Paul | Weiss

Private Equity Digest

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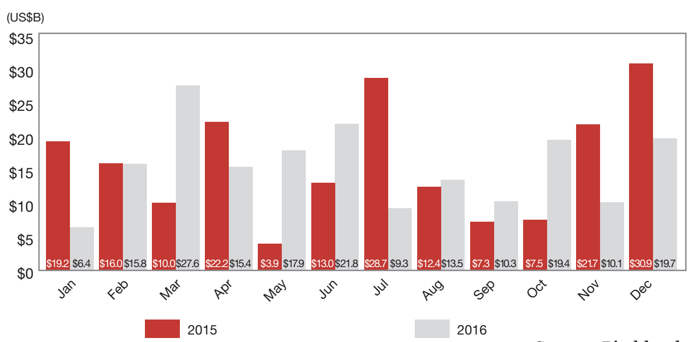
A Review of U.S. Private Equity M&A Trends from 2016 and Expectations for 2017

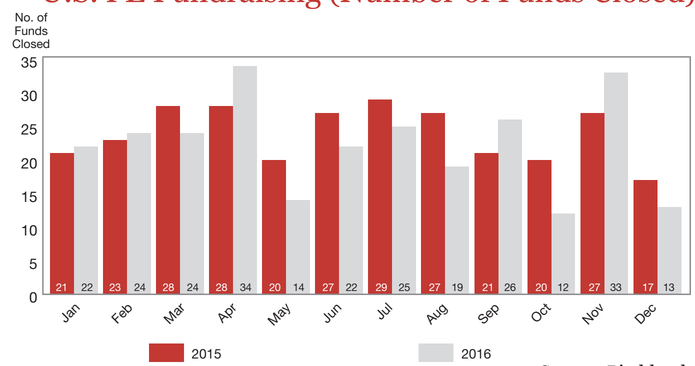
In this issue of the Private Equity Digest, we take a look back at private equity M&A activity in 2016 and forward to possible developments for 2017. In 2016, private equity investment downshifted somewhat.

U.S. PE Fundraising (Billions of Dollars)



Source: Pitchbook

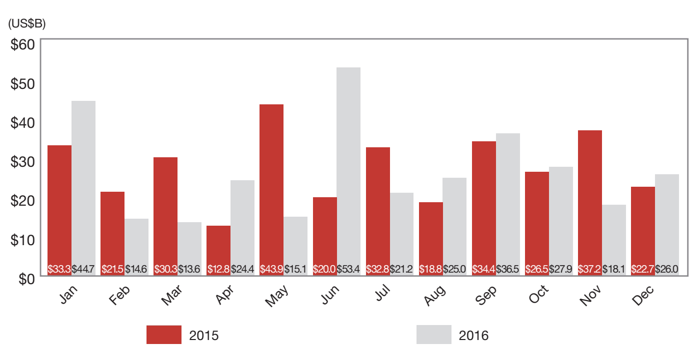
U.S. PE Fundraising (Number of Funds Closed)



Source: Pitchbook

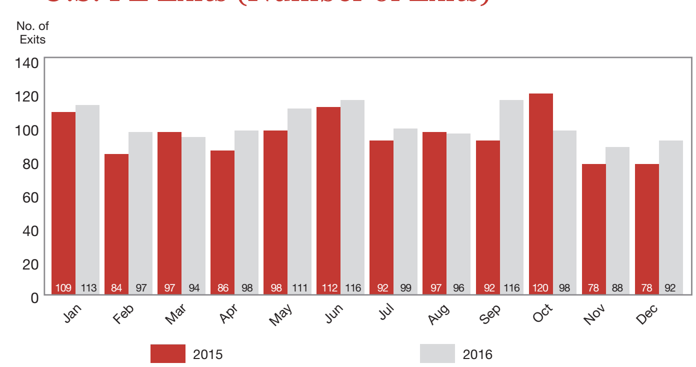
U.S. sponsor-backed exits in 2016 were valued at $321 billion across 1,218 deals in 2016, representing a 4% decrease and a 7% increase, respectively, from 2015. The first half of 2016 showed a brisker pace, averaging a total of 629 exits valued at $166 billion total, compared to 589 exits valued at $155 billion total in the second half of 2016.

