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Learnings from Private Equity

What transactions from the last five years tell us

2022

Introduction

A common notion among investors and deal makers is that Private Equity firms outperform their Corporate counterparts on investment returns. In our 'Learnings from Private Equity' series we test some common PE myths to see what the data tells us, and what we can learn.

First installment: Testing 4 common PE myths

Myth #1

Private Equity firms tend to buy at higher multiples than Corporates

Myth #2

Private Equity firms typically target small to mid-sized companies

Myth #3

Private Equity firms have gone on a buying spree during COVID-19

Myth #4

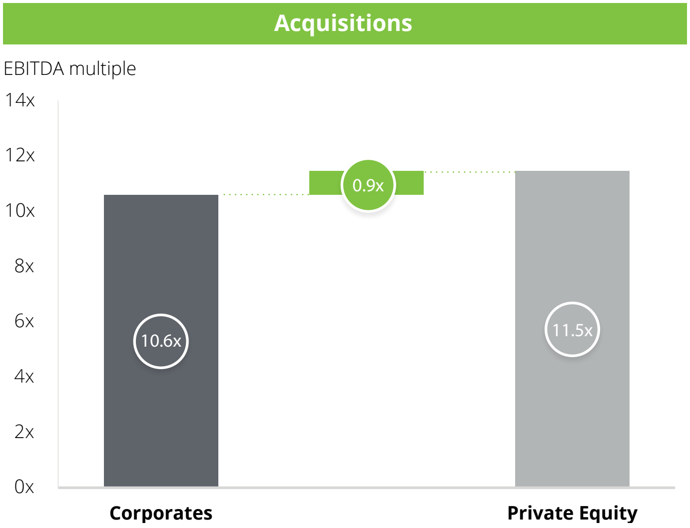
Private Equity firms spot trends ahead of others

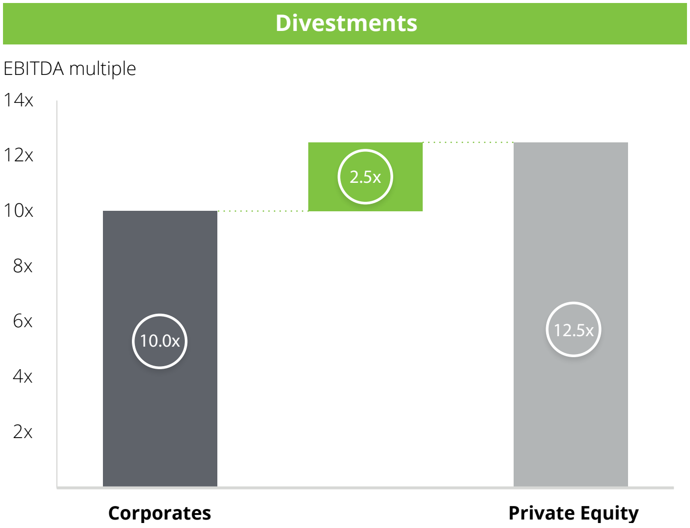
Read on as we share our observations on value creation levers from a recent portfolio company transformation at one of our Private Equity clients.

Learnings from Private Equity

Myth #1: Private Equity firms tend to buy at higher multiples than Corporates

Median transaction EBITDA multiples (2017 – 2021)





While purchasing targets slightly higher than Corporates, Private Equity have divested at significantly higher multiples, indicating an average value creation of 1.0x over their investment and 2.5x over their Corporate peers in the past 5 years.

Note: Based on transactions across developed markets in 2017 – 2021.
Transactions without any reported EBITDA multiple or EBITDA multiple above 50 were excluded.
Source: Capital IQ

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Myth #2: Private Equity firms typically target small to mid-sized companies

Targets' pre-transaction LTM revenue (%) (2017 – 2021)

Private Equity acquisitions trend toward targets with ever higher revenues. For instance, last year over 2/5 of PE acquisitions have hit the > CHF 500m range. On the other hand, Corporates seem to shift their focus towards smaller, strategic bolt-on acquisitions.

