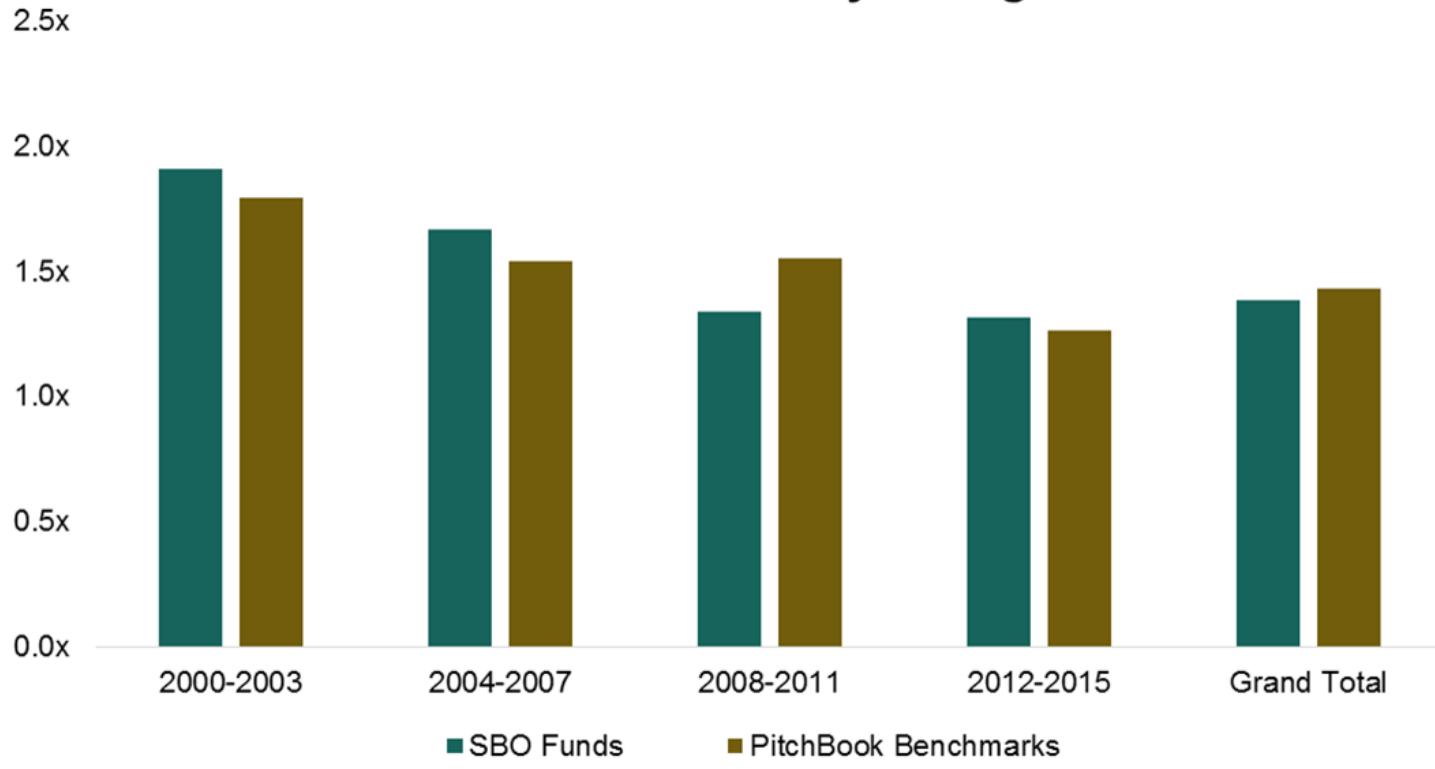


Are SBOs a drag on fund performance?

PitchBook | October 17, 2018

Median TVPI by vintage



Download PitchBook's Report [here](#).

Secondary buyouts are one of the most critiqued aspects of the private equity industry. But SBOs aren't going anywhere, and they represent one of the largest deal sourcing opportunities in today's market. Still, it's worthwhile to investigate the wisdom of buying "used" portfolio companies, since PE's justification is tethered to operational improvements. Our analyst team set out to quantify the SBO question on a fund returns level by identifying SBO-heavy funds and comparing their performance to their broader peer groups. [The results were mixed](#). Using a set of funds that relied heavily on SBOs—in this case, between a quarter and a half of all deals being sourced as SBOs—our team found that "SBO funds" performed on par with other buyout funds on a cash-on-cash basis. 27% of SBO funds wound up in the top quartile of their peer groups, percentage points higher than a randomly selected fund. Other SBO funds were fairly evenly distributed, with 19% in the second quartile, 29% in the third and 25% in the fourth. Overall, not bad for a maligned deal strategy, and one that has been pilloried by academics for years.

This latest note, while limited in scope, adds to previous analysis we've done on SBOs. This past summer, we found that SBOs are less risky compared to primary buyouts, at least in terms of bankruptcy rates. Moreover, hold times actually shorten for companies that undergo at least three back-to-back buyouts, a positive for a time-

sensitive industry. If SBO funds also see comparable fund performance, that would provide another datapoint for a broader conclusion: If you have a clear plan in place for a past-owned company, it's a viable target. While portfolio companies sometimes change hands for the wrong reasons—a lack of creative deal sourcing, pressure to deploy capital, etc.—many SBOs are done deliberately. Our sample of SBO funds utilize the strategy heavily, suggesting that SBOs might be part of their game plans at the outset. Having prior success with SBOs is an overlooked positive, because it often means that investors have learned how to unlock value when, at least in theory, there shouldn't be many stones that went unturned by prior sponsors.

Contact: Alex Lykken

alex.lykken@pitchbook.com