# Privcap/ Report

Includes a bonus interview with

**Stewart Kohl**

Co-CEO,
The Riverside Company

# 2016 Dealmaker Roundup

## Year in Review

*Featured Topics*

**Big Deals Rebound, Roll-ups Abound**
**2006 vs. 2016: Boom vs. Boomlet**
**What Will Happen in 2017?**

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# About This Report

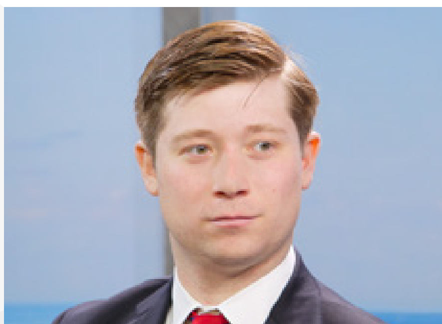
This publication is a companion to Privcap's Dealmaker Roundup, a quarterly video program on the latest trends in private equity deals.

## About the Experts

**Giles Tucker** is a managing director at Harris Williams & Co. He has more than 20 years of investment banking and investment management experience, including 13 years at Harris Williams, during which time he served as a managing director and as co-head of the Energy & Power Group. Previously, he co-founded investment management firm Blue Edge Capital, LLC, before returning to Harris Williams.
Learn more about **Harris Williams here.**

**Click to watch the full program**

**Michael Fanelli** is a partner in the Transaction Advisory Services practice at RSM US LLP, focusing on retail and consumer products and business and professional services. He performs transaction advisory services on both buy-side and sell-side transactions, assisting both financial and strategic buyers. Prior to his transaction advisory experience, Fanelli worked as a controller of a middle-market company and as an auditor at a Big Four accounting firm.
Learn more about **RSM here.**



**Leopold Peavy** joined Preqin in 2012, and is head of investor products at Preqin. In this role, he oversees all commercial elements of Preqin's investor-focused suite of products and manages various other strategic initiatives and partnerships. He is also responsible for publications and research reports for LPs/investors in alternative assets, and for developing and promoting new products for this client group.
Learn more about **Preqin here.**

**David Snow** is CEO and co-founder of Privcap Media, the leading channel for thought leadership in private capital investment.
**www.privcap.com**

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# Big Deals Rebound, Roll-ups Abound

**Privcap: Giles, from your perch as a senior partner at a major middle-market investment bank, what did you see in 2016 by way of deals?**

**Giles Tucker, Harris Williams:** I wouldn't read too much into the volume number in any given year. The volume number, as we know, can change pretty dramatically if two or three or four notable deals don't get done. We saw a bunch of notable public deals that didn't get done. So if you think about that backdrop, 2016 was a great year in terms of number of deals getting done. I suspect you'll see '17 [have] a nice rebound on the volume front.

**Leopold Peavy, Preqin:** Looking back, we saw about 87 of these deals over $1B, and that's certainly high. And looking back at 2006, there were about 127 deals over $1B as well. So I think that we're not near those pre-crisis levels just yet, but we're certainly rebounding.

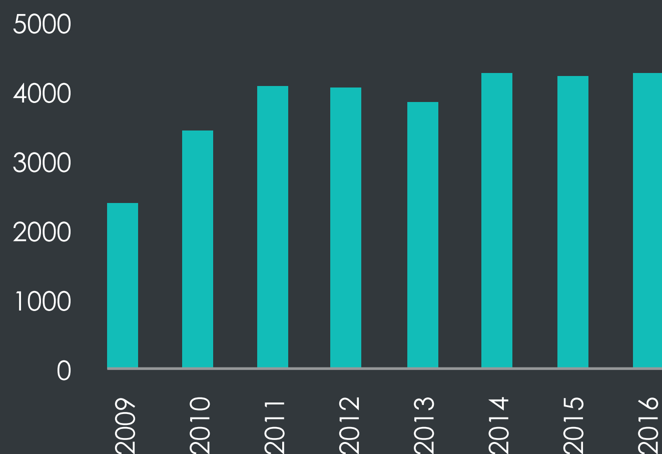
**Michael Fanelli, RSM:** The thing that we're seeing too is middle-market private equity firms acquiring platform companies and really having this roll-up strategy of doing a significant line of add-on acquisitions. And so you can get a significant number of deals done with that strategy. And they're saying, "Hey, from an inorganic growth perspective, we have an add-on strategy in a fragmented industry with also getting multiple arbitrage." So a lot of times—and I think we saw it in 2016—you see the higher number and volume of deals going up.

