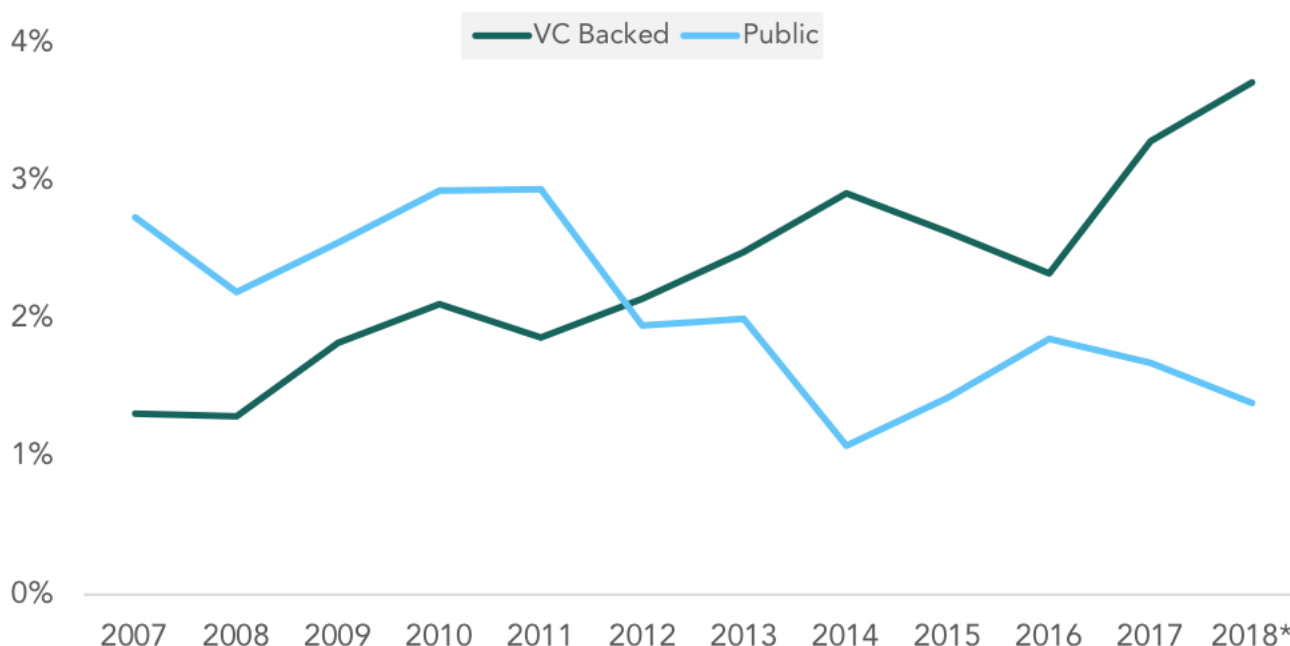


Heading west: PE sourcing more from the valley than public market

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Proportion of PE deal flow by backing status



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We've remarked in the past that PE firms are warming to VC-backed targets. Younger tech companies are increasingly becoming viable buyout targets, or at least intriguing add-on candidates for their platforms. Meanwhile, we've also seen far fewer headlines about billion-dollar take-privates, particularly as the stock market has soared. Still, it was interesting to see buyouts of VC-backed companies have outpaced take-private deals as a percentage of PE deal flow since 2012. Granted, the percentages for both are comparatively very low, ranging from 1% to 3% any given year. If nothing else, it's a symbolic shift for an industry that made its name poaching the public markets.

There are several contributing factors. First and obviously, public market valuations have been hot for some time, aided in large part by easy monetary policy. It may be true that inflated stock prices are masking underlying problems in some companies, and those companies would make otherwise good targets. But entry prices are critical in PE's calculus, which is why some recent take-private deals have involved low premiums (KKR/Envision Healthcare was a 5.4% premium) or standard premiums for low-performing share prices. When Thoma Bravo bought Barracuda Networks earlier this year, it was at a 22.5% premium over recent trading but a full 70% lower than its 2015 high. Moreover, take-private litigation has only gotten worse, which means

premiums need to be high in a pricey market to avoid getting mired in costly legal battles.

One pre-crisis trend has returned, that of the mega-fund. In fact, they're even bigger this time around—Apollo's ninth flagship fund of \$23.5 billion is the largest individual pool ever raised. What's missing this time is the so-called club deal—multi-billion-dollar deals involving several mega-funds. Many of the biggest deals in years past included four or more cooks in the kitchen; today's take-privates are more likely to involve just one or two. Lenders are eager to finance take-privates in any form, which have cleaner books and more potential for bigger debt packages. That said, the market has been expecting a turnaround on take-privates that hasn't really materialized. In its 2018 Private Equity Report, Bain & Company scoured the universe of public companies trading at 9x or below of EBITDA and "with potential for revenue and margin expansion," which netted 72 US public companies "that seem ripe for conversion." Most of them are large opportunities for today's mega-funds, but still, only 72?

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