PRIVATE EQUITY INDUSTRY

The Rise of Private Equity

As the rate of Initial Public Offerings (IPOs) slow down, many business owners are turning to private capital for their financing needs. This has led to another strong year for the private equity industry resulting in record buyout values and exits realizing healthy gains. Since 2012, over $3tn in capital has been raised for private equity mandates, a large portion of which is yet to be deployed. With an excess of capital and limited opportunities, firms have stayed away from investing passively and simply trusting management to get the job done. Instead, private equity managers are shifting their efforts to a more activist based approach to creating value in partnership with portfolio company management.

This report provides context into the history of the private equity industry as a whole including a breakdown of the largest transactions in the space and the impact of the financial crisis on the industry. The report then goes on to analyze the dry powder existent among the large private equity players and the impact it has on valuations across the M&A market. Thirdly, the report will highlight three key strategic shifts firms are making in order to maintain their competitive position in the market:

1. Sponsor-to-sponsor transactions
2. Public-to-private transactions
3. Add-on acquisitions

In addition to these strategic shifts, this report will further analyze recent trends in the market and provide context on the global landscape.

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What is Private Equity?

Private equity (PE) can be defined as shares representing ownership in an entity that is not publicly listed. In this industry, private equity firms source investment capital from various investors to purchase a controlling position in a firm. Since this can require a significant amount of capital, it is commonplace for PE firms to take on large amounts of debt to finance their acquisitions and boost internal rate of return.

Difference Between PE and VC

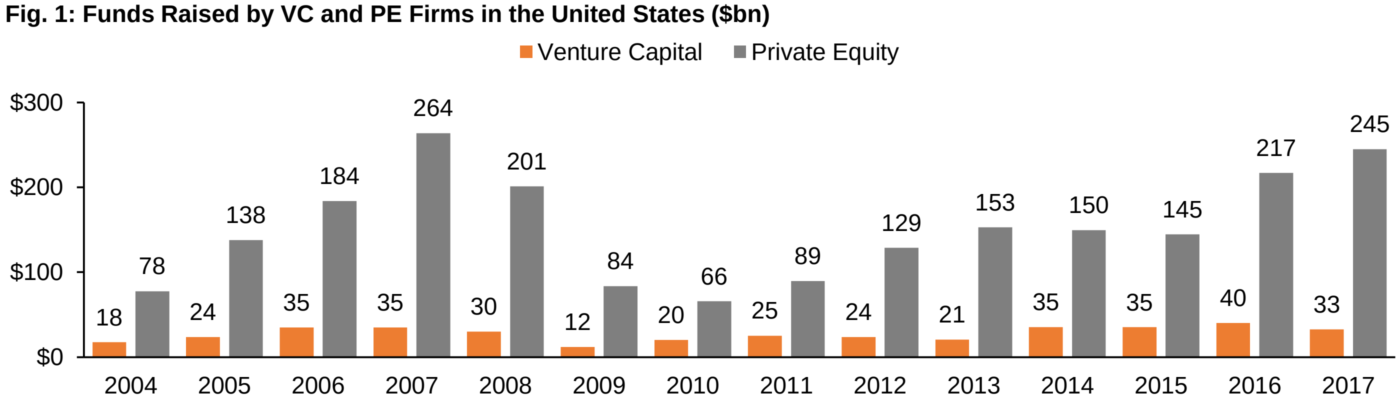
Although venture capital (VC) is typically seen as a subset of private equity, there remain key differences between these two types of investments. PE firms are focused on buying mature companies with relatively stable cash flows or with operations that the firm believes it can improve to benefit from higher margins. Conversely, VC firms invest in early-stage companies with high growth potential that often have yet to experience positive cash flows or even profit at time of investment. In addition, VC firms typically focus more on tech, bio-tech, and clean-tech companies, while PE firms are generally open to investing in all sectors.

One of the main distinguishing differences between private equity and venture capital is transaction financing. PE firms use high levels of debt and a mix of equity to acquire firms; in this way, they are able to achieve much higher levels of IRR than if they were to use exclusively equity financing.

On the other hand, VC firms take out no debt and only use equity to invest in firms. In addition to deal size, key differences also arise in investment size and percentage of a business acquired. While private equity deals can usually range from $100mm to $10bn, venture capital investments are mostly below $10mm in value. Intuitively this makes sense, as PE firms generally acquire a majority stake to control a company whereas VC firms only acquire a minority stake less than 50% in companies invested.

The risk and return profiles of these two forms of investment are also vastly different. Venture capital firms invest in start-up firms that often fail, and so they rely on at least one investment to generate huge returns before selling off their stake. Consequently, VC's invest small amounts of money into dozens of companies to spread their risk. In venture capital, it is commonplace for VC firms to also provide advice and mentorship to the management teams they are invested in; however, their day-to-day involvement may vary. In contrast, PE firms employ a strategy that involves heavy investment in one or a few companies, where the firm may hire a new management team and implement changes to the day-to-day operations of the newly acquired companies, hoping to improve operational efficiencies and eventually sell the company.

Fig. 1: Funds Raised by VC and PE Firms in the United States ($bn)