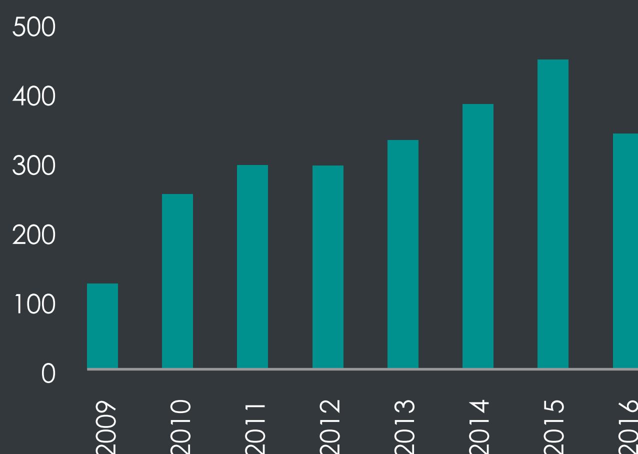
**Peavy:** Add-ons have actually doubled from 18 percent in 2006 to about 35.5 percent in 2016. So [we] certainly have seen large growth there—double the growth, actually—in those type of investments.

**What's been remarkable is that in the past three, four years, the number of deals done has been remarkably consistent. Is that what you've all seen?**

**Tucker:** We have. The last three years, across the board, have been almost equal in terms of the number of transactions that we've worked on. We had good growth in '16, '15 was a little bit better than '14, but overall our level of activity across all 10 industry groups has been very consistent. So I think it matches up well with the data. The one thing I would say about the large deal market is it's just a much thinner market than the middle market. There're just not as many good-quality assets out there for the big funds to chase.

**Fanelli:** We focus 100 percent in the middle market, so we're not seeing as much of the five, 10, even more so on the billion-dollar deals getting done. But what we are seeing is those larger private equity firms, who are typically going after those larger, deep-value type assets, is they're coming down a little bit. Not always, but they're coming down on occasion to go to the upper middle market or even core middle market to do deals and/or find that one asset that they feel comfortable [with].




*Source: Preqin*

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# 2006 vs. 2016:
# Boom vs. Boomlet

**Privcap: Dry powder is now at record levels. That capital has to be put to work or the managers have to give it back. And this is going to drive deal activity significantly. I'd like to go back 10 years to 2006—another notable year in private equity dealmaking. How would you judge the two markets to get a better understanding of what's likely to happen next?**

**Tucker:** [The year 2006] was one of the best markets we've ever seen. Now, you can describe it however you want—bubble, whatever—but if you look at the things that were driving that market, everything was hitting on all cylinders. You had plenty of confidence out there in boards and management teams. You had plenty of liquidity. I mean, the banks were doing some pretty incredible things on the leverage front. And at that time, if you remember, true banks were involved in the marketplace. I think about 60 percent of the LBO [leveraged buyout] facilities who are out there were actually funded by banks. Very different than today—it's about 15 percent, I think. The non-bank banks are doing all the deals today.

