THE STATE OF PRIVATE EQUITY: CURRENT TRENDS AND OUTLOOK

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Intense competition for private equity deals will continue through 2017, keeping valuations high. But market opportunities remain.

Those are some of the points made by a panel of experts during a recent roundtable, "The State of Private Equity: Current Trends and Outlook." The Deal LLC and Donnelley Financial Solutions co-sponsored the webcast.

Panelists included **Andres Saenz**, managing director and co-head of private equity at **Parthenon EY**; **Richard Prestegaard**, partner of business development at **High Road Capital Partners**; and **Shamit Grover**, managing director of private capital group at **MSD Partners**. **Daniel Perez**, director of business strategy for **Venue, Donnelley Financial Solutions'** virtual data room and end-to-end deal solution suite, served as moderator.

"It's over 500 billion dollars of dry powder the private equity firms have. It's a lot of pressure to put that capital to work, which consequently leads to more competition and high valuations, high multiples on the buy," Saenz said. "Ultimately, it's still a seller's market today," he added.

"I don't see it getting less competitive. If anything it's going to continue to get more competitive," Prestegaard added. "That doesn't mean that there are not opportunities to be had." Opportunity comes with a price. "I think 10 times multiple is kind of what's referred to right now as the median or average multiple for clearing a private equity buyout deal," he added. High Road Capital Partners focuses on the smaller end of the market and has seen deal flow increase since the start of the year.

In the middle market and larger markets, Grover is also seeing 10 times multiples, even for assets that used to have multiples of 7 or 8 times just two or three years ago. "That's sort of the entry price for basic assets and anything that has any reasonable growth to it you probably saw ... is a lot higher," he said.

The increased competition for private equity deals comes as more buyers chase assets. "Number one, there is competition from strategics, but the private capital universe has expanded as well," Grover said. "There's private equity of all different sizes, there are the long funds now within private equity. There are family offices that are getting more organized. There are pension funds getting more organized, sovereign wealth funds, so not just strategic competition but competition from a number of different providers of capital," he added.

Prestegaard said he has seen "aggressive behavior" from larger funds doing smaller deals, particularly in the consumer space, while Saenz said he's seen that type of deal activity in health care as larger funds buy small "mom-and-pop providers" in areas like dermatology and eye care. He noted that big multiples are being paid for what are considered to be platform companies in those spaces.

Platform deals are one area where private equity firms are spending a lot of energy, according to Grover, who also sees PE firms trying to do a combination of two companies at the same time to hit a targeted level of capital deployment. Additionally, carve-outs are attracting a lot of interest. "People are getting more and more focused around trying to be the drawdowns of the large industrial conglomerates or technology conglomerates and seeing there you can pull some assets out," he explained.

In the smaller end of the markets, Prestegaard said he is seeing a prevalent use of earnouts, which are used when sellers and buyers don't agree on expectations of a company's future growth.

On the topic of deal financing, Prestegaard said he has seen an increase in funds having their own lines of credit, which they can draw on to fund a transaction closing, while Grover said his firm spent a lot of time in the past 18 months focusing on structured capital.

The panelists were in agreement that the expected gradual rise in interest rates this year shouldn't affect transactional activity. "At the end of the day, I think there are bigger secular drivers of why the deals are happening," Saenz said.

"What really drives dealmaking and deal activity tends to be more dry power than anything else," Prestegaard said.

But the experts said they believe deal activity has been impacted by the presidential election, with the potential for new opportunities in some sectors. With President Donald Trump's call to reinvigorate infrastructure investment, Prestegaard said he sees a "great amount of activity" in that

sector, along with an increase of interest in transactions in the manufacturing sector, and some areas of healthcare, such as businesses that focus on reducing healthcare costs.

Beyond those sectors, Saenz said he sees interest in technology, particularly software. "I think you have a whole generation of vertical software platforms that have gotten to scale, that have a leadership position or at least a No. 2 position in a market. They have real cash flows and, in fact, many of them have recurring revenues. So they've become a very, very interesting set of assets for private equity to jump in on."

2017 might not bring a return of private equity to the public markets, with the panelists in agreement that initial public offerings are not their preferred exit strategy. "I think in general, for us the preference is always an outright sale as a opposed to a public offering," said Grover, who noted that a sale to a strategic buyer can result in a higher multiple. Prestegaard agreed, saying an IPO is typically not a viable option at the smaller end of the market, although he is indifferent about selling a portfolio company to either another PE firm or a strategic.

"We are seeing at the top end of the market, the strategics in the past few years have been a very, very good landing spot for PE exits," Saenz said. "I think, over the last few years, over 70% of PE exits go to strategics. I think it's much higher than it was five, 10 years ago."

On another topic, the panelists addressed whether activists campaigns were driving an increased number of PE deals. "There is probably a natural tendency as you think about activists who push for better management and noncore assets getting divested, which creates opportunities for private equity," Saenz said.

In terms of fundraising, 2017 may remain robust, after a strong 2016, with 807 PE funds globally raising almost $350 billion. "There's a powerful secular force around putting money into private equity," Saenz said. "If you look at the pension funds they have to deal with funding gaps. One way to bridge that gap is to look for alternative assets including private equity," he added.

Deal sourcing is also a priority for our experts, with an emphasis on spending time building relationships with companies and their executives. "We enjoy investing in businesses and helping them grow," Grover said. "If you can sit down with an entrepreneur, with a manager, with a founder, spend time with them, understand the business ... frankly while it increased deal sourcing and creates focus, it's just a better fun approach."

Private equity is also facing a new challenge, thanks to the expanded use of social media. Saenz said he's seeing funds actively manage their brands and investment profile. "There is a recognition that the controlling of the m essage is much more widespread now and that they have to be actively and deliberately managed as opposed to necessarily be reactive to it. It can really derail a situation for a private equity fund," he said.

"Social media and its impact is a relative wild card still. It's an important part of the universe now," Prestegaard added.

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