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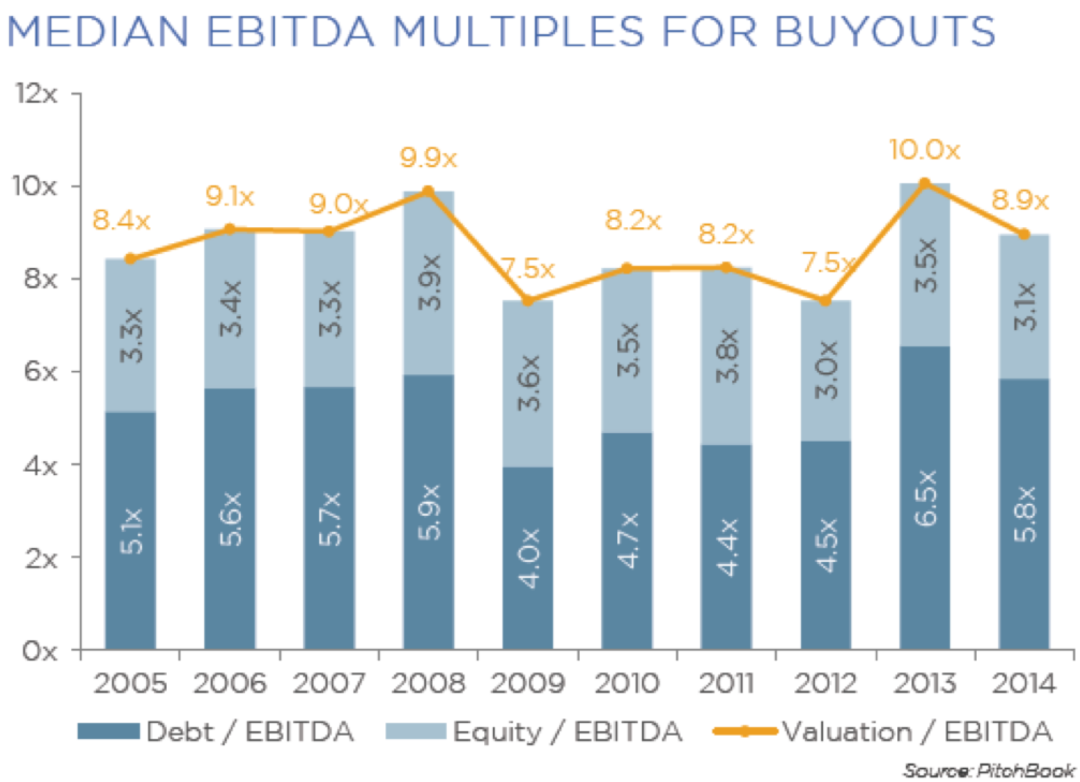
The Pulse of Private Equity – 6/15/2015

PitchBook | June 17, 2015

Valuations met with a shrug

High valuations have become a headache in the PE industry, not only for the firms themselves but also their own LP investors. Overpaying today leads to under-reaping tomorrow.

Even so, deal activity continue sapace, particularly in the middle market. Judging by the data, whatever concerns are being voiced today are being met with a shrug by dealmakers. They have a record amount of dry powder that needs to be used and a limited time horizon to use it. What are they supposed to do, sit on the sidelines? They'd argue that they can't, justifiably.



But they know they can't justify inflated spending for its own sake, which is why today's investing is, in fact, much more targeted and deliberate than in years past. In many cases, platform buyouts aren't being made until a number of add-on acquisitions have been identified and brought into the fold before the platform deals are finished. Speaking more generally, though, investors are being more deliberate within certain sectors. Consider the niche sub-sectors where activity is most buoyant today: branded, consumer-growth companies, healthcare service providers unreliant on government-subsidized reimbursements, niche professional service firms and "sticky" SaaS providers with high customer retention rates. By and large, those sub-sectors are seeing some of the highest valuations in their industries, but they're also seeing the most explosive growth rates, as well. PEGs know they’re paying more for their deals, but they’re figuring out ways to make them successful and profitable, even if the multiple is at 10x or higher. If the company is growing enough and has enough potential for a good exit, the deal is still going to happen.

Time will tell whether this is a sound approach, but private equity has been written off many times in the past before posting some “surprising” results.

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