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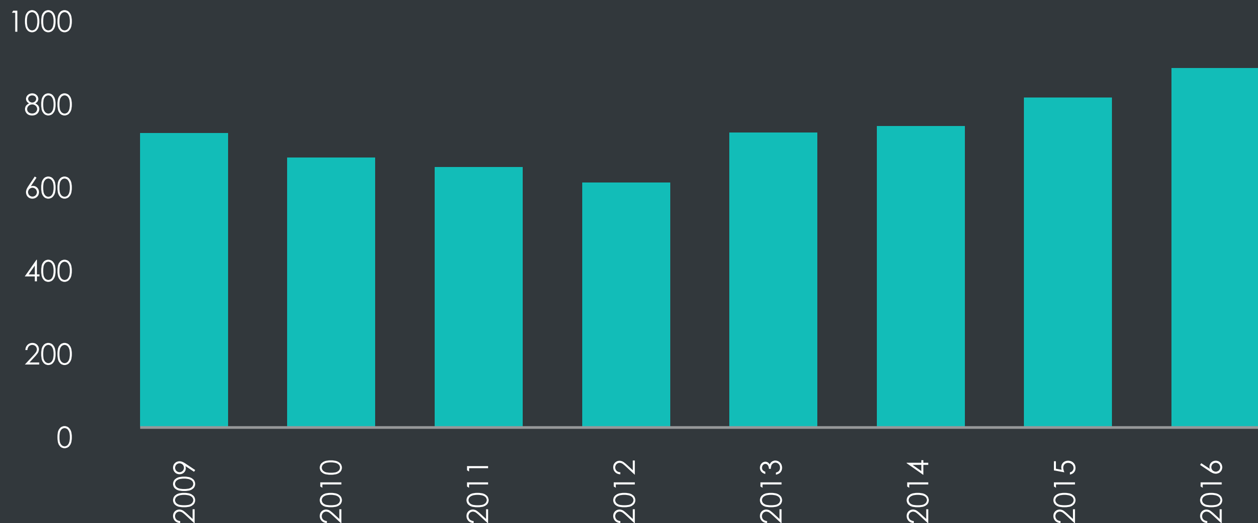


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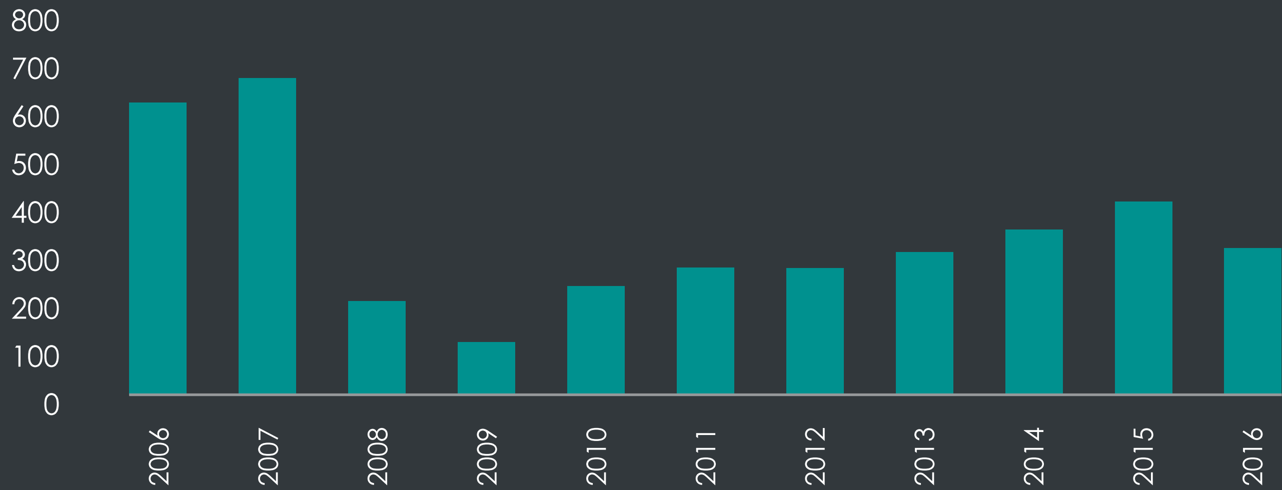


Little did anybody know we were headed into a pretty difficult time period in 2008. A lot of people put money to work during those two years into various companies, proven out by the level of transactions. And there are some people who had a tough stretch from '08 to '09 into '10.