Note: Based on transactions across developed markets in 2017 – 2021. Transactions without any reported Last-12-Month (LTM) revenue excluded.
Source: Capital IQ

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Myth #3: Private Equity firms have gone on a buying spree during COVID-19

Impact of COVID-19 on M&A activity (2019 – Q1 2022)

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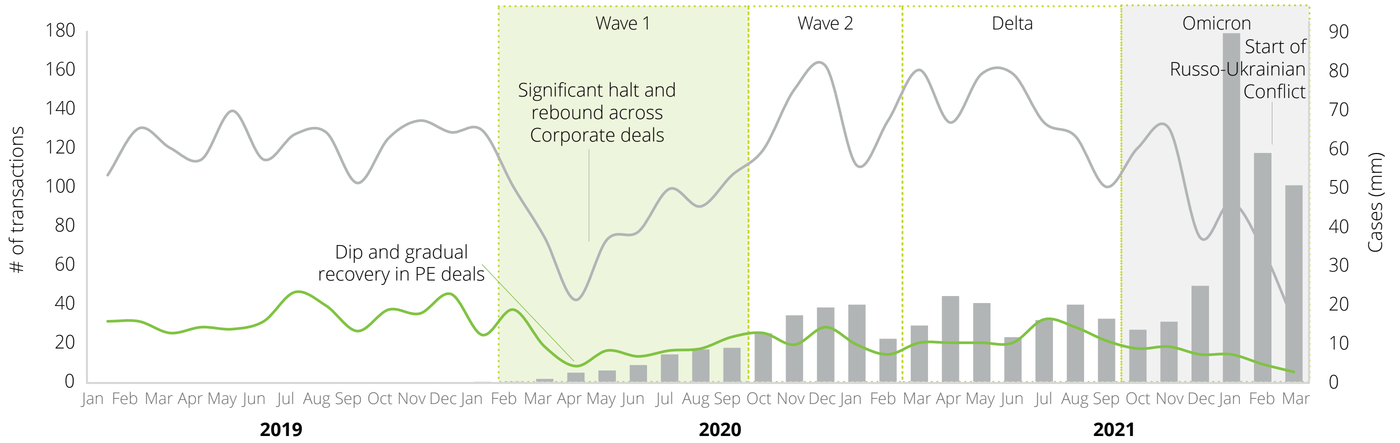

The run-rate of PE transactions was higher pre-pandemic, at levels which have not yet reappeared. Corporate deals in comparison, following a significant halt upon Wave 1, have spiked towards year-end 2020 and remained fairly elevated until Omicron hit.

Note: Based on transactions across developed markets in 2019 – 2021. Approximate COVID wave designations based on news research.
Source: Capital IQ, WHO

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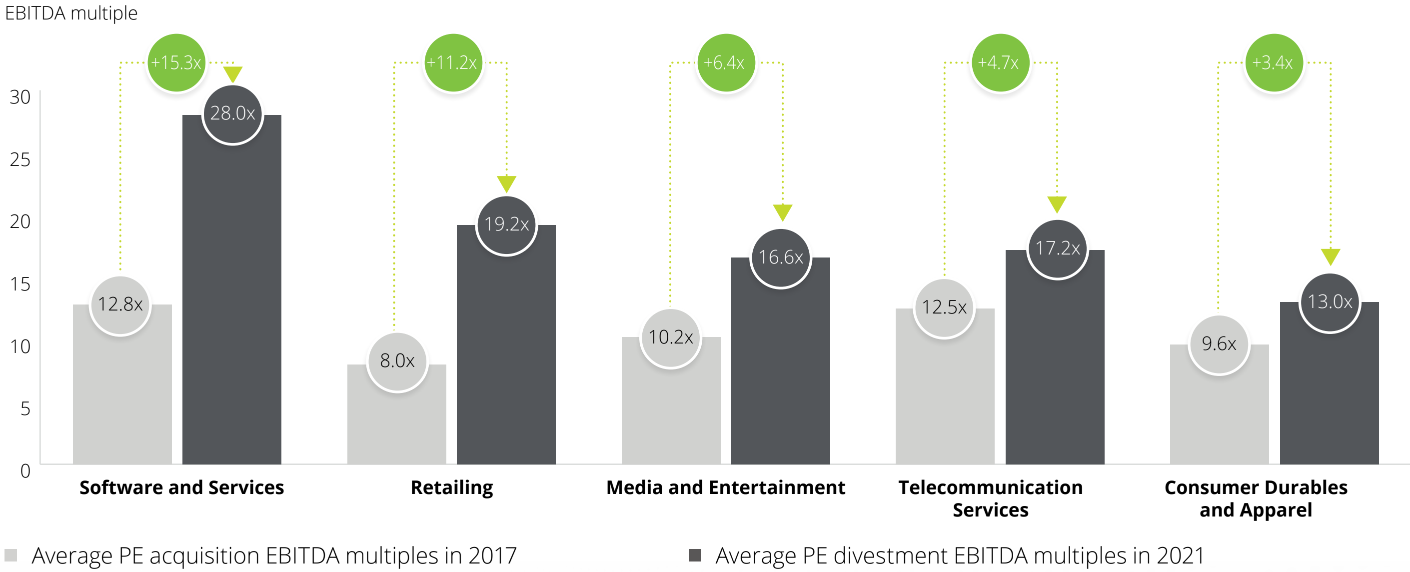
Myth #4: Private Equity firms spot trends ahead of others

