PitchBook

Analysis of PE Take-Privates

How the buyout strategy has evolved and why it is likely making a comeback

PitchBook is a Morningstar company. Comprehensive, accurate and hard-to-find data for professionals doing business in the private markets.

Credits & Contact

Analysts

WYLIE FERNYHOUGH Analyst, PE
wylie.fernyhough@pitchbook.com
DARREN KLEES Data Analyst II

Contact PitchBook

RESEARCH
reports@pitchbook.com

Contents

Key takeaways	1
Introduction	2-3
Opportunities	4-5
Sector considerations	6
Performance	7-10
Conclusion	10

Key takeaways

- Take-private buyouts, defined as acquisitions of publicly traded companies by PE firms, are poised to rise in prominence in 2019 and beyond given the spread between public and private multiples has converged.
- Take-privates tend to skew more toward healthcare and technology, accounting for more than half of the cumulative deal value in the past three years. B2C, particularly retail—a sector in which PE has not had the best of luck lately—has also contributed heavily to take-private activity in recent years.
- Portfolio companies that were taken private are more than twice as likely to go bankrupt or out of business as non-take-privates of a similar size. For companies that don't go through a bankruptcy proceeding, there is a discernible outperformance in annualized EV growth by take-privates over non-take-privates. Take-privates appear to put forth performance that compensates (at least partially) an increased risk of going bankrupt or out of business.

Some items to note in this analysis:

- *We consider a take-private to be only a full acquisition of a public company by a PE firm.*
- *Carveouts of a public company that are purchased by PE buyers do not qualify as take-privates.*
- *The geography of the target companies is limited to North America and Europe*
- *Real estate investment trusts (REITs) are not counted toward deal or exit activity.*

Published on April 8, 2019

COPYRIGHT © 2019 by PitchBook Data, Inc. All rights reserved. No part of this publication may be reproduced in any form or by any means—graphic, electronic, or mechanical, including photocopying, recording, taping, and information storage and retrieval systems—without the express written permission of PitchBook Data, Inc. Contents are based on information from sources believed to be reliable, but accuracy and completeness cannot be guaranteed. Nothing herein should be construed as any past, current or future recommendation to buy or sell any security or an offer to sell, or a solicitation of an offer to buy any security. This material does not purport to contain all of the information that a prospective investor may wish to consider and is not to be relied upon as such or used in substitution for the exercise of independent judgment.