Ptichbook, Investopedia

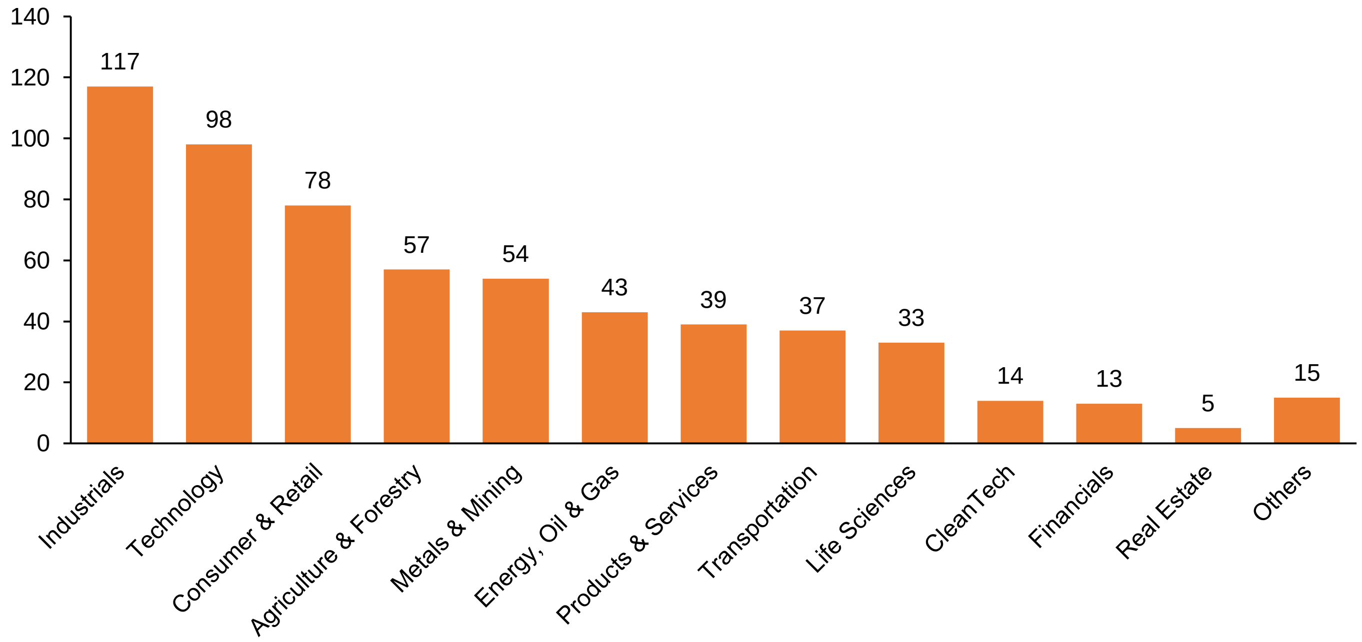
North American Private Equity Markets

The Canadian private equity landscape is much smaller compared to its American counterparts. In 2017 alone, Canadian PE accounted for $26.3bn in deal value over 603 deals, while U.S. PE firms executed $803.5bn in deal value across more than 5000 deals. This is unsurprising given the respective sizes of the Canadian and American markets; despite this, however, the industry has increasingly seen larger Canadian involvement in recent years.

Specifically, the Canada Pension Plan Investment Board (CPPIB), OMERS, Ontario Teacher's Pension Plan and other Canadian pension funds have played an integral role in the formation of many deals with the largest and most influential players in the US market. The involvement of these pension funds have had heavy implications on the market. First, the funds have provided the market with an abundance of cash, which has led to significant amounts of dry capital waiting to be deployed. Second, the pension funds have adapted. In 2015, California Public Employee's Retirement System (CalPERS), America's largest pension fund, announced that it had paid over $3.4bn in performance fees to managers since 1990. This has led many pension funds like CPPIB to focus more on its own direct private equity arms, whose strategies are not limited by the "ticking clock" that private equity firms face to realize investors' returns. Without constrained timelines, pension funds have avoided the aggressive and often disruptive strategies employed by their traditional PE counterparts. By eliminating the middle man, pension funds save millions each year on their investments. With large internal teams with industry-specific expertise, "it is hard to see the difference between these funds and a GP," says Ludovic Phalippou, Associate Professor of finance at Oxford University.

In terms of sector level activity, Canadian private equity focuses heavily on business products and services, consumer and retail, and natural resources, whereas the American private equity scene sees most of its deal flow revolve around TMT, consumers, and healthcare sectors.

Fig. 2: Number of Deals by Industry in Canada (2017)



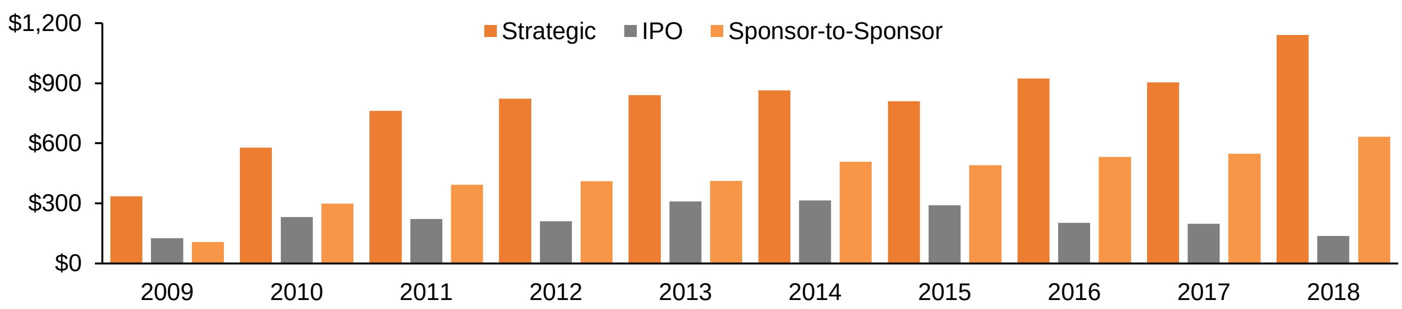
Ways to Exit a Private Equity Investment

The strength of the equity markets in recent years have offered many private equity firms an appealing and rewarding exit opportunity for their investments. In 2017 alone, 1063 exits were completed, with deal values amounting to $366bn. But as strong as the exit opportunities were in 2017, data shows that PE firms are also holding on to their investments for longer periods of time, with the new average around 5 years. In addition to public market exits, PE firms also look to peer firms in a sponsor-to-sponsor deal as well as other corporations interested in a strategic acquisition. Typically, PE firms will prefer to sell to strategic buyers, as they have the capacity and willingness to pay more than financial sponsors.

In the public markets, buy-out backed IPO activity rebounded in 2017 after a poor showing the year prior. This is partially due to more stable markets globally, particularly in North America, where the value of IPOs nearly doubled the levels of 2016. However, it is also important to understand that top-line IPO exit numbers aren't everything in public exits. Typically, IPOs only make up a small portion of a PE firm's total stake in a company. This is due to the mandated holding periods and other factors, such as market timing considerations, which causes firms to hold large shares of its investments past their IPO. As a result, firms often unwind their stakes more slowly in transactions that are not accounted for in the exit numbers. For example, when TSG Consumer Partners took Planet Fitness public in 2015, they did not completely exit their position until they sold $325mm in additional stock in 2017. Building on the idea of partial exits, selling a stake in a company – but maintaining a fair amount of ownership – was a trend that gained significant traction in 2017. This is likely due to the pressures that PE firms receive from their LPs to return capital, as this strategy allows a PE firm to declare victory on a deal, return capital to investors, all the while maintaining a stake in a company whose upside potential will outlive the firm's payback timeline. In addition, exit numbers also are unable to capture dividend recapitalizations, a process through which a portfolio company takes on debt to fund a dividend for investors. This strategy is highly dependent on an accommodating debt market, when market demand for high-yield debt is strong.

