WSJ Pro PE (6/25/21)

Private-Equity Firms and Their Bankers Race to Handle Deal Surge; Deal makers are hiring more talent and becoming increasingly selective in taking on new business

By Laura Cooper

A Covid-muted 2020 gave way to a tidal wave of potential mergers and acquisitions this year that has private-equity firms, their advisers and investment bankers racing to keep up with the crush of deals. "Things are pretty crazily busy across the whole market," said Justin Abelow, a managing director in investment bank Houlihan Lokey Inc.'s financial sponsors group. "The market is on fire."

A confluence of factors including the pent-up demand following last year's pandemic-driven deal slowdown and the continued growth of private-markets assets—in step with a rising tide of capital to put to work—have spurred a rush in deal making.

Private-equity firms had announced 987 transactions in the U.S. worth a massive $543.76 billion as of mid-June, according to data provider Dealogic. The data suggest a surge in higher-value and more complicated transactions compared with the same period last year, which saw 853 deals worth $88.94 billion.

Still, the number of transactions announced so far this year doesn't fully reflect the overflowing deal pipeline that investment bankers and sponsors say they are scrambling to manage, including by seeking to hire more staff.

"The constraint right now is not that there's not enough deals or capital; it's the bandwidth at the private-equity firms," said Richard Harding, a managing director and the head of the U.S. private-equity solutions group at investment bank Moelis & Co.

Mr. Harding said Moelis began to see the deal market "come back strong" starting last fall. Across all industry sectors—but specifically in technology, healthcare and media—the firm is seeing significant levels of deal activity, he said.

Aside from some pent-up demand, he cited factors such as attractive rates on debt financing, a large amount of private-equity capital that has been raised despite the pandemic's disruptions and the potential for tax changes at the end of the year as fueling the hot deal market.

Private-equity firms are sitting on some $3 trillion of dry powder, industry consulting firm Bain & Co. reported earlier this year. While last year's turbulence encouraged firms to focus on helping their portfolio investments survive the pandemic, many fund sponsors are now coming to the table to buy new assets.

The rush has produced some constraints.

A number of consulting firms that produce market studies tied to prospective deals, for instance, can only start work on new projects months from now, according to Houlihan Lokey's Mr. Abelow. Auditing firms also have their hands full. Even bankers are feeling the pinch.

"Investment banks are raising minimum fees," he said. "And turning down business."

For private-equity firms, the deluge of deals has led to sponsors being both overwhelmed and picking their spots.

Megan Preiner, a managing director at Thomas H. Lee Partners, said that so far, "2021 has been a standout in terms of the level of deal volume and activity."

"It's a very busy market, but we're being disciplined with our time," she said.

Processes are also changing, investment bankers say. Auctions are moving quicker, according to John Neuner, a managing director at investment bank Harris Williams & Co. That's partly because bankers are reaching out to a "narrower group" of parties early in the bidding process, as opposed to blanketing private-equity firms with deal books on companies that are up for sale.

"Instead of seeing 15 halfhearted bids that are almost vague expressions of interest, we may see four to five bids at a higher valuation," Houlihan Lokey's Mr. Abelow said of the narrower sale processes. "Where the bidders have done material amounts of diligence work ahead of the bidding."

Intense competition tends to boost valuations. Private-equity sponsors have seen price multiples for companies across sectors rise this year, according to investment bankers and private-equity investors, especially for prized assets.

These elevated values are possibly unsustainable over the long-term, according to Mr. Harding at Moelis. He added that "it's hard not to see some degree of multiple risk at some point."

As a whole, investment bankers said they generally believe that deal activity surrounding private-equity firms and what they buy and sell will remain strong for the foreseeable future.

"I don't see a catalyst in the near-term that is going to change it," Mr. Abelow said.

As for coping with the crush, he said, "Investment bankers and lawyers are in the best position of all. Our time is flexible. We can keep on ignoring our exercise routines or families to do more work."

--