Introduction

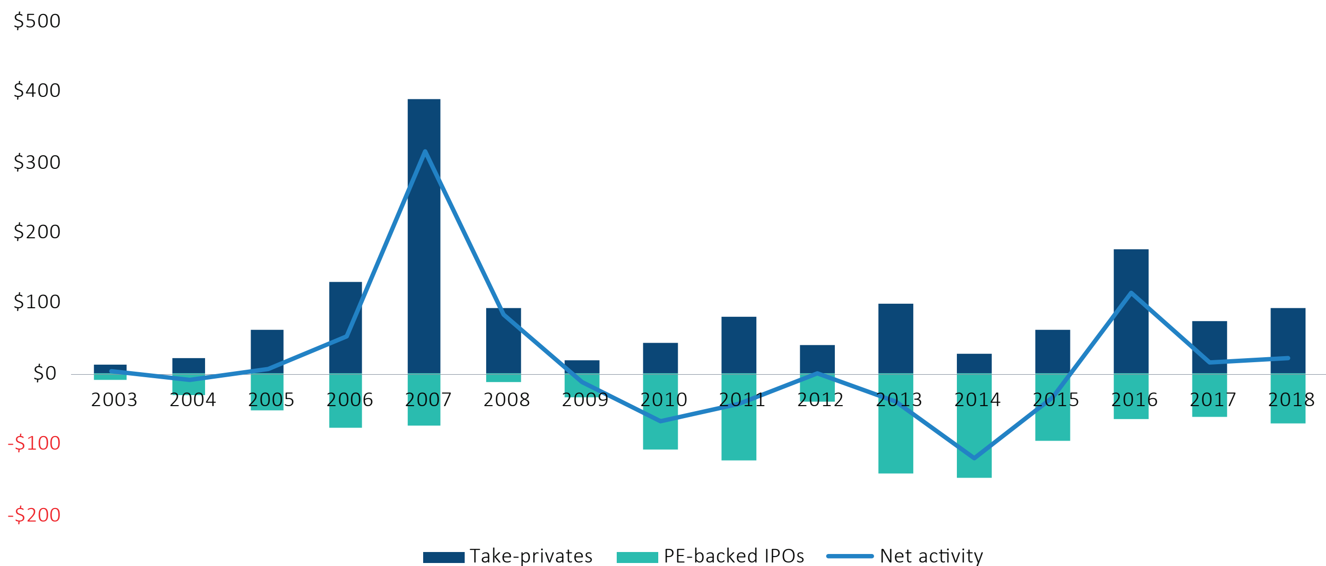
Take-private buyouts—whereby a public company is bought out and taken private by one or more PE firms—have been declining as a portion of overall deal activity for nearly two decades. In 2018, these deals accounted for 1.1% of deal flow in North America and 0.8% in Europe. However, the number of take-privates has held relatively steady as the count of non-take-privates has ballooned. 2003 saw 65 take-privates in North America and Europe whereas 2018 saw 66. Those same years saw 1,669 and 6,838 non-take-privates, respectively. Interestingly, these deals now account for a higher portion of deal value than 15 years ago—5.7% in 2003 for North America and Europe compared with 8.0% in 2018. The size of take-privates has dramatically outpaced non-take-privates during that time, with the median rising at a 16.6% CAGR compared to a 6.9% CAGR for non-take-privates.

Take-privates (#) as proportion of overall deal activity by region

Source: PitchBook | **Geography:** North America & Europe

While the count of take-privates may be level with the figures of 15 years ago, some structural changes are underway in the PE industry that we believe will boost the number of take-privates in the coming years. Public markets in North America and Europe offer fertile hunting ground for billion-dollar-plus buyouts that allow GPs to spend down dry powder and begin earning fees on uninvested capital. To note, PE mega-funds ($5 billion+) have $328.3 billion in dry powder as of 2Q 2018 and are seeking deals sizable enough to move the needle on called capital; this is nearly double the sum of dry powder just four years prior. On top of a growing number of multi-billion-dollar buyout funds, the spread between multiples in public and private markets has diminished to the point that many public companies trade below private market equivalents. In fact, the last three years have seen the cumulative value of take-privates outstrip the value of PE-backed IPOs, showing the market's preference for capital to move from public to private markets.

Take-private and PE-backed IPO net activity ($B)

