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Q&A in the PE Space: Mike McGill of MHT Partners

December 2, 2019 | **BY CLAIRE POOLE**

In the first half of 2001, former Donaldson Lufkin & Jenrette investment banker Mike McGill co-founded MHT Partners in Dallas to advise middle market companies on transactions. The timing wasn't great: The Y2K scare led to an eight-month economic recession beginning in March and the Sept. 11 terrorist attacks on the U.S. put a pall on activity.

But the investment bank muddled through and today has around 35 employees in Dallas as well as in Boston and San Francisco, where it merged with MidSpan partners in 2013. The 51-year-old McGill recently spoke with **The Texas Lawbook's** *Claire Poole on the firm's growth and where he sees deal activity headed.*

Q: Why did you start MHT in 2001?

A: My founding partners and I identified Dallas as a highly dynamic, entrepreneurial city where there was a mismatch of high quality, sophisticated M&A execution resources delivered on a regional level. DLJ had built a very successful regional practice and I stayed through the transition with Credit Suisse [which bought DLJ in 2000]. But it became clear to me that Credit Suisse was not focused on the same market as DLJ. And when DLJ disappeared, we could step into the void.

Q: Wasn't it difficult to start an investment bank in 2001?

A: I don't know if it was the worst or best time to start a firm. It was not a particularly strong economic or M&A environment – we had bottomed out. We naively thought we would be awash in deal flow. It was a little bit of field of dreams: Build it and they will come. A year after we started the firm, we made hard decisions about those we had hired. And over the next decade, we were far more conservative than other firms that had sprung up during that time, none of whom survived during the 2008 and 2009 downturn.

Q: Aren't you mostly sell side? Or do you do buyside work as well?

A: Of our M&A activity, two-thirds of of our revenues come from the sell side, so a meaningful piece comes from the buyside. As a percentage of closed transactions, it might be more like 60/40 if you look back over time. On the buyside, we work with existing platform companies backed by private equity, rather than one-offs, or a private equity firm buying a new platform. Given the current M&A market, with prices where they are, it's harder on the buyside.

Q: How do you generate business?

A: Our primary source of transactions is referrals from people with whom we previously transacted: lawyers, accountants and former clients. We occasionally receive referrals from lawyers, as a lot of companies have corporate counsel before they have investment bankers because there's more need.

Q: How is M&A activity given this point in the economic cycle?

A: The number of transactions peaked in 2015 in North America. It was an upward trajectory from 2009 through 2015, with a minor dip in 2013 [following 2012's year-end rush to close deals before tax changes]. But in 2016, 2017 and 2018, we've seen single-digit declines in terms of closed deals.

Q: How do you see this year shaking out?

A: I would anticipate that 2019 will represent a decline from 2018. Multiples ran up pretty significantly into the peak and they have really flattened out. Debt in transactions until recently was relatively consistent. We've seen leverage multiples and valuation metrics creeping up.

Q: How has private equity changed the landscape?

A: Private equity and private equity-backed companies from 2008 to 2015 represented less than 30% of the buyer universe. Year to date, it's north of 40%, according to PitchBook. If you look at committed but uninvested capital that's out in private equity land, it's north of $1 trillion. The trend has been upward since 2012, with an abundant supply of capital and a modest decline in activity. It's more complicated than supply and demand. Supply has shown a modest decline and demand a modest uptick.

Q: So that's resulted in higher premiums?

A: I would say that the market is still bifurcated. It's harder to get deals done for companies less than pristine and it's hard for even good companies to sell because of higher values. When values creep up, buyers get nervous about overpaying, and the more nervous buyers are about overpaying, the more diligence that has to be done. I speak with my peers and they're seeing the same thing.

Q: Who would you consider your peers?

A: We occupy a bit of a unique market in my view. We're not as large as Houlihan Lokey, Harris Williams and William Blair nor are we as small as some of the new single vertical-focused firms and we compete with both of those.

