Strategics are the real barbarians

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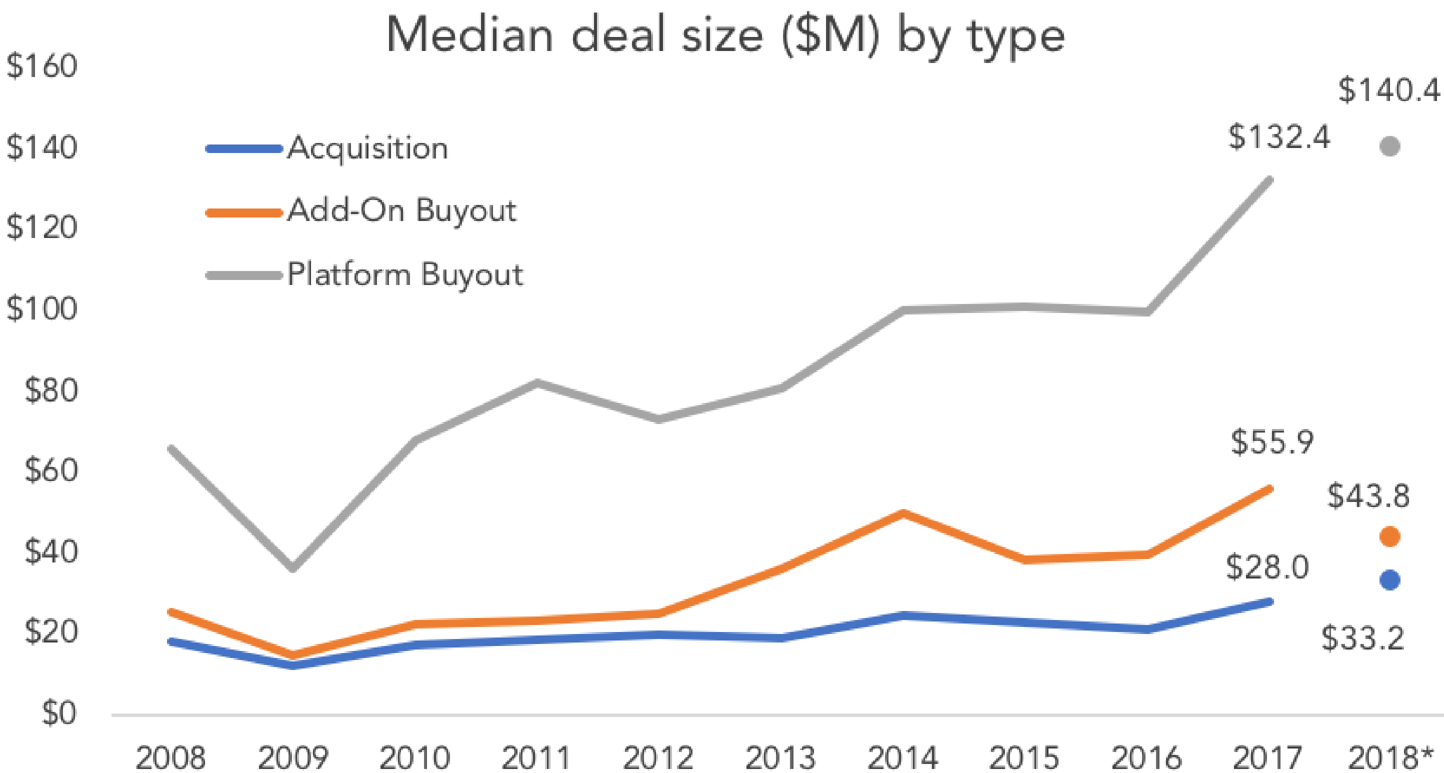

“Barbarians at the gate” is an idiom that has lived past its shelf life. Classifying PE firms as barbarians implies they can raid and conquer at will. There was a tinge of truth to that in the 80s, but it’s a laughable argument in today’s market. As any investor will tell you, the closest thing to a barbarian these days is an eager strategic buyer. When strategics want an asset in the current market, PE firms aren’t going to be able to outbid them, especially in a low-growth environment. The benefit of lower capital costs alongside synergy opportunities will always have a leg up on IRR-bound PEGs.

The chart above compares median deal sizes by type, specifically LBO vs. corporate deals as well as PE-led add-on deals. Strategic acquisitions appear to have grown at a much more modest pace compared to LBO sizes. In fact, a closer look shows that strategic acquisitions have increased more in size compared to PE acquisitions over the past two years. Between 2016 and H1’16, median corporate acquisition sizes are 56% higher today, while LBOs are 41% bigger. The broader takeaway is that corporate buyers are more prolific at the low end of the market than many realize. Strategic acquisitions don’t necessarily have to boost scale to make sense; many acquisitions are now done to speed up product development or distribution to keep up with competitors. Many of those smaller, corporate acquisitions could have been suitable for PE as standalone targets, at the right price. But as long as corporate interests keep raiding auctions looking for growth, PEGs will continue to have fewer opportunities to pursue than they otherwise would have. The impact on PE is most felt at the lower end of the middle market, and by extension the broader middle market as potential add-on targets. It’s hard to think of

LMM investors as barbarians when they miss out on opportunities due to the “product development” needs of a competitor.

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