Top 5 of 24 segments over 5-year PE transaction cycle (2017–2021)



Private Equity has made significant investments (44% of all Private Equity acquisitions in 2017) into the Top 5 of total 24 segments that experienced the largest increase in their divestment vs. acquisition transaction EBITDA multiples over the past 5 years.

Note: Based on transactions across developed markets in 2017 and 2021. Transactions without any reported EBITDA multiple or EBITDA multiple above 50 were excluded.
Source: Capital IQ

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Case study: Transformation driven by Private Equity

Life under PE vs. Corporate ownership

A pharmaceutical company (the "Company") was acquired by a multinational food and drink corporation (the "Parent"). The Parent decided to transform the Company by revising its strategy and aligning it with that of its own. After an unsuccessful transformation, the parent decided to divest the Company to a PE consortium ("PE"). PE's contemplated investment horizon was 3-5 years. The Company is currently preparing for an IPO, which will end PE involvement.

	Private Equity ownership	Corporate ownership
Corporate culture	• Action oriented culture – actions were valued more than words • Decisive culture and ability to make fast decisions ("what to do vs. kill") • "Ok to fail if you correct your course" mentality, while still having kept a strong culture of accountability	• Culture focused on consensus and risk avoidance – leading to significantly more alignment need across the organisation and longer timelines to make decisions, ending up as "low risk, low impact"
Corporate governance	• PE ownership put emphasis on achieving results – less politics, more decisive actions while not looking for perfection • Specific set of KPIs (e.g. entry & exit value) introduced while short time horizon created some constraints on M&A activity and organic innovation	• Implementation of new governance principles, corporate tools and ERP with a new set of KPIs – created a new dynamic with greater scrutiny which was perceived by the Company's management as too strict
Acquisition strategy	• Acquisitions needed to enhance the Company's equity story and support its vision/mission – seen as add-ons to the equity story • Story focus – if an asset had a high chance of commercialization, its potential was appreciated while reflecting involved risks in valuation • Financial criteria – strong focus on IRR, capital gains	• Acquisitions had to be accretive to the parent's profitability from Day 1 – seen as a transformation tool • Cash flow focus – if no cash flows as the asset is not on the market, then valuation is zero • Financial criteria – strong focus on DCF, NPV

To create value, an acquisition should be transformative – but not necessarily only from a financial perspective. It should enhance and be seen as an add-on to the equity story, with an achievable time horizon of 3-5 years.

Deloitte Value Creation Services

Our typical value creation mandates, bringing a PE perspective

Early Upside Assessment

When: Prior to- or in parallel with diligence to test the initial equity thesis and challenge the upside potential

What: An outside-in assessment leveraging benchmarks, insights from comparators and testing initial value hypotheses

Why: Provides the investment committee with an initial litmus test of the initial valuation potential

Commercial & Operational Due Diligence

When: As part of the diligence phase, in parallel or subsequent to the financial, tax, and other diligence work

What: Internal and external assessment to build confidence over growth outlook, forecast cost development and assess market & operational risks as well as opportunities

Why: To confirm the investment's underlying equity thesis and obtain an objective opinion on risks and opportunities

Value-led Integration & Transformation

When: Post-deal but ideally pre-Day 1 to embed the right objectives into integration and transformation plans

What: Establish & execute a fully validated set of upside initiatives that form the basis of an integration programme or transformation

Why: Defines key focus areas and tangible levers for the program to ensure the assumed value and synergies are being created and realized

Private Equity Lens Review

When: When a business or unit underperforms or when a step change is required in competitiveness

What: An outside-in assessment of performance potential and opportunities, leveraging an 'external investor' perspective

Why: Takes an unconstrained view of improvement potential, relying on facts and experiences from outside the business to push the envelope

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