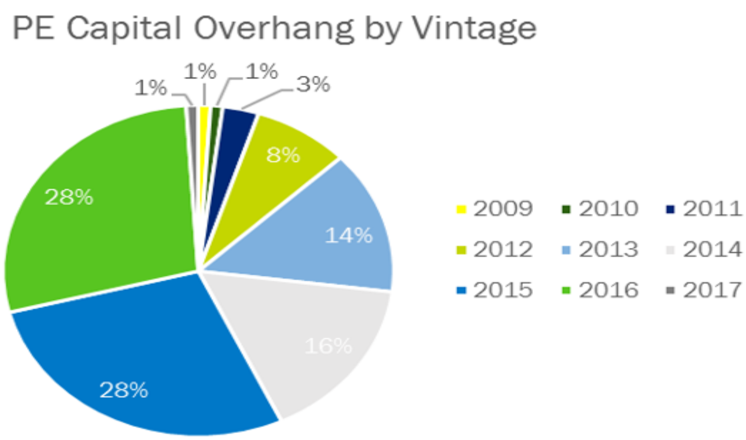
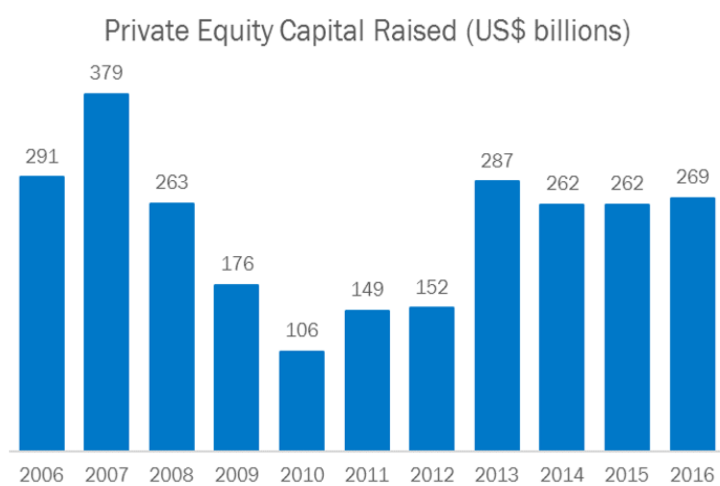
Valitas Capital Partners

Valitas Insight: The Dry Powder Saga continues in 2017…

"Dry powder at record highs." This phrase has acquired cliché status in current Private Equity (PE) circles. According to Pitchbook, the global PE capital overhang hit a high of US$754 billion by June, 2016, with Prequin reporting the total as US$820 billion by year end. Worthy of note: more than 70% of that overhang comes from prior vintages, with 81.5% of capital raised in 2015 still to be deployed[1].



Fundraising in 2016 increased 2.6% over 2015, representing a fourth year of enthusiastic capital commitment by Limited Partners (LP's) to Private Equity. And current sentiment suggests that capital overhang will persist through 2017.



According to a recent Prequin survey, 95% of institutional investors reported that their PE fund investments met or exceeded expectations, and 84% reported a positive view of the asset class, up from 65% in 2015. Of the respondents surveyed, 89% intended to commit the same or more capital more capital to PE than they did in 2016. Our takeaway assumption: despite escalating valuations and a competitive deal environment, the dry powder will continue to accumulate.

Common sense and history suggest that this will correct over time. High valuations are, inevitably, going to limit PE investor returns, resulting in the reallocation of funds into alternative asset classes and less competition for acquisition targets. But in the meantime, it is worthwhile to consider insights shared by Roger Martin, former dean of the Rotman School of Management, in the Harvard Business Review.

In his article, M&A: The One Thing You Need to get Right, Martin concludes that successful acquirers – those that create value for shareholders - are more likely to be givers rather than takers. What does that mean? Martin explains that acquirers need to bring something of value to the table i.e. be smarter providers of capital, provide better managerial oversight, or bring valuable skills, in order to create value, His thesis is aligned with views articulated at a recent webcast on the current state of private equity. On the topic of effective competition in this challenging deal environment, speakers agreed that PE investors had to develop expertise at "playing" in specific sectors or verticals, in order to better understand how to provide value to a prospective target.

In other words, and particularly in the current deal landscape:

"Ask not what your [target company] can do for you, ask what you can do for your [target company]." – Valitas adaptation of John F. Kennedy's famous quote