U.S. PE Exits (Billions of Dollars)



Source: Pitchbook

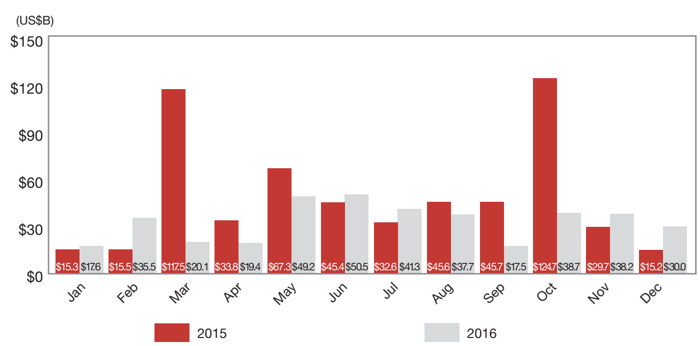
U.S. PE Exits (Number of Exits)



Source: Pitchbook

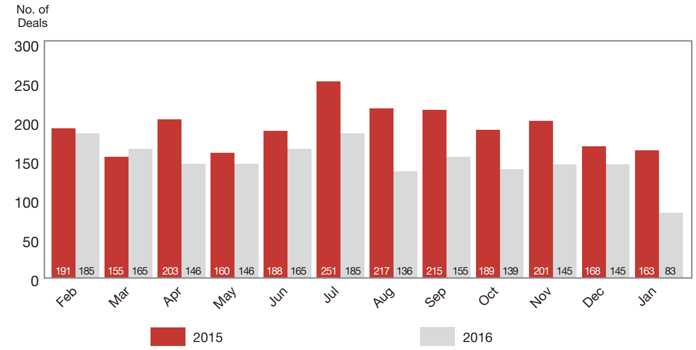
Turning to M&A activity, $396 billion in U.S. sponsor-related M&A transactions was completed across 1,795 deals in 2016, representing 33% and 22% year-over-year decreases from 2015 levels, respectively. U.S. sponsor-related M&A activity, as measured by number of deals, was stronger in the first half of 2016, with 992 deals closed in the first half compared to 803 closed in the second half of the year. U.S. sponsor-related M&A activity, by dollar value, trended in the opposite direction with $192 billion in deals for the first half and $203 billion in deals in the second half of 2016. Global sponsor-related M&A activity in 2016 exhibited similar trends to U.S. sponsor-related M&A activity. The differences in variability between 2015 and 2016 in U.S. M&A activity by dollar value are primarily due to the spikes in activity in March and October 2015 caused by Heinz's acquisition of Kraft Foods and Dell's acquisition of EMC, respectively.[1]

U.S. Sponsor-Related M&A Activity (Billions of Dollars)



Source: Pitchbook

U.S. Sponsor-Related M&A Activity (Number of Deals)



Source: Pitchbook

Discussion

So, what led to the overall decline in private equity M&A activity in the U.S.? Survey data indicates that few fund managers saw market or political uncertainty as the primary causes of limited deal flow.[2] Instead, fund managers pointed to elevated valuations caused by generally increased competition from both strategic and private equity buyers and the limited availability of attractive acquisition targets.[3] Median enterprise value/EBITDA for all M&A transactions in 2016 was 10.9x as compared to 10.0x in 2015.[4] This increase in multiples has been attributed to competition from strategic acquirers flush with cash and fueled by cheap debt with a willingness to pay a premium due to their longer term strategies and potential for synergies.[5] Further elevating valuations was the lack of attractive buyout targets as the increase in the number of private equity funded companies in the U.S. has significantly outpaced economic growth over the past few years. Near the end of 2016, dry powder held by private equity firms was at a record high reflecting this seller's market.[6]