Of the $366bn in exits in 2017, over 60% went to cash-rich strategic buyers, who have continued to be avid buyers of PE assets. This is especially true for companies whose growth strategy relies on strategic acquisitions. In addition, sellers are also beginning to benefit from the immense amounts of dry powder in the industry that PE firms are looking to invest. The second-largest method of exiting by value in 2017 was sponsor-to-sponsor sales, no doubt spurred on by the effects of the aforementioned dry powder.

Fig. 3: Deal Value by Exit Type in the United States ($bn)

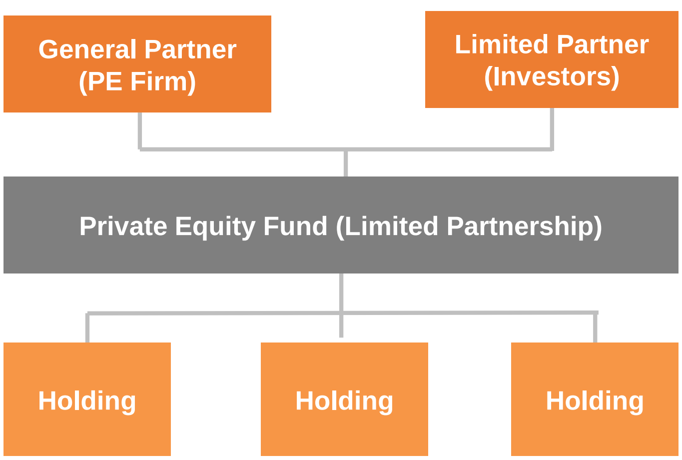


Bain, Statista

Structure of Private Equity Funds

At its core, PE funds act like an investment vehicle through which high-net-worth individuals as well as institutional investors can directly invest in and acquire ownership in companies. There are two classifications of fund participation: general partners (GPs) and limited partners (LPs). GPs are given the right to manage the private equity fund and choose the portfolio of companies invested in. GPs are responsible for attracting and attaining capital commitments from LPs, which include pension funds, university endowments, insurance companies, and others. Limited partners have minimal sway or influence on investment decisions, and at the time that capital is raised, the precise amount of capital required is yet to be finalized. A key distinction between GPs and LPs is that LPs are liable up to the full amount of money that they invest in a fund, whereas GPs are fully liable to the market and are thus responsible for any debts or obligations.

Fig. 4: Structure of Private Equity Firm



In recent years, LPs have begun to shift away form their traditional roles as capital providers. IN 2017, LP's contributed $104bn in co-investment deals, doubling the value of co-investment deals in 2012. The number of LPs making co-investments in PE rose from 42% to 55% in the last five years. But these co-investments are hard to scale, and academic research shows significant variance in returns.

When a private equity fund raises money, the LPs agree to specific investment terms presented in a Limited Partnership Agreement (LPA). The LPA outlines the "Duration of the Fund" which typically has a finite length of 10 years consisting of five different stages. These are:

- Organization and formation (Year 0)
- Fund-raising period (Year 0 to 2)
- Period of deal-sourcing and investing (Years 1 to 4)
- Period of portfolio management (Years 2 to 7)
- Exiting investments (Years 3 to 10)

In addition, one of the most important components of any LPA outlines the fees, which fall into three categories. Carried interest is paid if returns exceed a specified threshold level. Management fees are usually earned based on committed capital rather than capital invested, and is commonly set at roughly 2%. This can be seen in the 2/20 model, which stipulates that private equity firms charge 2% in management fees and keep 20% of the return on investment above a certain pre-established threshold. The third type of fee is net monitoring and transaction fees, where fees are charged to portfolio companies.

Lastly, the LPA will outline the contractual provisions that specify the rules governing what the PE firm can and cannot do. Guidelines will be established around the management of the fund, the activities of the GPs and the types of investments that GPs can make. In most cases, the PE fund will have a limited partner advisory committee to oversee investment decisions.

Welcome to the Club

Club deals are an interesting phenomenon in the highly coveted world of private equity. A club deal is characterized as a leveraged buyout consisting of two or more financial sponsors. These consortiums exist for both Venture Capital investments as well as later stage buyouts.

Club deals facilitate skill and maximize the amount of synergies generated through the transaction. These synergies can take the form of information sharing between the sponsors, or through operational changes and knowledge after the transaction is completed. The increased synergies from shared resources lead to a greater capacity to write larger checks and spread the risk amongst all sponsors.

The Infamous Fail

The interesting thing to note, is that club deals became increasingly unpopular after the financial crisis in 2008. In the private equity boom in the mid-2000s, club deals accounted for about half of all platform buyouts of more than $1bn. Club deals also comprised of nearly two-thirds of all capital invested in large deals within that era. However, as an increasing amount of investors found it difficult to exit their investments, and more club deals became unsuccessful and ended in bankruptcy, the allure slowly faded away.

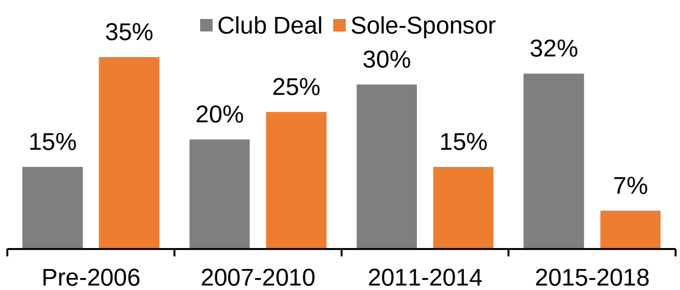
One of the most notable failures that harrowed all investors was the infamous bankruptcy of American big-box retailer, Toys “R” Us. The toy haven was originally bought out in 2005 by a consortium of powerful investors including New York based buyout specialist firm KKR, Boston based private equity firm Bain Capital, and New York based REIT Vornado. Under this partnership they all owned equal stakes within the company. Toy companies were under a lot of pressure to generate sustainable revenue streams and earnings, while shifting to a more omni-channel approach to entice the new, tech-savvy generation. At the time, this seemed like the perfect move for Toys “R” Us to re-invent its image alongside some financial and strategic expertise.