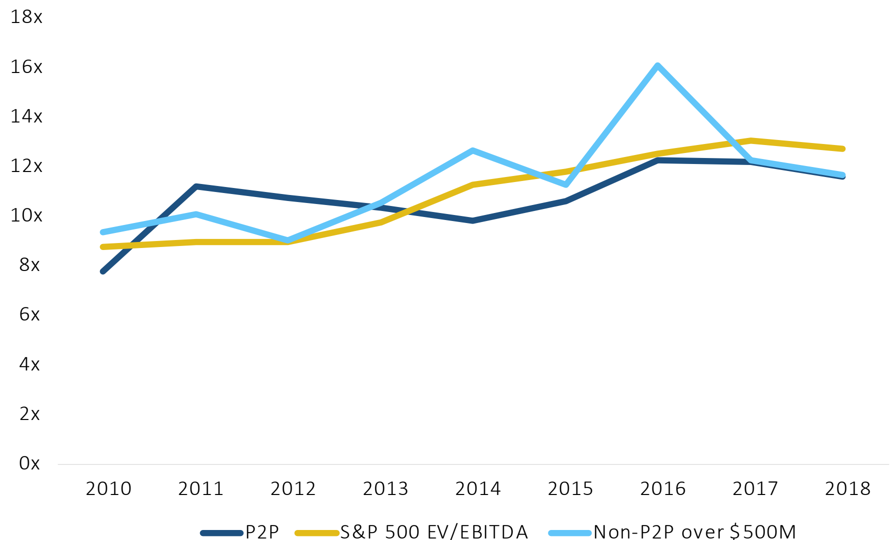


Source: PitchBook | **Geography:** North America & Europe

Opportunities

For many years, public companies traded at a premium to their private market counterparts. This was mostly due to liquidity preferences and the increased visibility into financials. Heightened competition for private assets, among other factors, has caused a paradigm shift whereby private market multiples have approximated public markets for nearly a decade. This presents PE firms with a massive opportunity. Pockets of downward volatility can cause public companies to drop by 20% or more in a quarter. If a company trades at 12x EV/EBITDA, that is a drop of nearly 2.5x. These moments of price weakness present a buying opportunity for PE firms. Public companies also have the benefit of always technically being “for sale” as well, whereas PE-backed companies may go on sale only every four to six years and carveouts from conglomerates are even more infrequent.

Median take-private and S&P 500 EV/EBITDA multiples

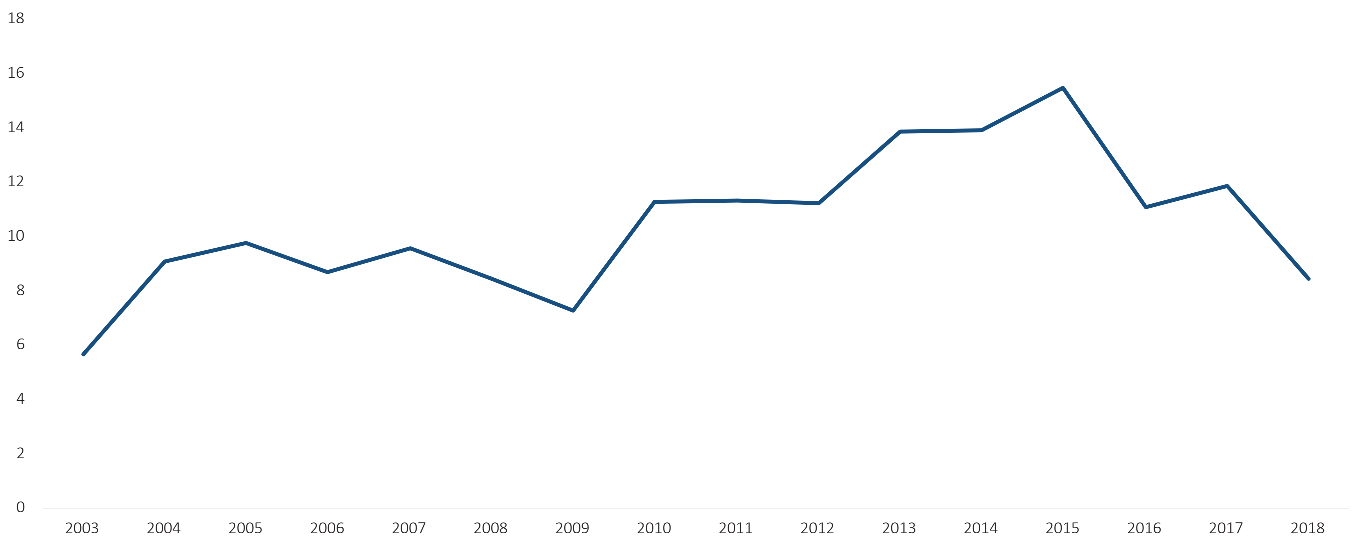


Source: PitchBook | **Geography:** North America & Europe

This change in thinking opens up a new cohort of potential takeover opportunities. Many younger companies in sectors undergoing radical changes, especially healthcare, financial services and IT, are likely to be on the radar of PE firms.

