

Bain Global PE Report

Idea In Short

Private equity firms must shift from relying on multiple expansion to creating value through operational improvements, bolt-on acquisitions and new product development. The era of cheap money inflating returns is plateauing.

Buyout Firms Have Outperformed

Bain and Company published their Global Private Equity Report in February 2020. The report delivers the main point immediately: private equity firms outperformed public equities across regions and most time frames. They find good value, do the work, locate ready buyers and deliver returns to investors. The spread between private equity and public equities is shrinking in the United States. Over ten years, private equity and US stocks ran neck and neck. In Europe and Asia the comparison was lopsided, with private equity winning decisively.

Fund Managers Brace for a Downturn

General Partners (GPs) were bracing for a downturn, a caution that held true in 2019 and intensified in 2020. Valuations remained high. The economy was not on a recovery path and relied largely on the sugar high of cheap money from central banks. This does not mean private equity sat idle. Even at low interest rates, the opportunity cost of time pressed managers. Limited Partners (LPs) want their capital returned within five years plus returns. Plenty of work, thinking and positioning remained, just with a change in tenor and direction.

Firms focused more on counter-cyclical positions and exercised greater caution during due diligence. As Will Rogers quipped about making money, you need to buy low in order to sell high. Roughly 40% of PE funds altered their investment strategies, with some assessing recession risks more carefully during due diligence. The shift reflected a broader recognition that a decade-long bull market had compressed risk premiums and lulled investors into complacency about downside scenarios.

Global Buyout Value and Leverage Trends

The 2019 global buyout value held at \$551 billion. The number of deals remained flat at approximately 3,600 per year. The previous five years delivered strong performance with deal values of \$608 billion, \$426 billion, \$551 billion, \$607 billion and \$551 billion. This consistency reflected a mature market where firms deployed capital steadily despite growing macroeconomic headwinds. Money was remarkably cheap, with the 10-year Treasury at 0.58%, making borrowing sensible for firms chasing good returns.

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Deals with leverage greater than 6x represented 75% of all transactions. Bain attributed part of this trend to the rise of covenant-lite loans. These instruments comprised nearly 80% of outstanding loans and became standard within the US institutional loan market. They made loans easier to obtain and looser in their terms. Purchase price multiples climbed aggressively, with 55% of US buyout deals carrying EV/EBITDA multiples above 11x. These elevated multiples left no margin for error, placing enormous pressure on post-acquisition value creation plans to deliver results quickly.

Public-to-Private Deals and Dry Powder

The massive increase in money supply combined with a slow growth environment led to aggressive corporate buyers and rising purchase price multiples. Private equity firms broadened their hunting grounds, targeting larger public companies. Eight of the top ten deals were public-to-private transactions, nearly reaching the peak from 2007. Public companies faced greater regulatory reporting requirements and quarter-to-quarter shareholder expectations, making privatization attractive. Going private freed management to pursue long-term transformations without the tyranny of quarterly earnings cycles and analyst scrutiny.

There was \$2.5 trillion of dry powder across all fund types, looking for deployment and a home. Uncalled capital stacked up for several reasons. Private equity had beaten most other asset classes for over ten years, money was cheap and stocks looked expensive. The vintage of this capital was young at 2.6 years, giving firms a longer lead time to invest and generate returns within an acceptable window. A fund with substantial undeployed capital at year four creates obvious pressure.

Holding Periods and Value Creation

The median holding period across all exits fell to 4.6 years in 2019. Investors received their capital back more quickly than during the post-crisis years of 2012 and 2013, when money remained tied up in investments damaged by the 2009 financial crisis. Firms tried to return capital within five years, an ambitious timeline that demanded disciplined execution. This acceleration of holding periods created pressure to demonstrate value creation earlier in the ownership cycle, leaving less time for transformational changes to take hold.

The easy and obvious price arbitrage disappeared long ago. Firms now need to think through creative ways to create Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) and value for buyers. Key themes and exit types include Good to Great transformations of stable companies, improvement of public companies needing new cost structures, turnaround of distressed assets, portfolio breakups from conglomerates refocusing on core businesses, sponsor-to-sponsor exits representing 30% of total sales, dividend recapitalizations and initial public offerings.

Multiple Expansion Plateaus

Cheap money creates inflation, with more capital chasing the same assets and returns. As private equity grows as an asset class, there is only so much revenue and cost synergy the entire category can generate. The factor that lifted all boats was the rising ocean of multiples. Bain's analysis of CEPRES data across approximately 430 fully realized buyout deals completed between 2010 and 2019 found that growth in multiples led to nearly half the increase in enterprise value. With multiples at record highs and macroeconomic conditions deteriorating, the spread between entry and exit multiples likely plateaued and could diminish. This finding sent shockwaves through an industry that had grown comfortable relying on market tailwinds rather than operational improvements. The implication was clear: firms that continued banking on multiple expansion would underperform.

This represents the deepest point of Bain's analysis. Private equity firms will need to find new ways to create returns because the spread between entry and exit multiples will likely

flatten. Most GPs no longer include multiple expansion in their deal models. Firms must make their own weather through mergers and acquisitions, bolt-on additions to platform investments, market share expansion, new product development and international scaling. The firms that succeed will be those that build operational expertise rather than relying on financial engineering. They will treat portfolio companies as businesses to transform, not assets to flip. The era of passive value creation through market timing has ended, and the era of active value creation through operational excellence has begun.

- 1Private Equity Market 2019 Year in Review
- 2Bain Global PE Report 2020 Analysis
- 3Private Equity Mega Funds and Dry Powder

Summary

PE firms face shrinking entry-exit multiple spreads and record dry powder. Winners will create value through operational excellence and strategic M&A rather than waiting for market tailwinds.