The wizards of opps: Blackstone and the rise of special opportunities strategies

Blackstone's Tactical Opportunities strategy, hatched a decade ago by David Blitzer, is nimble, focused and all-weather. Other big-name firms are also making creative contributions to the unique asset class.

By **Kirk Falconer** - October 1 2021

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In 2011, David Blitzer, a then 20-year veteran of private equity giant Blackstone, had an idea.

Blitzer had just returned to New York from London, where he led Blackstone's European business. Joining the global PE leadership team, he set his sights on dealflow in a market that was then making an unsteady comeback from a deep recession and still burdened by the legacy of the financial crisis.

In this environment, Blitzer spotted some opportunities that were not being taken up by his firm – or, for that matter, by anyone else.

David Blitzer, Blackstone

"We were seeing some very interesting transactions out there that had nowhere to go." Blitzer tells *Buyouts*. "At the same time, financial services regulation was changing dramatically as a result of Dodd-Frank and the Volcker Rule and capital was disappearing from the system."

This, Blitzer says, together with financial industry restructuring in the wake of the crisis, "left a supply gap."

The white spaces observed by Blitzer, many of them financial assets like distressed mortgages and credit-card receivables, were not being neglected by Blackstone due to a lack of interest or appreciation for their return potential. Rather, the mandates of its PE, credit, real estate and other flagship funds were unable to accommodate them. "They simply didn't fit," Blitzer says.

Blitzer's idea was to launch an altogether new strategy. It would be differentiated and nimble, he says, investing opportunistically and without constraint across assets, geographies, markets and sectors "in times of stability or volatility, in good markets or in bad." Its only limitation would be a focus on activity that was outside of the scope of Blackstone's other funds.

It was Blackstone co-founder and CEO Steve Schwarzman who came up with the program's name – Tactical Opportunities – which "suggested something new and creative," Blitzer says.

As Tactical Opportunities' global head, Blitzer assembled a fledgling team that included COO Chris James, who had recently disengaged from Blackstone's post-IPO strategic development. Blitzer and James designed a business plan and ramped up initial investing. Their debut deal was Inwood Park CDO, a distressed CLO vehicle left over from the Lehman Brothers bankruptcy.

Christopher James, Blackstone

Blackstone also invested in LocusPoint Networks, an acquirer of struggling TV stations, to obtain spectrum that could be sold for a premium to wireless operators. It marked the beginning of a major Tactical Opportunities' theme: digital infrastructure.

> *"We created an asset class for what we do. Today, market agents and intermediaries will see a specific type of deal and say: 'That's a Tac Opps.'"*
> ***David Blitzer, Blackstone***

Talks about the freshly minted strategy were held with longtime Blackstone limited partners. Despite the unfamiliarity of the concept, investors grasped the potential benefits, such as access to unique opportunities they probably had not seen before, pension documents suggest.

Things moved quickly from there. Before the year was out, New Jersey Division of Investment became Tactical Opportunities' first LP through a $750 million managed account. California Public Employees' Retirement System followed with an $800 million account. A maiden commingled fund was unveiled in 2012.

The rise of special opps

Blitzer's idea proved to be a pioneering one. In the decade since, Tactical Opportunities has emerged as a core Blackstone platform with $32 billion in managed assets. As of mid-2021, it had accounted for nearly $28 billion deployed to 146 investments, distributed globally and in everything from mines and shipping to data centers and software.

More than this, Tactical Opportunities helped inaugurate a new investment niche – broadly known as special opportunities – that seems to be catching on in private markets.

Presently, a dozen or so PE firms offer these strategies, or ones that resemble them. Along with Blackstone, they include Apollo Global Management, Ares Management, Brookfield Asset Management, Sixth Street and TowerBrook Capital Partners.

While programs under this banner vary widely in emphasis, they share a few key characteristics. Among them is Tactical Opportunities' concentration on assets, geographies, markets and sectors that are not covered by a firm's flagship funds.

Other common features are the provision of tailored, non-control capital solutions to address unmet private and public business demand. Strategies also tend to invest in the middle of the capital structure, between equity and debt. Finally, and perhaps most importantly, they tend to be all-weather in nature, on the hunt for opportunities in both up- and down-cycles.

By bringing these criteria together in dedicated teams and funds, special opportunities appeal to GPs and LPs alike, says Brian Gildea, head of investments at Hamilton Lane.

"These strategies fill a gap for GPs because they capture dealflow that has no other natural home," Gildea says. "Rather than ceding an opportunity to someone else, the manager now has a pool of capital to make the investment. This gives GPs another way to differentiate themselves from competitors."

Brian Gildea, Hamilton Lane

"For LPs like us, they also fill a gap," Gildea says. "Investors want more choice and customization than ever before. Through these strategies, they get exposure to something new and a little bit different. The creation of a hybrid between equity and debt should also provide for diversification and uncorrelated returns."