So why did this buyout fail? Simply put, the financial sponsors used too much leverage to finance the transaction. More than 80% of the $6.6bn purchase price was financed with debt. This was problematic given Toys “R” Us needed around $400mm to service the debt, and another $250mm to meet their capex requirements. Due to their illiquidity, Toys “R” Us was unable to compete with other big-box retailers such as Walmart, especially in the innovation and R&D department.

The Comeback

So the question is, why are club deals making a comeback today? Research shows that club deals have a much stronger track record than the reputation preceding them. Mega funds such as Blackstone are stirring rumours about a potential return to the pre-crisis era of club deals after the success of their consortium buyout of Thomson Reuters Corp. With Reuters being the largest leveraged buyout since the crash, investors realize that they need all the help and cash they can get with the inflated valuations. With the shared risk, cheap credit, and support of some of the largest names in PE, club deals please both investors and management teams.

Fig. 5: Club Deals vs. Sole-Sponsor Deals



History of Private Equity

Before Modern Private Equity (1600 – 1950)

Although the private equity model is relatively new, its methods are as old as capitalism itself. In the 1600s, many of the early British North American colonies were founded by joint-stock companies. Many of these companies were in the business of making large profits. Those who settled new colonies in North America were given the title of a "planter" while those who stayed in England and provided the capital to the colonists were called "adventurers" – a term that echoes a venture capitalist.

Before the 1900s, enterprises were not in need of external financing. This changed when corporations started to become a major part of the economic world. However, a troubled economy gave rise to distressed investing which is when J.P. Morgan – the man, not the institution – became prominent on Wall Street. New enterprises, such as railroads, required more capital than a family can afford, so they looked at merchant banks for help. These bankers that entered distressed situations took control of the companies, modified its capital structure, and often provided a new, more competent management term.

The first leveraged buyout ("LBO") was in 1901 when J.P. Morgan & Co. purchased Carnegie Steel Corporation for $480mm. After accepting the deal, Carnegie Steel's assets were merged with those of other companies which allowed Morgan to form the largest company in the world, United States Steel, capitalized at a staggering $1.4bn. Carnegie and his partners were paid in bonds of the new corporation that were floated by Morgan.

Boom and Bust Period (1951 – 2000)

After the 1960's, more companies began playing with the idea of leverage. Jerome Kohlberg, Henry Kravis and George Roberts made the first modern leveraged buyout in 1964 through the purchase of the Orkin Exterminating Co. while working for Bear Sterns. Following a dispute with the parent company, the three partners founded KKR and closed their first institutional fund of $30mm in 1978. The excitement following the early LBO quickly died as the U.S. government raised capital gains taxes making it difficult to raise sufficient capital. However, Congress relaxed capital gains taxes in the 1980s, which lead to some of the best-known private equity firms being founded – Bain Capital (1984), The Blackstone Group (1985), and The Carlyle Group (1987). In 1988, KKR raised private equity's visibility with their $31.4bn acquisition of RJR Nabisco.

Figure 6: Largest Leveraged Buyouts

Target	Acquiror	Year	Size ($bn)[1]
TXU energy	KKR	2007	$32.1
NABISCO	KKR	1988	$31.4
First Data	KKR	2007	$25.1
alltel	atlantis group	2007	$25.1
Equity Office	The Blackstone Group	2006	$24.7
Heinz	Berkshire Hathaway Inc. / 3G Capital	2013	$23.5
Heathrow	ferrovial	2006	$21.8
Dell Technologies	SilverLake	2013	$21.5

1. All values in USD at the time of the acquisition.

History of Private Equity

The LBO industry was thriving in the boom period for most of the 1980s due to cheap debt, relaxed lending standards[1] , and attractive exit opportunities. The robustness of the private equity was put to the test in the early 1990s. The reckless use of leverage and the collapse of the high yield debt market caused several high profile LBOs going bankrupt proving that the industry is cyclical.

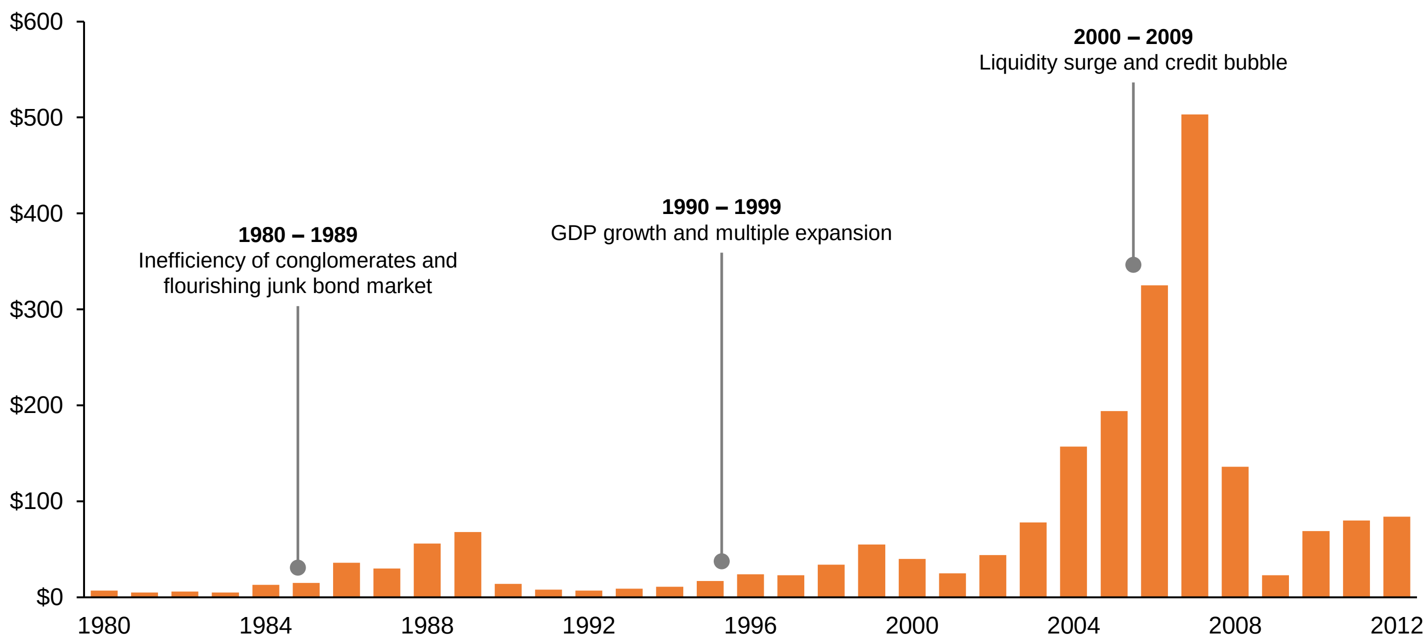
A second boom and bust cycle from 1993 – 2000 saw the introduction of a few different styles of investing. TPG Capital saved Continental Airlines from liquidation by recruiting a better management team, increasing aircraft utilization, and refocusing on profitable routes. On the contrary, Carl Icahn, one of today's most successful hostile investors, took over Trans World Airlines and then stripped and sold pieces of the company to pay down the debt he had used to acquire the company. The bursting internet bubble in 2000 and the subsequent recession again put the brakes on PE's growth as credit markets dried up. Many PE firms got burned on their investments in TMT which stalled fundraising from LPs.

