Which way for PE valuations?

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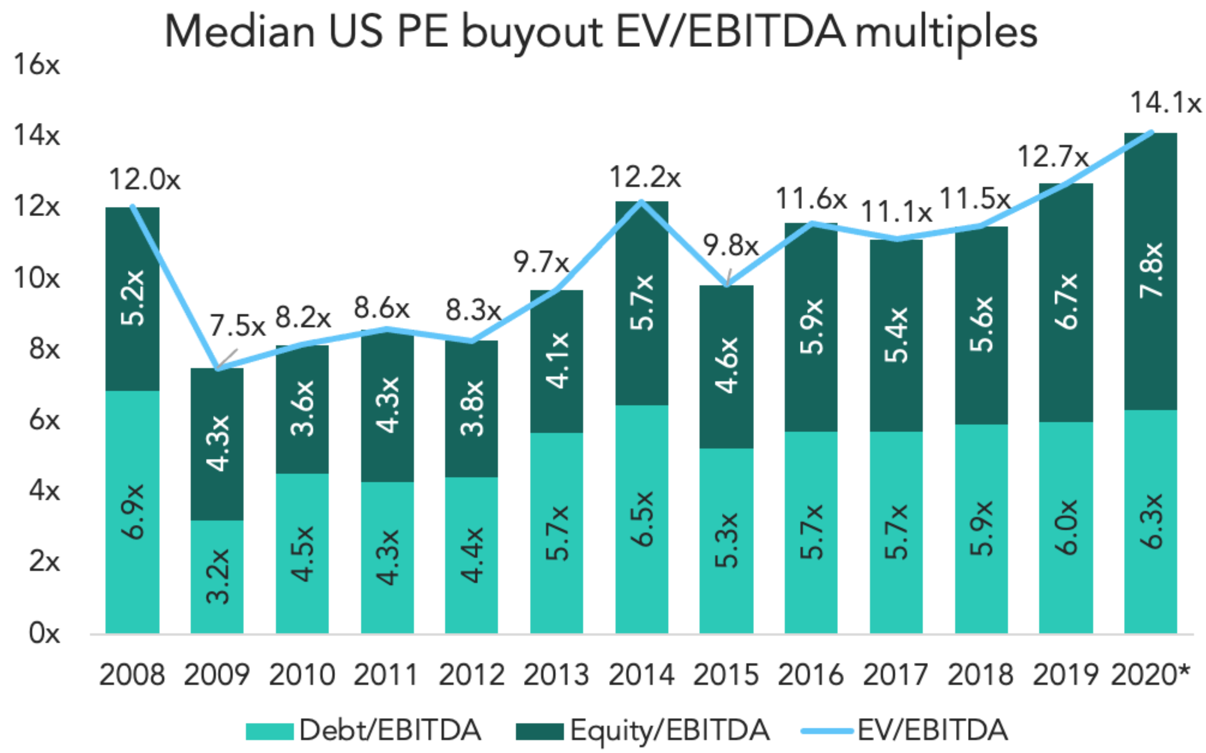

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US PE buyout multiples went up in 2020, according to the 2020 Annual US PE Breakdown. At 14.1x, 2020 is actually the new high-water mark, increasing almost a turn and a half over 2019's median of 12.7x. 14.1x certainly isn't reflective of the entire market. Many of the companies that were bought out last year weren't severely impacted by COVID-19, and some companies saw their bottom lines improve due to lockdowns. Tech is a prime example, especially at the higher end. Virtusa, a digital strategy and engineering firm, went private last month at an implied valuation of 16.2x firm value/last twelve months EBITDA. Industry observers say negotiations at 20x and higher are relatively common. Tech deals made up a bigger share of PE activity last year: 24% of all PE dollars invested went to the industry, up from 18% in 2019.

The bigger point, though, is that 2020 multiples reflect companies that were healthy enough to come to market in the first place. Because buyer/seller expectations diverged so drastically this year, many would-be target companies stayed on the sidelines. 2020 also had two healthy quarters—Q1 was normal by historical standards, and Q2 included a lot of agreed-to valuations that had to be honored, even with the market shakeup. We did see COVID's impact on multiples in Q3, on a four-quarter rolling basis. The Q3 median fell to 12.9x, from 15.2x in Q2. Not coincidentally, the third quarter saw the most distressed buyouts of any period last year, and the rolling median shot back up again in Q4 to 14.1x. With money expected to pour into the buyout market in 2021, there's reason to believe multiples will remain elevated, or perhaps even creep up throughout the year.