**If you look at the statistics comparing 2006 with 2016, there's roughly the same number of deals were done, but the value was double, essentially. Leo, how do you compare the two years?**

**Peavy:** When you look at 2006, 77 percent of deals done were over $1B when you look at the aggregate universe. Today 63 percent are over $1B in terms of aggregate deal activity globally. So you see about a 15-point drop-off there.

[In] 2006, 41 percent of aggregate deals were over $5B [globally]. Today it's just 13 percent, so that's almost a third difference. And that's a tremendous change within a decade [for] an entire industry.

**Fanelli:** There are a lot of things that are different now. The regulatory environment is different. The lending environment is different. And then a lot of larger buyers were kind of scared straight because of some of the deals that didn't go well in the '05 through '09 time frame.

**A number of the very large deals done in 2006 at heavy multiples and with large amounts of leverage are still on the books of the private equity backers and have not yet been exited, to the chagrin of their investors, in many cases because they haven't performed as people had hoped. Is there the sense that we shouldn't repeat the actions of 2006 in today's market?**

**Fanelli:** [This year] could be an interesting time to start thinking about how we can divest those assets that we've had on our books for 10 years. The overall economy is a little bit better.

**Tucker:** If you look at where purchase multiples are today, on average, versus 2006, they're very close to the top. Debt multiples are sniffing at the high points of 2006. One thing that has changed since 2006 is, the average equity contribution going into a traditional buyout has gone from roughly 35 percent back then to 45 [or] even 50 percent today.

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# What Will Happen in 2017?

**Privcap: What are your predictions for deal flow in 2017?**

**Tucker:** As long as we don't have some type of regulatory surprise coming out of Washington, whether it's tax policy or something with the Fed—something to really stir the market up—2017 could be a terrific year.

Confidence is such a huge factor in the M&A market. Boards, management teams, private equity group professionals—if they're feeling confident about the deal market in 2017 and they're sitting on a company that's performed reasonably well, you have to think that they're having discussions with their advisors and internally about taking those businesses out.

**Fanelli:** I totally agree with your sentiment in terms of 2017 is going to be a very good year for overall M&A. And the interesting thing, too, to bring it to the next level, is there are some industries that maybe haven't been very active in the last two years, like energy and infrastructure.

And then ... retail has been very choppy. But then you have this new-age buyer of consumer products and the integrated everything between online, brick and mortar, and otherwise, into one buying experience. There's a lot of new-age companies out there that have been starting and incubating over the past few years that have things like digital-interface type, technological-type consumer purchasing patterns. And if some of those companies start coming to the market, it could start to drive up volume pretty significantly.

**How are private equity buyers getting comfortable with deploying capital, when it's clear to everyone that multiples are on the higher end of the spectrum?**

**Fanelli:** The private equity clients that we speak to really think about it from a perspective of "Our limited partners invest in us, and they expect us to invest throughout the 10-year cycle of the fund and into the next 10-year cycle in Fund 2, and so on and so forth." They're not trying to pick when multiples are at the peak versus the trough. They're just saying, "In the current environment that we're in, where can we add the most value and increase the rate of return within my fund to the highest extent possible?"

**Tucker:** We hear frustration from a lot of different middle-market private equity groups about going far in processes—sometimes two or three or four—to the finish, completing all their due diligence, and not prevailing. And that clearly is frustrating to them to some degree. But to Mike's point, they are in the business of putting money to work.

And on a relative basis, private equity looks pretty good to the bond market. It looks pretty good to the public market. The spread is still there, so they fully expect the groups that they're investing in to deploy capital through all the cycles.