As a result, private equity funds shifted strategies by both adopting a more critical eye towards analyzing potential targets and focusing on targets for which firms have a differentiating factor and are willing to potentially pay a higher premium.[7] According to survey data, fund managers indicated that towards this end, firms are investing in data analytics, automation and personnel development to improve their ability to identify such targets.[8] Firms also directed time and energy away from new acquisitions towards balance sheet transformation and operational value creation to produce returns for investors.[9]

Firms also focused on smaller deals and more esoteric industries to attain more attractive valuations.[10] Buy-and-build strategies continued to be essential for private equity acquirers to lower the aggregate acquisition cost of their portfolio, generate a higher exit price and position their portfolios for dips in the economic and business cycles. However, smaller targets and add-ons sometimes require more time and analysis to identify, which meant that firm investments in deal sourcing, data analytics and streamlined diligence practices are of even greater importance.

2016 also saw firms pivot their investment strategies towards certain sectors, such as health care, power and utility, and technology,[12] a strategy consistent with investors' increased interest in funds focused on these sectors in recent years.[13] In anticipation of secular growth and regulatory changes, private equity investment in the U.S. healthcare sector increased from 4.9% of total 2015 deal value to 9.8% in 2016.[14] As a consequence of the challenges faced by electricity producers due to lower natural gas prices, increased production of renewable energy, and lower overall demand, investment in the power and utility sector increased from 1.4% of total 2015 deal value to 15.9% in 2016.[15] Investment in the tech sector also ramped up from its 2015 level, increasing from 16.3% of total 2015 deal value to 20.4% in 2016.[16]

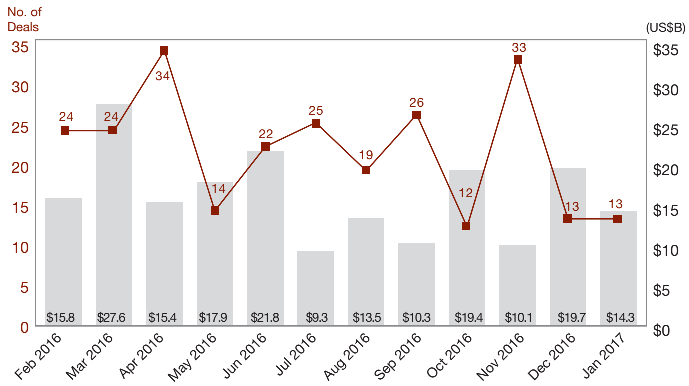
Expectations for 2017

The trends of elevated valuations, limited attractive targets and increased competition for deals are all expected to continue into 2017. However, reports indicate that the recent rally in public equities is expected to bolster the IPO market, including for private equity held companies, and the increase in portfolio inventories in the last few years could create significant secondary buyout opportunities for fund managers as well.[17] Anecdotal evidence indicates, however, that political and regulatory developments will play a larger role in 2017, either as a result of actual shifts in policy and regulation or of continuing uncertainty as to the direction of any shifts, with the latter likely to be a further weight around private equity M&A activity.

1 EY January 2017 Private Equity Capital Briefing.
2 PitchBook Crystal Ball Report.
3 PitchBook Crystal Ball Report.
4 PitchBook 2016 Report.
5 PitchBook 2016 Report.
6 Private Equity International Article: Looking Back: North America in 2016.
7 Private Equity International Article: Looking Back: North America in 2016.
8 EY 2017 Global Private Equity Survey.
9 EY January 2017 Private Equity Capital Briefing.
10 EY January 2017 Private Equity Capital Briefing.
11 PitchBook News and 2016 Report.
12 EY January 2017 Private Equity Capital Briefing.
13 Private Equity International Article: Investors maintain strong interest in mid-market.
14 EY January 2017 Private Equity Capital Briefing.
15 EY January 2017 Private Equity Capital Briefing.
16 EY January 2017 Private Equity Capital Briefing.
17 PitchBook Crystal Ball Report.