Record Deals and Financial Crisis (2001 – 2009)

4 of the 5 largest deals of all time happened during this period. Private equity firms began going through the IPO process to be listed on the public equity markets. The Blackstone Group, The Carlyle Group and KKR were one of the first private equity firms to be publicly listed. The record LBO was in 2007 when the consortium of KKR, TPG Capital and Goldman Sachs bought TXU Energy for $44bn.

The spending spree rapidly halted in 2008 when credit markets seized up and the CDO markets stopped operating virtually overnight. Some LPs were not allowed to hold more than 5% of their total assets in private equity. When their portfolios suddenly fell by ~35%, the stakes in private equity were much larger than the allocated amount. This led to LPs attempting to sell their PE stakes on the secondary market at fire-sale prices.

Figure 7: U.S. Private Equity Deal Value ($US bn)

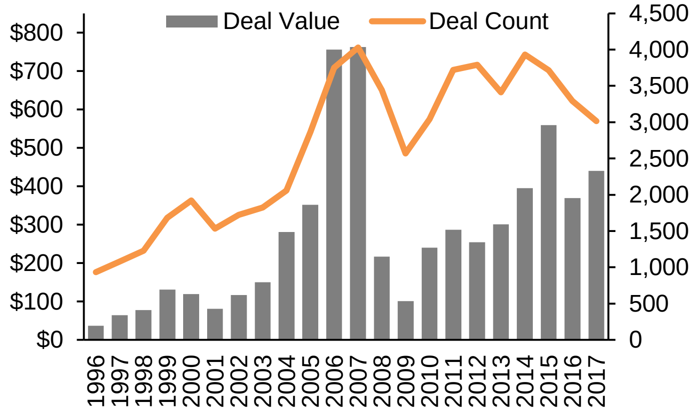


1. The most famous example is Wesray Capital's acquisition of Gibson Greetings in 1982 for ~$80mm while only paying ~$1mm in equity with the rest of the proceeds in debt financing.

The Strategic Secret of Private Equity

Over the course of the past ten years we have seen private equity deal values of ~$100bn annually in 2000 to over $400bn in 2018. While this drastic increase could be attributed to an influx of capital available on the market the largest contributor to this significant growth comes from a perfection of the buy-to-sell approach. Through the aggressive use of debt and emphasis on increasing cashflow, private equity firms are able to drive margin improvement ultimately increasing their exit multiples.

Figure 8: Global Buyout Investment Value ($bn)



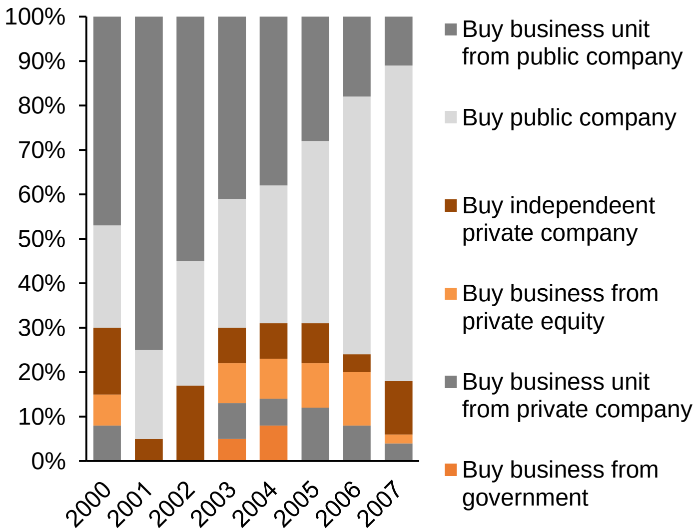
Buy to Sell Approach

Acquiring a business with the ultimate intention of selling it could seem counterintuitive especially if the largest value drivers come from long-term organic growth or synergies with existing holdings. While employing this strategy is not ideal for traditional public businesses seeking growth through acquisition, private equity firms have experienced tremendous success by exploiting short-to-medium term value creation opportunities through taking outright ownership positions and controlling interests.

Shift in Targets

While during the early days of private equity firms targeted noncore business units of larger public companies more recently, an emphasis has been placed on identifying entire public companies in search of higher yields. The traditional approach exploited the fact that large public companies often neglected certain noncore units of their business which allowed private equity firms to realize efficiencies with ease. With this shift in focus to entire businesses, several unique obstacles emerge for private equity investors. Due to increased corporate governance and increased levels activist capital deployed in the market, an increased dependence is placed on the firm's ability to implement effective strategy in order to grow the top line while improving margins.