Q: Which sectors are hot for dealmaking activity right now?

A: Healthcare remains a very active sector and it will be for a long period of time, as it's a big part of the economy. From our perspective, it's a highly inefficient market and there are now businesses that drive efficiencies in the system and there will be for a long time. Tech-enabled services with recurring revenue also are attractive for several reasons: You tend to have high visibility on revenues and profitability and be cash flow efficient and generative, whether that's software or services.

Q: How about consumer?

A: Consumer, including direct-to-consumer, also has been active. We sold First Lite, a hunting apparel company that has no physical store; all of their revenue is online. The growth area where we focus our time and energy within consumer – pet health – tends to be acyclical, as people continue to spend on their pets, even if we go into a recession [the firm advised Thompson Street Capital-backed Pulse Veterinary Technologies on its sale to Branford Castle Partners in September].

Q: Where do you anticipate there will be growth?

A: The whole cannabis space; it will be interesting to see how that plays itself out. There's a sentiment that it's experienced over-investment. We have not yet ventured into that market but we're keeping an eye on it. As a father of 20-year-old children, there's zero stigma they perceive attached to it.

Q: What's not hot?

A: We spend a lot of time in education and for-profit education been challenged for a long period of time. Anything that is likely to cycle: oil and gas, industrial and consumer-facing businesses that are discretionary.

Q: What do you think of the widespread worries of a possible economic downturn?

A: Given the fact that we focus on growth businesses, we may not be the best prism through which to look. Our clients are not experiencing slowdowns in their businesses. It does make me nervous that leverage multiples are creeping up, as that's historically been a sign that recession is around the corner. Frankly, I'm more concerned with the geopolitical climate and the risk that sometimes crazy happens versus cracks the economy. The European economy is not as strong as the U.S. economy, which is not the world's most comforting fact. If we do have a slowdown, the wheels won't come off. As one of my partners said [Patrick Crocker in San Francisco], “We’re in extra innings and you’re never sure how long those innings will go.”

Q: Have sale premiums come down some from record highs earlier in the year?

A: I have not seem premiums come down. I’m looking at data that would suggest that they were the same in 2015 and 2016, crept up in 2017, increased one more turn in 2018 and it now appears they have crept up again. I’ve seen other data, from 2015 through 2018, that they were flat. I don’t think 2019 will be as good as 2018, and 2018 was a record year.

Q: Which law firms do you encounter mostly?

A: We’ve worked with a broad swath of law firms, with [Foley] Gardere at the top of the list in Texas. We’ve also been involved in a number of transactions with Haynes and Boone and Hallett & Perrin and we’ve done some things with Winstead, Jackson Walker and Egan Nelson. Firms with people who have come out of larger firms make for an interesting alternative for companies in Dallas. You have large firm experience in these smaller, more nimble firms.

Q: How have out-of-state firms affected the deal business?

A: It’s been interesting to watch. Kirkland & Ellis appeared on the buyer side recently for a client we were selling. The firm seems to be developing a real presence in Dallas. We certainly see more of these out-of-state firms than we had seen historically. It makes perfect sense to me why they find Dallas appealing, with the third most Fortune 500 headquarters of any city in the country [after New York and Chicago]. We’re attracted a lot of businesses and the quality of life trade seems to appeal pretty significantly.

Q: So what’s your prognosis for the economy, particularly in Texas? And how will that affect deal flow?

A: I think it will be more of the same. It’s not very exciting answer, but that’s my instinct, because I haven’t seen the leading indicators that seem to have preceded prior downturns, either a significant run-up in transactions or price multiples or leverage multiples. They’ve inched up and volumes have trickled down, which signals to me a continuation of a supply/demand balance.

Q: Anything you’re doing to prepare for a potential downturn?

A: We’re pretty lean, with a headcount in the mid-30s. The most significant thing we’re actively focused on and thinking about is our buyside practice – being prepared to pivot to buyside if we find ourselves in a significantly softer M&A market.