Jill Shaw, a managing director with Cambridge Associates, agrees.

Jill Shaw, Cambridge Associates

"From the classic buyout onwards, strategies have multiplied over the past 20 years to fill the pieces in-between," Shaw says. "Special opportunities represent another hash mark on the line of a growing spectrum. Historically, there have been investors who have trafficked in white spaces but not in a holistic way like Tac Opps and similar products."

Their qualities notwithstanding, special opportunities remain a nascent category. Tactical Opportunities is one of the only strategies with a long-term track record developed over several funds.

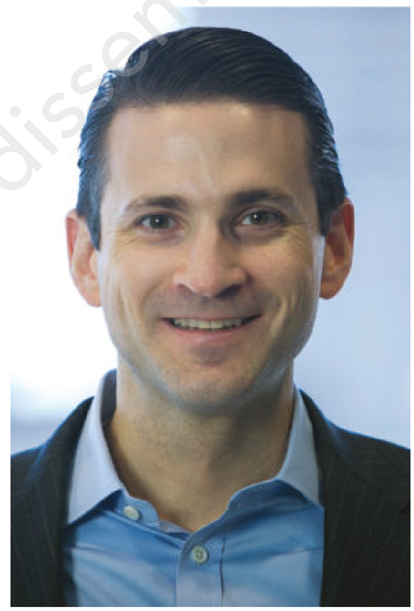
In addition, programs are confined to a few especially large PE firms. For LPs in the early stages of assessing them, this may prompt concerns, such as whether special opportunities are less about a distinctive opportunity set and more about asset-gathering.

LP interest, however, appears to be on the rise. This is reflected in current fundraising, with fresh offerings targeting $20 billion-plus in all, *Buyouts* estimates. They include Blackstone's fourth fund, which is seeking $4.5 billion, we reported. Blitzer declined to comment.

Playing to strengths: Apollo

In pursuing overlooked transactions, special opportunities strategies leverage a PE firm's in-house capabilities and resources. Tactical Opportunities has since 2011 developed themes and sourced dealflow by tapping into the accumulated data and knowledge of Blackstone's ecosystem, Blitzer says.

This is also the modus operandi of Apollo's Hybrid Value, led by co-heads Matt Michelini and Rob Ruberton. Launched in 2018, the strategy acts as an extension of Apollo to invest flexibly, opportunistically and without barriers – mostly through non-control structured equity and debt – among the firm's PE, credit and real-assets groups.



Matt Michelini, Apollo Global Managment

In its three years of investing, Hybrid Value has mostly been active in "sectors that Apollo knows well," Ruberton says. For example, it utilized Apollo's extensive background in the grocery industry in its largest deal to date: leading a $1.75 billion investment in Albertsons, the third-largest supermarket operator in the US.

Coming into 2020, Albertsons was the oldest investment of Cerberus Capital Management, which was contemplating an IPO, Ruberton says. Hybrid Value was approached to do a convertible preferred equity financing to help value the business and provide shareholder liquidity in advance of an offering.

Apollo's ability to write "a large check in a volatile period" proved crucial for Albertsons, Ruberton says. So too was its support of management and costconsolidation initiatives that led to "an uplift in profitability."

Rob Ruberton, Apollo Global Management

Hybrid Value oversaw $13.1 billion in assets as of June and has deployed $7 billion since inception. Closing the strategy's first fund two years ago at $3.25 billion, Apollo is now marketing a second vehicle with a $4 billion-$5 billion target, Buyouts reported. Michelini and Ruberton declined to comment.

Value-added minority investing: Brookfield

Supplying flexible, bespoke capital solutions to businesses outside of a control framework is another important feature of special opportunities strategies.

Companies that prefer this option include mid-market establishments owned and operated by families and founders. Demand from this and other quarters has "grown dramatically" since Tactical Opportunities got underway, Blackstone's Blitzer says.

Tactical Opportunities also acquires minority stakes in very large businesses. An example of this is Rothesay Life, a Goldman Sachs-founded acquirer of pension assets and liabilities, backed as part of the strategy's thematic interest in the insurance sector. Over seven years, nearly $2 billion was invested prior to Blackstone's sale in 2020 of a 36 percent share to GIC and MassMutual.

Brookfield's Special Investments also gives priority to investing that does not significantly dilute a company's ownership. Unveiled in 2019 to formalize balance-sheet activity, the strategy is a broadly focused investor of non-control equity and equity-like capital in opportunities linked with and complementary to Brookfield's other platforms – among them, infrastructure, PE and real estate.

"We heard a lot of businesses saying, 'We don't want to give up control and we don't want to take on more debt,'" David Levenson, a managing partner, private equity, says. Being able to structure a deal that satisfies this type of partner, he says, was "a driving factor" behind the strategy's creation.