Figure 9: Percent of Total Private Equity Deal Value



Competitive Landscape

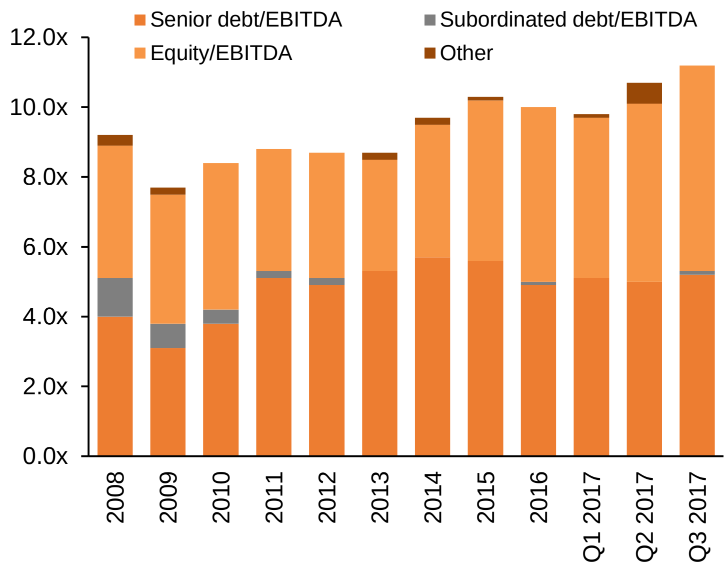
Through the natural progression of the industry the private investment space has become increasing crowded with public companies entering the market as strategic buyers. While these buyers are generally able to employ flexible time horizons in order to realize long-term gains, strategic buyers face a few significant obstacles.

The Strategic Secret of Private Equity

Tax Barriers

A crucial component to the buy to sell approach are the tax benefits a private equity firm is able to leverage due to the private partnership structure. This structure allows firms to pay no corporate tax on the capital gains realized through the sale of their holdings. Public companies however are subject to the normal corporate rate which puts them at a large disadvantage when competing in this space. It is important to note that this tax benefit has been eliminated in Europe and may follow suit to the United States which could level out the competitive landscape in private equity investing.

Figure 10: Buyout purchase price multiples on the rise



Investment Acumen

Private equity firms leverage the expertise of their investment professionals to screen dozens of potential targets prior to landing on one specific acquisition. These professionals tend to come from investment banking or strategy consulting which equips them with the required valuation tools to assess the viability of a potential investment.

The buy to sell strategy requires constant assessment of their holdings and the development of an exit strategy which can be difficult for businesses with other day to day operations.

Strategic Shift

With an excess of capital and very limited investment opportunities, private equity firms have been forced to pay record multiples for businesses. With competition for assets increasing as corporate buyers look for means to grow through acquisition, private equity firms have been forced to transition their strategy to maintain a competitive position in the M&A landscape.

As a result of this increased competition, private equity firms have employed several significant strategic shifts highlighted below:

Sponsor-to-sponsor: An increasing number of private equity firms are looking to the portfolios of other funds to identify promising companies that may be coming up for sale.

Public-to-private: As the price-to-EBITDA multiples paid in the private equity market converge with valuation multiples within the public market, a large number of public companies become potential targets. Due to the sheer scale of these public targets they provide ample opportunities to deploy capital.

Add-ons: Over half of all private equity acquisition activity done in the last year were add-ons to larger platform already in the portfolio. This strategy allows private equity firms to acquire growth much less expensively ultimately lowering the average multiple of the initial platform investment.

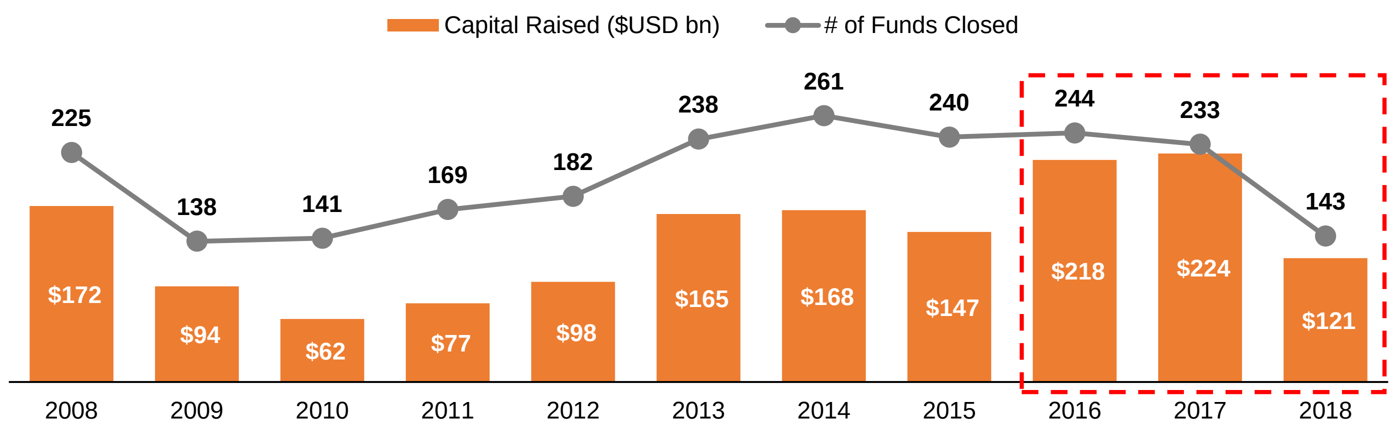
Harvard Business Review, Bain & Company, JP Morgan

Overview of 2018 Private Equity Markets

Record Levels of Dry Powder Easing

By the end of 2017, over $1tn of committed capital was available for drawdown by fund managers, with $961.5bn available to private equity alone. Since 2016, fears that unprecedented levels of dry powder being allocated towards a small pool of deals have persisted. The concern that this oversupply of capital has been bidding up purchase multiples, and compressing returns is chief among these fears. Despite 2017's record levels of fundraising however, the pace of this fundraising has slowed substantially through 2018.