The average age of public companies is rising, but PE firms have begun targeting younger publicly traded firms. The median number of years since the public listing of take-private targets fell from 15.5 years in 2015 to 8.5 years in 2018. This critical turnaround is likely due to the abundance of young tech companies that were taken private. In a recent example, cloud-based Apptio was barely public for two years before Vista Equity Partners took the company private in a $1.9 billion buyout in 2018. In some cases, PE firms are not waiting for companies to go public, instead acquiring them while still VC-backed or in IPO registration. This change in thinking opens up a new cohort of potential takeover opportunities. Many younger companies in sectors undergoing radical changes, especially healthcare, financial services and IT, are likely to be on the radar of PE firms. Various subsectors within this group are highly fragmented, setting up PE firms to acquire a platform company and pursue the buy-and-build strategy of growing through myriad acquisitions. Additionally, many businesses within these sectors have predictable cash flows and high levels of organic growth. Consequently, we believe these three sectors present the best opportunity for take-privates going forward.

Median time (years) since IPO for take-private targets



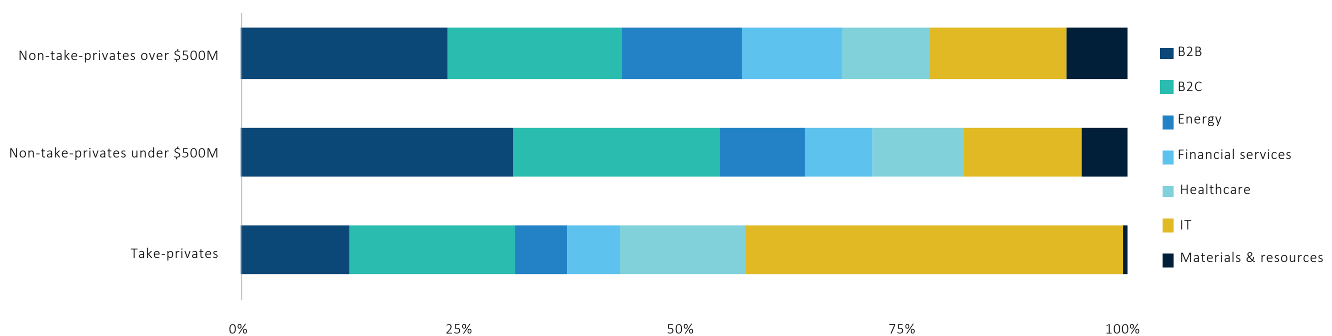
Source: PitchBook | **Geography:** North America & Europe

Sector considerations

Take-privates are typically massive; in 2018, 24 take-privates above $1 billion lifted the median deal size above $700 million—the highest on record and nearly six times the size of non-take-privates. Such massive buyouts are inherently risky ventures. As such, GPs are less willing to invest in cyclical industries that often carry additional layers of risk and have instead pursued a high portion of deals in technology and healthcare—accounting for 42.5% and 14.2% of capital invested from 2016 to 2018, respectively. These sectors also achieved the highest gross pooled multiples of invested capital between 2009 and 2015.[1]

One area of interest in the data is the deal value in retail, as many of the recent take-privates, including Staples and Cabela's, focused on the space. PE buyouts in this sector have not ended well lately, with Claire's, Gymboree and Toys "R" Us all filing for bankruptcy. Additionally, Staples just underwent a $1 billion dividend recap as Sycamore Partners pulled approximately two-thirds of the original invested equity out from the business, potentially setting up another poor outcome due to the additional debt burden for a low-margin company in a dying industry. The fundamentals within the US retail space tell a chilling story; the US has approximately five times the retail square footage per capita as many European countries.[2] Furthermore, consumers in North America and Europe continue turning to online rather than physical retail. As such, we believe PE firms should avoid retail take-privates unless there is a truly compelling opportunity. (Examples may include separating the real estate from the retail company, carving out or adding on a digital retailer or combining smaller players.) PE firms may be taking note; 2018 saw a marked slowdown regarding take-privates of retail companies.

