used as an alternative to conventional private equity for secondary transactions, buyouts and refinancings, so while its relevance to corporates is undoubtedly growing as an alternative to debt in today’s de-leveraging environment, it is also an increasingly useful tool for private equity for certain kinds of transaction.

I met Matthew Collins, co-founder of Hutton Collins, in the firm’s office on Pall Mall, close to St James’s Palace. A modest man, he was anxious that the interview should not come across as a ‘hard sell’ for his firm; rather, he wanted to make the case for the type of funding that his firm provides.

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MB: Why did you and Graham set up Hutton Collins?
MC: We felt that there was a gap in the market in the grey area between conventional mezzanine debt and private equity. We took what we thought