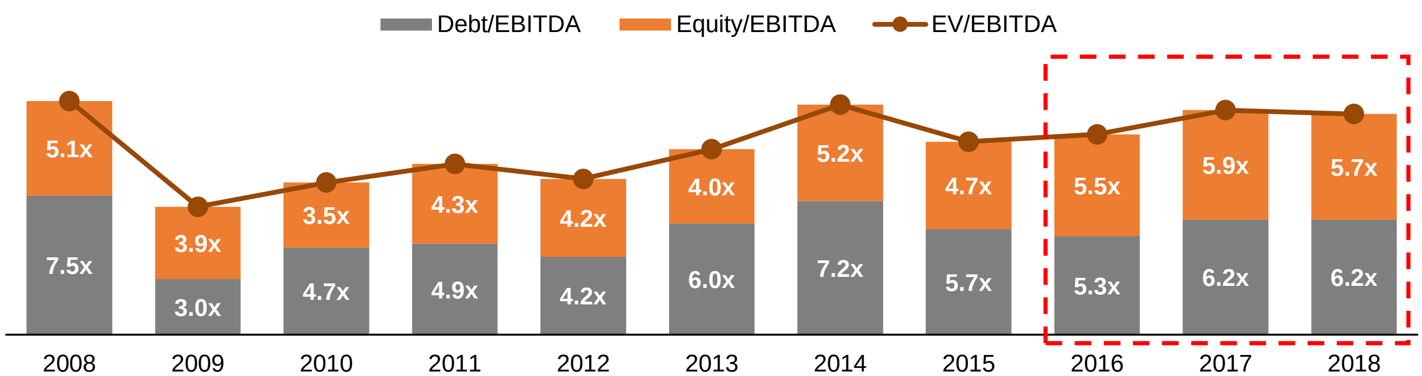
Figure 11: The Pace of PE Fundraising in the United States



Understanding the Excess Capital

In an effort to resuscitate major economies following the 2008 financial crisis, central banks unleashed record levels of asset purchases – otherwise known as quantitative easing. The effects of this form of unconventional monetary policy have pushed interest rates to record lows, and inflated the prices of fixed-income assets. Many banks responded by shifting their portfolio allocations towards riskier assets, pushing prices up across the board. The resulting bull-run in public equities has created a "reverse-denominator effect", prompting investors to allocate a greater proportion of their capital towards their private equity portfolios. In essence, this effect occurs as a result of an investor's private equity portfolio value falling below its target allocation, due to the rising value of other investment classes. The need to reallocate funds towards private equity has therefore fueled the massive influx of dry powder across the past two years.

Figure 12: U.S. PE Buyout Multiples



Overview of 2018 Private Equity Markets (cont'd)

The Surge of Megafunds

The recent rise of "megafunds", those of more than $5bn, has becoming increasingly common in the United States. Analysts partly attribute this to the fact that investors have realised that their massive scale has not hindered performance. In fact, over the past decade it has been the largest funds who have delivered the highest returns on average. This trend has clearly accelerated over the last two years, with raises for all buyout megafunds up over 90% YoY – compared with middle-market fundraising growth (for funds between $500mm to $1bn) of ~7%. To put this into perspective, megafunds now account for over 15% of total fundraising, up from just 7% in 2016.

Long-Hold Funds

Typically buyout firms aim to profitably exit an investment after three to five years. Doing so however, creates reoccurring costs for the funds and increases pressure to find new assets for General Partners. According to Bain, this patience presents an opportunity to generate higher returns on committed capital. The recent trend of more investors putting their money into longer-term investments has developed as a result. Large PE firms such as Blackstone, CVC, and The Carlyle Group have already begun launching longer duration buyout funds, with Blackstone expecting holding periods to double those of a traditional fund. At the same time, two primary types of long-hold funds have surfaced:

Figure 13: Long-Hold Buyout Fund Types

<table>
<tr><th>Fund Name</th><th>Risk Profile</th><th>Fee Structure</th><th>Other Benefits</th></tr>
<tr><td>Core Buyout Funds</td><td>Target portfolio companies with lower risk and return profiles such as CVC's Strategic Opportunities fund (target IRR of 12% to 14%)</td><td>Charges lower fees than a traditional buyout fund</td><td rowspan="2">▪ Reduced transaction costs
▪ Fewer management distractions
▪ Deferred taxation of capital gains, to allow for more compounding
▪ More flexibility on investment horizon to sell at optimal time</td></tr>
<tr><td>Long-Hold Buyout Funds</td><td>Targets risk and return profiles in line with traditional buyout funds – preventing investors from having to sacrifice returns in exchange for a longer duration</td><td>Fees charged are in line with traditional buyout funds</td></tr>
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Covenant-Lite Debt

Covenant-lite loans offer creditors less protection than traditional credits, now accounting for 75% of the ~$970bn worth of leveraged loans in the United States. This is up 15% from 2015, during which the share of covenant-lite loans accounted for 60% of the total market. Unlike traditional fully covenanted loans, which typically feature maintenance and incurrence covenants, covenant-lite loans generally feature only incurrence covenants. Many investors consider these types of loans to be structured similarly to high-yield bonds.

A large concern for market bears is that a turn of the credit-cycle will be aggravated by the large proportion of covenant-lite loans on the market – which are believed to be more susceptible to defaults. Historically, these types of loans have defaulted at roughly the same rate as traditionally covenanted loans. However, by the end of the last credit-cycle there were a fraction of the total amount of covenant-lite loans outstanding that there are today, making the future impact they will have on markets uncertain.