PE buyouts ($) by sector (2016-2018)



Source: PitchBook | **Geography:** North America & Europe

1: "Global Private Equity Report 2019," Bain & Company, Hugh MacArthur, Brenda Rainey & Johanne Dessard, 2019
2: "A Retail Real Estate Company," GGP, Michael Berman & Kevin Barry, March 2017

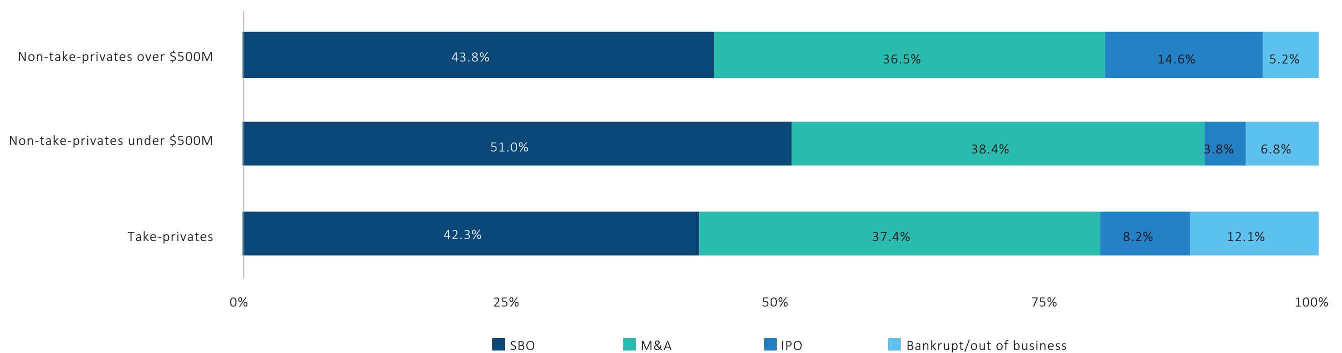
Performance

Looking at exits of take-privates over the past three full years, we see these buyouts are more than twice as likely (12.1% versus 5.2%) to go bankrupt or out of business when compared to similarly sized non-take-privates.

While they can be compellingly priced, take-privates present certain unique risks of which GPs need to be aware and for which they are (hopefully) compensated. Looking at exits of take-privates over the past three full years, we see these buyouts are more than twice as likely (12.1% versus 5.2%) to go bankrupt or out of business when compared to similarly sized non-take-privates. In addition to the deleterious impact bankruptcies can have on fund performance and stakeholders, bankruptcies—especially when high-profile—reflect negatively upon the GP, potentially causing reputational damage and making future fundraising efforts more challenging.

One explanation for the higher rate of bankruptcy in take-private deals is that to afford these massive buyouts, PE firms employ greater amounts of leverage. An illustrative example was the recent $9.9 billion take-private of Envision Healthcare by KKR, which closed in October 2018. This buyout was financed with $5.1 billion in leveraged loans, $2.2 billion in high-yield debt and $850 million in additional debt financing, bringing total leverage levels to over 80% of the purchase price. Lenders are often willing to boost leverage given the lower levels of perceived risk and added levels of financial insight that can be gleaned from years of public filings. However, given the higher bankruptcy rates, this line of thinking appears flawed.

Take-privates and non-take-privates (#) by exit type (2016-2018)



