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EDITORS' PICK

How Blue Owl's $12.5B SPAC Deal Could Shape The Future Of Private Equity

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What happens when you combine just about every major buzzword that has enveloped private equity in recent years in a single $12.5 billion transaction, one that underscores the many ways the industry has evolved and diversified away from its barbarian beginnings in the 1980s?

Blue Owl Capital is about to find out.

If you don't recognize the name, don't worry. Blue Owl didn't technically exist until this Thursday, when it began trading on the NYSE. But those in the alternative investing space are probably familiar with Dyal Capital Partners and Owl Rock Capital, the two cutting-edge firms that formally combined this week under the Blue Owl banner.

Dyal is a pioneer in the booming realm of GP stakes—it owns minority interests in dozens of prominent private equity and private credit firms, including Silver Lake and Vista Equity Partners. Owl Rock is a leader in direct lending, the business of providing loans to private equity portfolio companies. Adding to the fun is the fact that Dyal already owned a minority stake in Owl Rock. And the two have combined in the most 2021 manner possible: By merging with a SPAC sponsored by HPS Investment Partners, another prominent debt investor (which Dyal also owns a stake in), valuing the overall business at some $12.5 billion and creating a windfall for Dyal and Owl Rock executives.

Despite all that complexity, the motivations behind the deal are relatively simple: To create a one-stop shop for private equity firms in need of financing. If a firm is looking to add capital to its balance sheet to pursue new strategies or deal with succession planning, it can turn to Dyal. If a portfolio company needs a loan, it can turn to Owl Rock. Blue Owl might never actually conduct a buyout of its own. But the firm is positioned to be a fulcrum of the larger buyout ecosystem, operating as a key part of the infrastructure that helps deals get done.

Let's take a closer look at how this one-of-a-kind transaction came about—and at what the rise of Blue Owl could mean for the future of alternative investments.

Dyal was born from the ashes of Lehman Brothers. The firm's head, Michael Rees, was a managing director at Lehman when it went under in 2008. He then moved onto Neuberger Berman, a division that spun out from the defunct Lehman through a management buyout. (Dyal remained a wholly owned subsidiary of Neuberger Berman until this week.) With a small team around him, Rees decided to pursue what at the time was a novel idea: buying small, passive stakes in hedge funds as a way to gain access to their lucrative fees and carried interest.

A few years down the line, Providence Equity Partners approached Dyal about potentially selling a stake in itself, a deal that became Dyal's first foray into private equity. Since then, the business of buying stakes in PE firms has exploded, supplanting hedge funds as Dyal's main focus, with Blackstone and Goldman Sachs joining Dyal as the industry's three leading players.

Owl Rock, meanwhile, was formed in 2016 by three members of the Wall Street elite. Doug Ostrover had previously co-founded alternative credit investor GSO Capital Partners and was a senior managing director at Blackstone after the firm bought GSO. Marc Lipschultz was formerly the global head of energy and infrastructure at KKR. And Craig Packer was a partner and co-head of leveraged finance in the Americas at Goldman Sachs.

Like Dyal, their timing was propitious. In prior decades, the sort of small and medium-sized companies that are frequent private equity targets typically took out loans from major banks. But regulatory changes in the wake of the global financial crisis created a vacuum that has since been filled by alternative investors.

Dyal acquired its minority stake in Owl Rock in November 2019, with The Wall Street Journal reporting the deal valued the lender at around $2.5 billion. Negotiations to combine began in earnest last summer, and an agreement was announced in December. Owl Rock's executives and other shareholders will split up about $350 million in cash consideration and another $5 billion in stock from the deal, while Neuberger Berman and Dyal are set to receive $1.1 billion in cash and nearly $5.6 billion in stock, according to SEC filings.

The concurrent rises of GP stakes and direct lending are indicators of a broader shift in private equity and alternative investing. Leveraged buyouts are still the PE industry's bread and butter. But the buyout business can be unpredictable, with huge returns to investors in some quarters and more modest results in others, depending on the timing of exits. The process of raising a new fund from LPs every few years can also be a time-intensive slog.

So, over the past decade or so, more and more firms have embraced the pursuit of permanent capital—an asset base that could theoretically exist in perpetuity, rather than having to be returned to LPs on an established timeline like in traditional funds. Permanent capital also creates a steadier stream of fees and dividends, making it particularly appealing to publicly traded firms such as Apollo Global Management and KKR—and to their shareholders.

That brings us back to Blue Owl, which might be the industry's ultimate example of permanent capital. About 60% of Apollo's assets under management are permanent capital, "by far" the most in the mainstream PE industry, according to a recent PitchBook report. For Blue Owl, meanwhile, permanent capital makes up 91% of its overall asset base. Dyal still raises discrete funds from LPs, but the vehicles have a perpetual lifespan. Among Owl Rock's most prominent offerings are business development companies structured to be permanent in length, one of which trades on the NYSE.

Blue Owl operates in largely different lanes than private equity giants like Apollo and KKR, even as those firms have evolved to embrace the permanent-capital revolution. But just as KKR's buyout business served as one of the best examples of how private equity operated in its first few decades of existence, Blue Owl could be one kind of model for where the industry is headed.

One might think about Blue Owl as a type of index, one that packages together exposure to the activities of different private equity firms and their portfolio companies. You would need to either be a large institutional investor or a very well-connected billionaire to invest directly in funds managed by the dozens of private equity, credit, and real estate firms that comprise Dyal's portfolio. But now, to invest in that broad portfolio—and in the underlying loans issued by Owl Rock that power the deals those dozens of private equity firms are conducting—all it takes is $11.60 per share. F

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