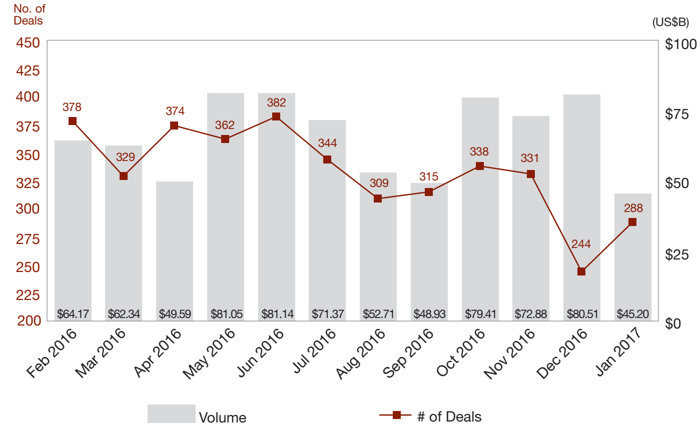
12-Month Private Equity Statistics

U.S. Private Equity Fundraising



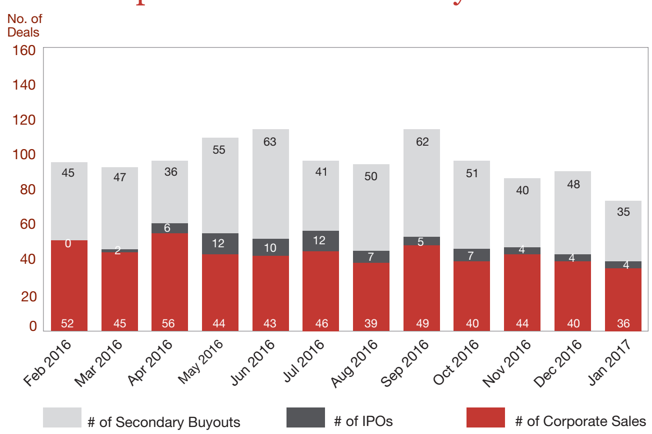
Source: Pitchbook

Global Sponsor-Related M&A Activity



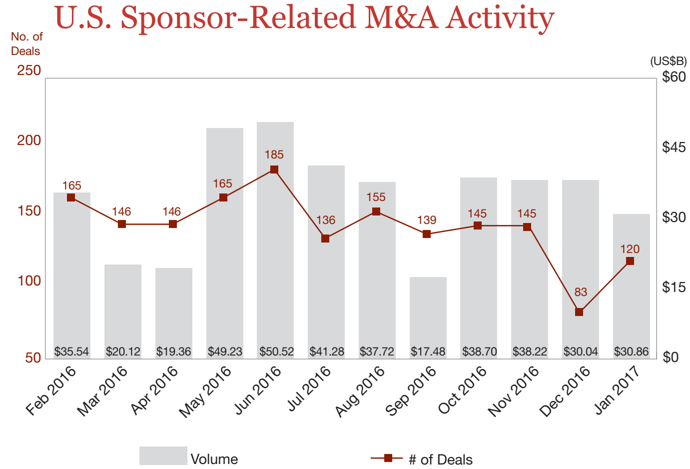
Source: Dealogic

U.S. Sponsor-Backed Exits by Number



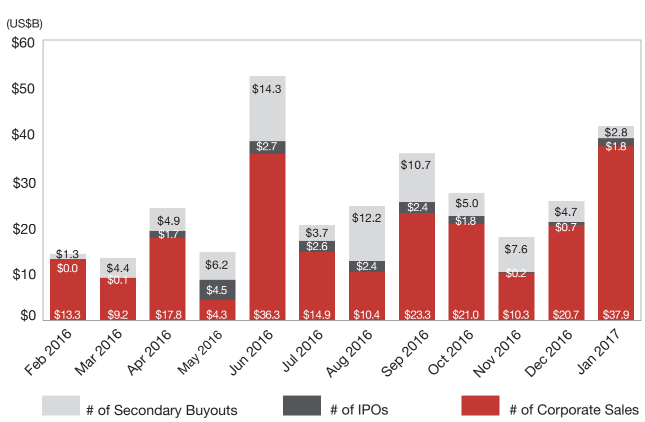
Source: Pitchbook

U.S. Sponsor-Related M&A Activity



Source: Dealogic

U.S. Sponsor-Backed Exits by Dollar Volume



Source: Pitchbook

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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