Source: PitchBook | **Geography:** North America & Europe

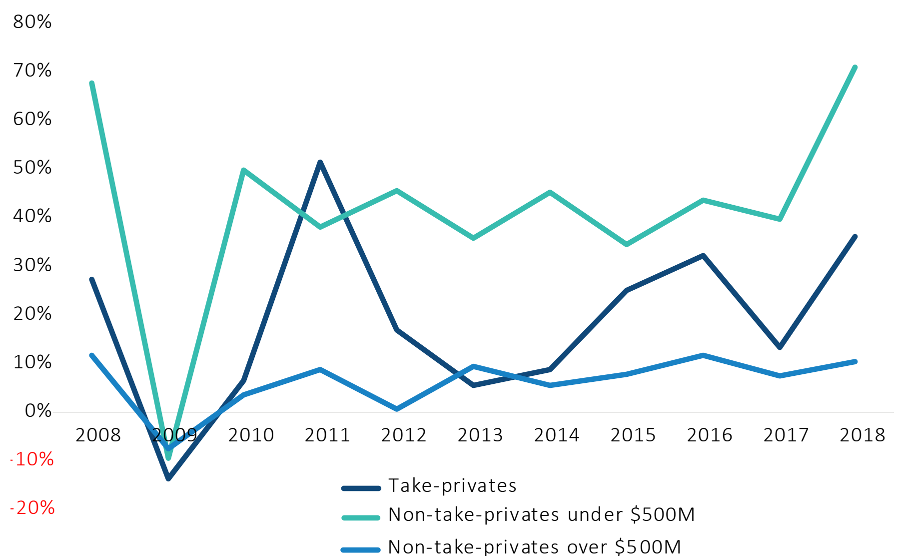
One additional consideration for assessing take-private performance is that these buyouts generally have longer holding times than non-take-privates, which can drag down IRRs because it delays cash flows to LPs (assuming the GP cannot keep up the same rate of value creation). This is a reversal of fortune, because between 2009 and 2013, take-privates exhibited a lower median holding time than non-take-privates of any size. There are several reasons we would expect holding times to be longer for take-privates. For one, these deals are larger, on average, and implementing changes into the enterprise takes additional time with extra layers of management. Additionally, take-privates—which often occur in fragmented industries ripe for consolidation—undergo nearly twice the number of add-ons than non-take privates do, which take longer to integrate into the organization. However, as the Staples example shows, GPs have been utilizing dividend recaps for take-privates at an elevated rate (higher than for non-take-privates) which can counter the negative timing effects of longer holding times on IRR.

Median holding times (years) for take-privates and non-take-privates by exit year

Source: PitchBook | **Geography:** North America & Europe

While take-privates present a clear opportunity for large, reasonably priced buyouts, they have seen a higher proportion of poor outcomes in recent years (as measured by the rate of bankruptcy or going out of business). The most important question as it pertains to performance, however, is if GPs are being compensated for this additional downside risk through higher returns. To judge performance, we measured change in EV for take-privates versus non-take-privates of similar sizes, looking at annualized performance rather than absolute percentage increases because extended holding times would be expected to boost total values, making for an unfair comparison. The volatility around this metric, as we see with performance across PE, has been relatively high. Overall, though, we find the answer to be that performance shows a discernible benefit for take-privates compared with non-take-privates over $500 million. One reason for this could be that GPs are able to act when price dislocation occurs, securing buyouts at more attractive prices than would be available in private markets. These findings may also give credence to the belief that public companies are overly focused on short-term thinking and become inefficient, allowing an actor with a longer-term focus to step in and realize untapped value.

Median annualized change in EV for take-privates and non-take-privates by exit year



Source: PitchBook | **Geography:** North America & Europe

There have been years in which similarly sized non-take-privates outperformed, but take-privates consistently realize higher changes in annualized EV increases. The spread has tightened somewhat in recent years, seeming to indicate that the benefits are diminishing due to competitive forces. Another takeaway is the clear outperformance by smaller buyouts as opposed to larger ones, with non-take-privates under $500 million exhibiting the best performance in 13 of the 15 years shown.[3]

Conclusion

In summary, take-privates suffer a higher level of bankruptcy or going out of business but show measurable upside, as compared to similarly sized non-take-privates, to justify this risk. When looking at take-privates as a source of deal flow, GPs ought to have a clear value-creation plan laid out. Additionally, GPs may consider altering the mix of financing—favoring equity—to derisk the acquisition and hopefully avoid bankruptcy. Since take-privates present opportunities to spend down heaps of dry powder at reasonable valuations, we believe the coming years will see a rise in take-private activity. We will have to watch performance closely as the recent flood of high-profile technology take-privates are exited and see how returns stack up.

3: We do not include companies that have gone bankrupt or out of business in the calculation of performance figures due to lack of clarity into bankruptcy values. The inclusion of these results would likely reduce performance measures for take-privates. Additionally, dividend recaps—which are hardly publicized and not included in this analysis—occur more frequently with take-privates and may boost the overall IRR for these buyouts. Lastly, higher leverage levels in take-privates would likely boost corresponding IRRs.