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Distress calls

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Raising a fund has required a Herculean effort since the private equity market came to a virtual halt in late 2007. But as Andrew Bursky, co-founder and managing partner of **Atlas Holdings LLC**, found out, it's good to be a distressed investor in midmarket industrial companies. Bursky's firm recently closed on $365 million of capital for its Atlas Capital Resources LP within about 10 months of its launch, greatly exceeding a $250 million target.

His nine-year-old firm hadn't raised an institutional fund before -- the partners previously invested their own money along with third-party co-investors. That is, until Bursky, an engineer and economist by training, felt prospects were too great to pass on. Bursky previously co-managed about $2 billion in capital at **Pegasus Capital Advisors LP**, founded by executives who hailed from **Apollo Management LP** and Drexel Burnham Lambert.

"We looked at the world midyear last year and determined that there'll be remarkable opportunities potentially unlike those that I've seen in my 30 years," he says.

The Greenwich, Conn.-based firm counts itself among the few operations-focused buyout groups that have thrived on industry-sector expertise. Structured as a diversified holding company, currently with $1 billion in portfolio company revenue, its principals like to wade into gnarly situations that go beyond financial challenges. These could involve operational, environmental or labor problems, says Bursky. Atlas has a complement of 16 full-time investment professionals and 35 operating partners that it taps for projects.

Generally it targets companies in bankruptcies, out-of-court restructurings, federal receiverships or corporate divestitures, then builds them, typically through acquisitions. Says Bursky, "Our existing group of eight platforms have delivered north of 4 times cash-on-cash return."

That evidently appealed to a group of limited partners, including some large global financial services firms, wealthy family offices and corporate pension funds that anted up.

Atlas benefited from the combination of the partners' track record of investing successfully through cycles, their industry specializations and the fact that they have "significant" skin in the game, says Tripp Brower, managing director at Dallas-based **Capstone Partners**, which served as placement agent.

The firm launched its fundraising last summer just as markets began to recover and limited partners' liquidity issues eased. "Control distressed investing was one of the few areas LPs were interested in," Brower says.

"Everybody gets the fact that there's still a big market opportunity for distressed investors that take control of distressed companies," though the market is still evolving, and the small- and midcap areas look promising, Brower adds.

While being a distressed specialist is clearly a plus for niche firms like Atlas, the outlook for the broad distressed arena is less clear. The larger special situation funds currently in the market tend to be smaller than those raised in 2007 and 2008, and take longer to close. **Oaktree Capital Management LP**'s OCM Opportunities Fund VIII and Fund VIIIB, **Blackstone Group LP**'s GSO Capital Solutions Fund and **CarVal Investors** are among those in the market, according to London's **Preqin Ltd.**

"It is slow going and not the size we want, but we are closing on LP commitments," says Marco Masotti, a partner at **Paul, Weiss, Rifkind, Wharton & Garrison LLP**. "Investors are a lot more patient and cautious."

There is skittishness over the timing of new funds, volatility in portfolio valuations and disappointing returns from funds that invested early in the cycle.

Distressed-debt investing confronts a particularly complex set of circumstances because capital markets have recovered somewhat. That makes it more difficult for investment funds to reconcile returns expectations with the realities on the ground.

"We're in discussions with several distressed funds that on one hand have solid teams and expect to generate returns in the high teens, yet what they're seeing is pricing in the 12% or 13% range. So there's a significant difference from what they expect over the longer term in their fund and the market opportunity today," says Brower. "It's a tough sell."

By contrast, Bursky argues that the timing for his new fund is just right: "We're still not out of the woods. Our working thesis is that while it will vary sector by sector, there will be businesses that will simply not grow their way out of the challenges. There will be significant opportunity for some time."

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