Downturn opportunities don’t last long

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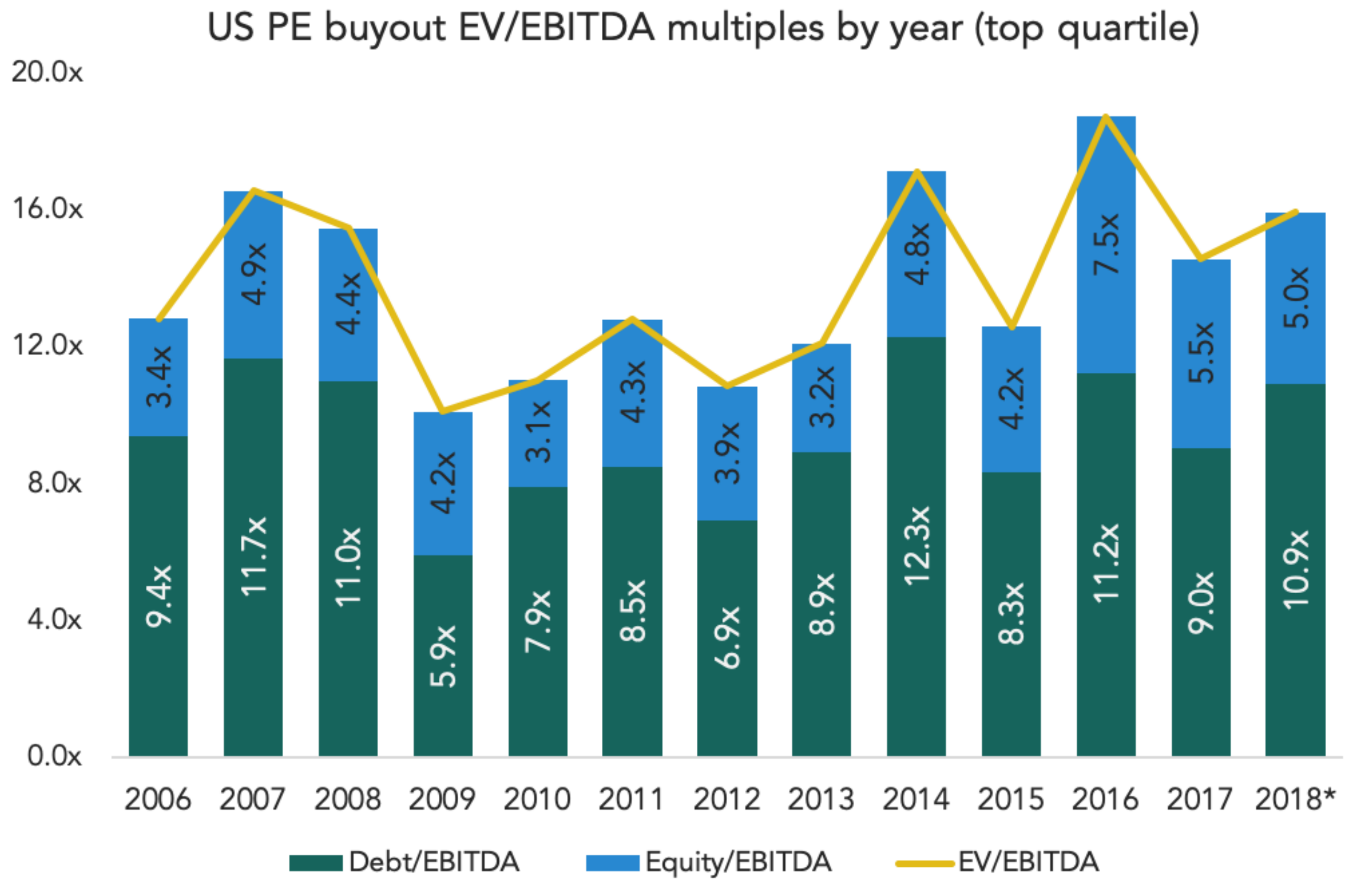

Bain & Company released its annual private equity report this week. It’s required reading for the industry every year. One of their more salient points is the resiliency of purchase price multiples following downturns. In the two-year window between 2009 and 2011, average multiples bounced back quickly (+15%) after falling 21% between 2007 and 2009. Percentage changes can be misleading—a 21% decline from the top is much more significant than a 15% increase from the bottom, since the bar is considerably lower the second time around. Still, it’s an instructive way of looking at the buyout market, and the trend is even more pronounced for the most attractive deals.

The chart above reflects top-quartile multiples by year, so the numbers are quite a bit bigger, even on a median basis. Using the same timeframe Bain did, top end multiples fell 39% between 2007 (16.6x) and 2009 (10.1x) before bouncing back 27% by 2011 (12.8x). 16.6x is expensive in any language, but so is 12.8x, and the latter number was recorded in the aftermath of the meltdown. In the span of four years—the amount of time one spends in high school—investors experienced the top, the bottom and a strong recovery, all in rapid succession. That’s not a lot of time in the grand scheme of things.

Private equity is said to operate best in down markets, but that point is strongest in relation to other asset classes. Within the PE universe itself, down markets don't really alleviate fraternal competition between firms. There may be more targets available and less competition from strategics, which certainly helps. But the best deals in any market will always attract plenty of bidders. In Bain's words, "it pays to be ready to pounce when the downturn arrives, developing a clear understanding of where the most attractive targets are in a given asset class or sector and striking aggressively as the cycle plays out." For PE firms looking for steals, though, it pays to remember that every other investor is trying to take advantage of the situation at the same time. Windows of opportunity will continue to close faster as the industry itself continues to mature.