BUYOUTS

Pension Bridge: LPs, GPs wary as PE market nears, breaks records

July 26, 2017 By Sam Sutton

- Fundraising, multiples at or near pre-recession peaks
- GPs underwriting new deals for possibility of downturn
- New York City may slow commitment pace

Private equity firms and their investors are readying their portfolio companies and investment programs for a possible downturn.

“Every single one of our base cases now involves a recession,” said **Todd Abbrecht**, head of private equity at **Thomas H. Lee Partners**, at a **Pension Bridge** event held at the Trump International Hotel in Chicago.

PE firms are paying increasingly higher prices for new portfolio companies and global private equity fundraising is at or near records, multiple speakers at the conference said.

U.S. fundraising is on pace to pass $250 billion this year, roughly in line with the amounts raised prior to the global financial crisis, according to *Buyouts* data. U.S. and European leveraged-buyout multiples hit 10x in 2016, surpassing 2006-2007 levels, **Ernst & Young** reported earlier this year.

While the economy shows no immediate signs of slowing, the prospects of another recession have entered conversations about how much money firms should inject in fresh assets and how much capital LPs commit to new investment funds.

Alex Doñé, who leads the private-markets program for New York City’s five retirement systems, said his team may undershoot its projected PE commitment pacing of $2.5

billion.

“This year, if we come under our target, that’s OK. And it’s probably not a bad place to be,” he said, speaking on a panel. “We’re not going to chase investments in this environment.”

Given the number of firms raising capital and the volume of cash firms have delivered back to their LPs, this market carries significant risk of institutional investors overallocating to private equity at the peak of the market, Doñé said.

Meanwhile, PE firms are starting to forecast recessions when they underwrite new deals.

“We’re building in for a moderate recession in 2019,” **TPG** CIO **Jonathan Coslet** said, adding that TPG’s underwriting for a recession doesn’t mean its exact time frame is certain. Rather, it’s an acknowledgement of a bull market that’s chugged slowly and steadily along for the better part of a decade. Downturns are inevitable, and history suggests one will occur at some point over the next few years.

The causes for a potential downturn remain unknown, however. Coslet noted that the markets for student loans and auto loans are starting to fray, while traditional causes of market recessions — such as the mortgage and corporate finance markets — remain relatively stable.

There haven’t been as many “excesses” as there were in the years leading up to the collapse of **Lehman Brothers** and the global financial crisis, Coslet said.

That could translate into sales of new portfolio companies at lower EBITDA multiples, which puts more pressure on firms to expand a company’s earnings prior to completing a sale.

“Our presumption is that we’ll be exiting at smaller multiples,” said **Alan Jones**, who co-leads the PE team for **Morgan Stanley Global Private Equity.** “If we’re wrong, it means we planned for a future that was worse than what actually happened.”

Action Item: More on Pension Bridge events: www.pensionbridge.com/

Photo of the Trump Intercontinental Hotel by Sam Sutton, Buyouts.

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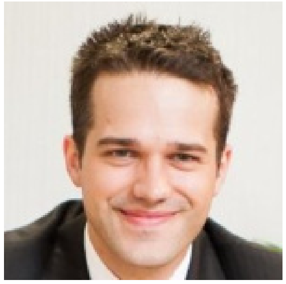

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