David Levenson, Brookfield Asset Management

This is seen in last year's $260 million investment in Superior Plus, an energy distribution and chemicals business. It was looking to expand by taking advantage of competitors weakened by the health crisis – but not in a control buyout scenario, Levenson says. Since the transaction, Superior Plus has done more than $1.6 billion in deals, including 10 acquisitions.

Holding a minority stake does not impede Special Investments' ability to add value, Levenson says. "We essentially do for a partner what Brookfield could do, just not on a control basis."

Brookfield earlier this year secured an initial $2.4 billion against a $5 billion target for the program's inaugural fund, Buyouts reported. Levenson declined to comment.

A strategy for all seasons: Ares

Anticipating shifts in markets and dynamics, and responding to fast-moving events, may be the most singular attribute of special opportunities strategies. It was put to test during the pandemic when widespread dislocation and volatility created "a more acute need for a partner," Blackstone's Blitzer says.

For Ares' Special Opportunities, a virus-roiled environment gave proof of all-season capabilities, program head Scott Graves said in the firm's Investor Day 2021.

"This is an all-weather product," Graves said. "We invest in both stressed-distressed and over-levered companies – be it rescue, private market or public market – but we also invest in healthy companies, companies that need a higher-risk, higher-reward direct lender."

Special Opportunities, launched in 2017 by Graves as part of Ares' PE group, takes a flexible approach to investing debt and non-control equity in mid-market businesses. It has deployed $4.1 billion over the past two-plus years, much of it in 2020 when an emphasis on privately held opportunities was changed to a mix of dealflow that gave more exposure to listed bargains.

Then, as the market began to recover, Special Opportunities adjusted again. "We rotated our portfolio from majority public during the pandemic to majority private today," Graves said.

Special Opportunities last year closed its debut fund at $3.5 billion. Managing assets of $6.3 billion as of June, it has returned to the market with a second offering, according to Ares' Q2 2021 earnings, reportedly with a $4 billion target. Ares declined to comment.

Other strategies also put large sums to work in the health crisis. Blackstone's Tactical Opportunities invested $4.8 billion last year, its largest outlay ever. Deals included a $275 million investment in Cryoport, a logistics solutions provider to the life sciences industry, to support its buy of MVE Biological Solutions.

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> ***Matt Michelini, Apollo***

Apollo's Hybrid Value invested $2.7 billion in 2020. "Dislocation," Michelini says, "well suited Hybrid Value," which "pivoted from helping companies play defense through covid, and address enormous liquidity needs, to later helping companies play offense and pursue growth opportunities."

Along with Andersons, Hybrid Value's activity included a major rescue financing. It led a $1.2 billion investment in online travel services provider Expedia, splitting the check with Silver Lake. "Travel was at the eye of the covid storm," Michelini says, "and it required more than $5 billion in liquidity to handle refunds."

"At the time," Michelini says, "good businesses could raise senior debt, but it was painful to raise equity." Expedia "wanted something in-between." Apollo's investment was paid off fairly quickly due to a rebound in bookings.

Brookfield's Special Investments was active last year in both rescue and growth financings. On the growth side, there was Superior Plus and a $470 million investment in the fiber division of Brazilian telecom business Oi.

Oi was "very challenging," Levenson says, as the business was under bankruptcy protection. It needed capital to expand the affiliate and preferred Brookfield as a partner because of its experience in Brazil and the infrastructure sector. In 2021, a majority of the fiber unit was sold to BTG Pactual for $2.5 billion.

How has special opps performed?

The hybrid nature of special opportunities is at the heart of its promise of risk-adjusted returns that are uncorrelated, or less correlated, to other investments. This was a key variable in the launch of Apollo's Hybrid Value, Ruberton says, which responded to a decline in private debt's capacity "to provide the returns LPs expected from that asset class."

Strategies differ, however, as to where on the equity-debt spectrum they sit.

In the case of Blackstone's Tactical Opportunities, "the biggest part is structured capital, between equity and debt," Blitzer says.

> *[Tactical Opportunities is] "a great innovation lab from which whole new businesses can emerge."*
> ***Chris James, Blackstone***

In practice, the investing of Tactical Opportunities is structured for downside protection while allowing for potential outperformance, pension documents show. The portfolio of its fourth offering will consist of 25 percent equity-like investments with upside potential, 25 percent credit-like investments that generate cash yield, and 50 percent hybrid investments.

Ares' Special Opportunities, on the other hand, is weighted to credit. Despite these variations, special opportunities strategies profiled in this story have turned in consistently solid performance.

Tactical Opportunities, which has the longest performance history, was as of June earning a combined multiple of 1.6x, Blackstone reported in its Q2-2021 earnings. The combined net IRR on realized investments was 18 percent, and the total net IRR, 14 percent.

