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Private Equity is Done…Well, Not Quite (Part One)

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It was apparently too much for Jerry. With things over-frothy in the buyout market, mega deals proliferating and purchase price multiple escalating, the co-founder of the largest buyout shop in the world announced he was leaving to start his own smaller practice.

In moving on, Jerry said in an interview he would look for more modestly sized opportunities. ”I won’t restrict myself to small transactions,” the exiting founder reported, “but I’ll stick with deals where reason still prevails.”

One of his remaining two partners ventured an explanation for their friend’s departure: “Jerry may have felt that the deals were getting too big.”

Recent news? Guess again. “Jerry” was Jerome Kohlberg, Jr., who in June 1987 left KKR to form Kohlberg & Company, one of the pre-eminent middle market buyout shops in the US. The firm raised seven funds and $5.3 billion of committed capital to create 64 platform companies and 133 add-ons, with an aggregate transaction value of $9 billion.

Our venture down memory lane was prompted by last Monday’s WSJ op-ed by Andy Kessler. The investor/author pronounced private equity “done,” stating it’s “glory days are over.” Having witnessed the buyout scene for years, and read similar obituaries in the kingdom of capital, we revisited the 28 year-old story to prove a point.

Private equity, like all capital formation, is cyclical. The industry has gone through at least seven stages since first coming to prominence in the early 1980’s. The first ended soon after Kohlberg left KKR and the market peaked with the RJR and Safeway LBOs. The second stage (1990-1992) marked a period of retrenchment as firms grappled with the collapse of Drexel and the shutdown of the high-yield market.

The institutionalization of leveraged loans in the early 1990’s helped fuel the resurgence of private equity, a boom which lasted until the tech bubble burst in 2000. Some larger firms struggled, but others refocused their efforts to smaller deals. As interest rates declined and the economy healed, PE began another climb upwards. Thus began what has been called “The Golden Age of Private Equity,” a time of heady growth that would only halt with the onset of the Great Recession.

To be continued next week.