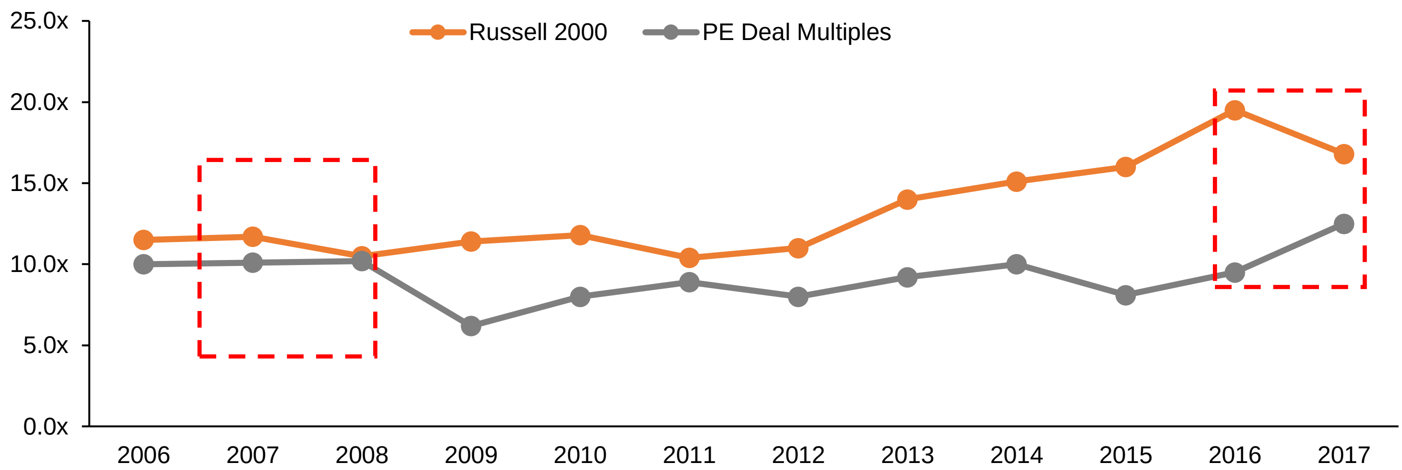
Overview of 2018 Private Equity Markets (cont'd)

Private and Public Multiple Convergence

As a result of the record high multiples being paid by private equity investors in search of ways to deploy their excess capital, the gap between U.S. private and public multiples has been narrowing. Traditionally, public companies are known to trade at higher valuations because of the "liquidity premium" they earn for being easily bought and sold on the open market. In 2016, private investors paid an average of 9.5x multiples compared to 19.5x multiples for public investors. Just one year later in 2017 however, those figures changed to 12.5x for private investors, and 16.8x for their counterparts.

Although many insist that these converging valuations will prompt a large number of investors to assess their exposure to private equity and take greater action in the public market, investors are still paying less on average for private companies. Analysts also point out that private equity investors are not only paying less, but they will hopefully be receiving greater control of the company and superior returns. It is important to note however, that a similar narrowing of the gap between these two markets occurred from 2007-2008, which poses as a concern for many observers.

Figure 14: PE Valuation Multiples Remain Below those of the Russell 2000 (EV/EBITDA)



Retail Healthcare

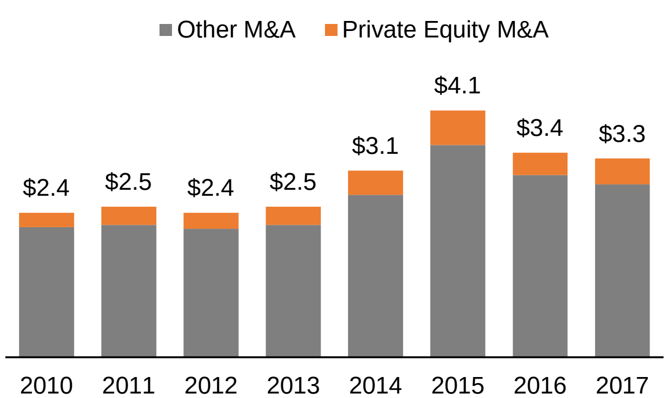
Between 2012 to 2017, the number of retail healthcare-related deals in North America have risen at a CAGR of 34%.The rapid growth of investors looking to deploy capital in this sector is largely attributed to the fragmented, high-margin, and high-growth nature of the industry. The market for retail healthcare covers everything from general health services and urgent care, all the way to physical therapy and dermatology.

These companies rely more heavily on consumer discretion than other healthcare services and often offer patients specialized care. With an aging population, and an ever-increasing mountain of healthcare issues, the success of this sector will likely continue to grow and attract more buyout deals in the near future.

M&A Private Equity Landscape

The Mergers & Acquisitions (M&A) environment has been strong in recent years with an aggregate value of ~$3.3tn transactions completed on a global scale. Large private equity firms will focus on deploying more capital in the form of M&A as global dry powder continues to reach record levels. One problem that private equity firms have been facing is the expansion of purchase multiples on key assets, ultimately making M&A in various sectors challenging. In 2017, private equity controlled a 13% share of the total M&A market by total deal value and 8% by total transaction count. This excessive dry powder could also be deployed in the form of bolt-on acquisition opportunities - acquiring smaller companies at the portfolio company level and rolling them up into an existing business to realize synergies or multiple expansion opportunities. There has been many firms who have pursued the strategy of increasing rates of return on existing investments through the acquisitions of other companies. In 2018, private equity firm JAB Holdings combined its own Keurig Green Mountain with Dr Pepper Snapple creating a pro-forma company with ~$11bn in annual revenue. Another example of this “buy and build” strategy was is in 2016 when Apollo Global Management acquired ADT for $6.9bn and merged it with its protection home security business to create a company valued at $15bn.

Figure 15: Global Mergers & Acquisitions Activity ($tn)



Source: Bain & Company

Generally speaking, private equity firms tend not to pursue large bolt-on M&A transactions given their expertise in creating successful companies through operational improvements rather than synergies. In addition, many of these firms have historically had short term fund mandates. This puts on pressure on mega M&A deals as these transactions have long execution timelines. Another reason why these deals are often not pursued is that they focus more on the scope part of the business in comparison to the scaling of a company. Large mergers can create opportunities to enter new markets, target a new customer base or change aspects of the business model. The industry has been facing challenges including soaring asset prices and increased sponsor competition in buyout processes. The private equity industry as a whole will have to look more toward M&A to boost company growth compared to the traditional organic methods.

Three main factors will drive private equity M&A activity in the near future:

(1) Increased fund raising: Private equity firms have been recently raising record levels of institutional capital. Apollo has raised a ~$25bn fund and CVC Capital partners has raised a ~$18bn fund. For the percentage of private equity M&A deals to increase, this will be driven by large scale transactions which require larger find sizes.

(2) Long-term fund mandates: Longer period fund mandates will also allow the transaction timeline complexity and negotiation execution of large scale deals.

(3) Co-investing: Co-investing will also allow larger transactions to take place as financial sponsors continue to partner with each other and require less individual equity stakes.

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