Perhaps benefiting from covid-era investing, Apollo's and Ares' more recent programs were also as of June generating robust results. Apollo's Q2 2021 earnings showed a 29 percent gross IRR and a 23 percent net IRR for Hybrid Value's Fund I. Ares in its Investor Day 2021 reported a 67.9 percent gross IRR and a 52.2 percent net IRR for Special Opportunities' Fund I.

Asset class or asset-gathering?

The unique characteristics of special opportunities, together with early evidence of performance, suggest the investment category is here to stay. That is certainly the view of Blackstone's Blitzer.

"We created an asset class for what we do," Blitzer says. "Today, market agents and intermediaries will see a specific type of deal and say: 'That's a Tac Opps.'"

Strategies are, however, strictly the purview of big, brand-name PE firms. This is understandable, Cambridge's Shaw says, as they involve "a large platform with many disparate strategies under its belt." She expects further near-term uptake to remain with managers with assets in the hundreds of billions.

> *"A manager with multiple products is attractive to large LPs, because it is efficient. [Special opportunities strategies represent] "another arrow in the quiver."*
> ***Jill Shaw, Cambridge Associates***

While LPs of all sizes commit to special opportunities funds, it is large institutions with "high-octane portfolios and a lot of capital to allocate" who are their primary backers, Shaw says. A factor here, she says, is trend whereby institutions are writing more checks to fewer GPs.

"A manager with multiple products is attractive to large LPs, because it is efficient," says Shaw. For those LPs, concentrating capital with select GPs will likely satisfy a desire for more choice and customization. From this perspective, she says, special opportunities strategies represent "another arrow in the quiver."

Hamilton Lane's Brian Gildea agrees, noting that in recent years "the largest managers have gained share by increasing the number of strategies they offer." Hamilton Lane, he says, is among LPs who "are looking for more opportunities to lean into certain expanded areas," such as special opportunities, from GPs "with whom we have commitments in flagship funds."

If consolidation of LP capital is helping drive growth in special opportunities – at least among large PE firms – it may also be breeding skepticism about asset-gathering (maximizing assets as a way to bump up fees).

Shaw acknowledges this, saying GPs should be ready to allay LP concerns by demonstrating alignment of interests. Part of this, she says, is being able "to prove out performance and the opportunity set" and show how a strategy fits inside a PE firm and vis-à-vis its overall priorities.

In addition, Shaw says, managers should point to a dedicated team and exhibit "confidence behind the strategy" through a substantial GP commitment. The latter, she says, is important as it amounts to "putting money where your mouth is."

Brookfield's Levenson rejects the notion of asset-gathering. "At Brookfield," he says, "we aren't asset-gatherers. We invest significant amounts of our own balance-sheet capital in all our strategies."

Blackstone's Tactical Opportunities, which was designed to search for white spaces in the fertile post-financial crisis period, is now targeting opportunities that have emerged as a result of the pandemic.

> *"Technology is what's driving many of the trends that are changing our lives, and it is infrastructure that powers technology."*
> ***Jasvinder Khaira, Blackstone***

"Covid changed a lot of things in the world," Blitzer says. In a recovery cycle, he says, Tactical Opportunities is using "a wide lens" to explore fresh shifts in markets and dynamics. Themes include those coming out of last year's widely touted digital acceleration.

One aspect of this has been investing by hyperscalers, such as Amazon, Google and Microsoft, in cloud architectures, Blackstone senior managing director Jasvinder Khaira says. "Technology is what's driving many of the trends that are changing our lives," he says, "and it is infrastructure that powers technology."

Growing the investable universe

Tactical Opportunities has so far deployed $3.5 billion to digital infrastructure – the cloud, data centers, internet-of-things and fiber-to-the-home. A key investment is Phoenix Tower International, which Blackstone set up in 2014 because there were no actionable tower companies then available to buy.

In the years ahead, Tactical Opportunities will ratchet up investing in platforms like Phoenix and scope out more digital infrastructure dealflow, with an eye kept firmly on the hyperscalers. "We plan to double-click on that long-term mega-trend," Khaira says.

Hunting for white spaces in sectors like digital infrastructure has made Tactical Opportunities "a great innovation lab from which whole new businesses can emerge," COO James says.

In fact, the strategy has over 10 years contributed to Blackstone's evolution and foray into several first-time areas, including growth equity and insurance.

This may be an under-appreciated aspect of special opportunities programs, Hamilton Lane's Gildea says. In creating "a sourcing engine" to pursue overlooked transactions, he says, they have found a way to "get more power" out of a PE firm and "broaden the investable universe."

Buyouts acknowledges with thanks the advice provided during the writing of this story by Marco Masotti*, partner and global co-head of the private funds group at Paul, Weiss, Rifkind, Wharton & Garrison.*

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