As Exits Hit New Records, Firms Brace For The Fall

Mohammed Aly Sergie

July 01, 2011

A record amount of exits this year is helping portfolios of general partners raising funds, but it's also a sign of the lack of confidence about markets later in the year, with firms hurrying to sell while they can.

Exits by private equity firms were valued at $85 billion about two-thirds into the second quarter of 2011, according to data provider Preqin, breaking the previous record of $81.3 billion in the fourth quarter of 2010.

Heading into the second half, however, general partners are weighing up the strong appetite for companies among corporate acquirers against the risk that markets could be unsettled by U.S. economic weakness or by a renewed sovereign debt crisis in Europe.

Carl Thoma, managing partner at Thoma Bravo LLC, attributes the rush to exit to a mixture of good valuations, earnings and a "less than total confidence that next year will be even better."

General partners will continue to feel the pressure to sell companies. "There is a considerable inventory of businesses held by the private equity community that will have to have liquidity over the next two years," said Bill Roman, a managing director at Harris Williams & Co., adding that there is a strong pipeline for exits which will continue into the third quarter.

He warned, though, that a rising trend of exits tends to follow a "linear upward progression and then drops logarithmically when something goes wrong."

Catching the cycle will make a significant difference in performance for many funds. But in a slow growth environment with corporations sitting on mountains of cash, some firms will still get strong returns on their best investments.

"If you have a company with good double-digit growth, a corporation or strategic is most likely going to buy it," Thoma said.

Buyout firms, sitting on an estimated $400 billion in dry powder, are also striking deals to buy companies from their peers. And the public markets haven't soured on debt-laden portfolio companies yet, with a number of initial public offerings completed this year.

Some firms are opting for dual-track public offerings, Roman said, with many preferring to find a strategic or financial buyer in order to get full liquidity and limit the risks of selling their equity stakes piecemeal in volatile public markets.

GPs are still recovering from the recession, when they struggled to manage the debt of their portfolio companies and couldn't find buyers to relieve the pressure. Firms were also reluctant to sell at the bottom of the cycle.

"People are just getting their heads above water," said Hicks Equity Partners LLC Chief Executive Thomas O. Hicks, and firms are completing the cycle for portfolio companies acquired in the exuberant years between 2005 and 2007. The Preqin data show that half of the 10 largest exits announced so far in the second quarter are realizations of deals made during the 2005-to-2007 period.

For many firms that struck deals during the peak-valuation period, this exit window comes as they are planning to raise new funds. Keeping the distributions flowing back to limited partners will factor in the success of rolling out new vehicles.

LPs who are fully allocated to private equity can't make new commitments or reup in exiting funds unless they have cash coming back, said Thoma. "It's common sense," he said. "If you are going to take on more money to manage, perhaps you should be getting some liquidity."

Dominic Petito, a founder of Wisdom Capital Partners LLC, a Greenwich, Conn., private equity firm, cautioned that the impact of the recession and market crisis has made sentiment more fragile.

"Any bit of uncertainty is going to cause a pullback because people remember what happened a couple years ago and don't want to get caught again in that situation," he said. "It's going to be a little more difficult to get things done in the second half of the year, so exits may not be as prevalent as we have seen in the first half."

Document DJFPEA0020110708e7710000e