**How do you think that a rising interest rate environment might affect the deal market?**

**Fanelli:** In the near term, I don't think it's going to impact it really at all. And I mean near term in terms of six to 12 months; 12 to 24 is an interesting story, because we think there's going to be three or so rate hikes in the next year. Once you start

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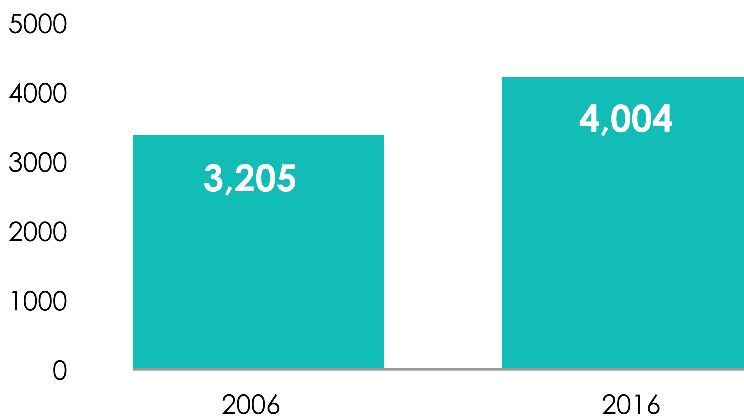
> “LPs are certainly weary, just because [of] three main market factors. We’re looking at record-level dry powder at $820B. We’re looking at record numbers of funds in the market. And we’re also looking at LPs moving more and more toward direct investing…”
>
> –Leopold Peavy, Preqin

## More Deals Today

Number of PE-Backed Deals




*Source: Preqin*

getting past that, it starts to get into the through process of “The amount that I’m paying on inter-est now, due to the higher rate, might make me pay one turn less on the asset class.” And if that nine goes to eight.

**Tucker:** If there’s tax reform and they start poking it—tax deductibility of interest on debt, for instance—that could have an impact.

**How would that change the economics of the buyout deal?**

**Tucker:** We currently model a transaction interest rate on the debt that you have on your balance sheet as a deductible. And if they start messing with that deductibility, it will naturally change the return profile of a particular deal, however you model it out. What you hope will happen is that they convert, at the same time, lower overall rates, which will offset the impact of losing that deduction, basically losing a tax shield in an LBO market, which would change your returns over time, all else being equal.

**These guys have a job, which is to deploy capi-tal, and their LPs want them to just get it out the door. On the other hand, with the ticking clock, do you get into the potential problem of perverse incentives to put capital to work in situations that don’t necessarily meet the normal standards?**

**Peavy:** LPs are certainly weary, just because [of] three main market factors. We’re looking at record-level dry powder at $820B. We’re looking at record numbers of funds in the market. And we’re also looking at LPs moving more and more toward direct investing—most notably some of the largest sovereign wealth funds in the Middle East and Asia, and also our friends up north, the Canadian public pension plans building out their own teams.

So one of the key questions for the LPs is, are the managers who I’ve hired directly—not through a fund-to-fund—going to be able to continue to access these deals when we know that there is a limited supply of strong deals out there? ■

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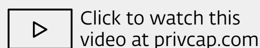
# POWER HOUSES

## IN PRIVATE EQUITY:

## Stewart Kohl

*Insights from the world's leading investors and dealmakers*


Click to watch this video at privcap.com

**Stewart Kohl**
Co-CEO,
The Riverside Company

**RSM office managing partner and national private equity leader Don Lipari interviews The Riverside Company Co-CEO Stewart Kohl about the appeal of the lower-middle market**

**Don Lipari, RSM: In '95, you closed your first fund [at] $34M, with a thesis of the lower-middle market. And that is the investment strategy to this day. What about the lower-middle market does Riverside finds so appealing?**

**Stewart Kohl, Riverside:** So, what's wonderful about where we play—these businesses that have less than $35M or $40M of EBITDA and, in most cases, much less—is that, number one, there are so many ways to make them more valuable. We're not buying flawed companies. We're not doing true turnarounds, but in fact we're buying what I would describe as "beautiful little businesses." But there are so many ways that we can add value to these companies.

We can professionalize the business by improving the management team, the management information systems, [by] writing the first written strategic plan, [by] creating the first real board of directors with outside experts, [by] using our toolkit to improve things like pricing at the business—[there are] all these ways to create value. So, that's one of the reasons we feel like the opportunities for an outsized outcome are better when you start where we do. ■

**Don Lipari**
Office Managing Partner,
National Private Equity Leader,
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