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MARKETS

Buyout Firms Cash Out at the Exit

Party City Holdco Inc. made its public debut in April, less than three years after Thomas H. Lee Partners bought a controlling stake in the party-supply retailer. A store in Hamilton, N.J. PHOTO: DORANN WEBER/MOMENT EDITORIAL/GETTY IMAGES

Buyout firms typically plan to sell companies some five years after buying them, having made financial and operational changes designed to increase their value. But that period is shrinking, as robust demand from companies, sometimes referred to as strategic buyers, allows private-equity firms to reap impressive gains in less time.

Private-equity firms now own a company for an average of 5.5 years, down from 5.9 years in 2014 and the lowest point since 2011, according to data provider Preqin. That decline reverses a trend toward longer holding periods in the aftermath of the financial crisis, when private-equity firms struggled to shed some companies. Before the crisis, the average holding period was about 4.5 years.

A flourishing takeover market has created ripe conditions for buyout firms to cash out of older investments and some newer ones, too. The dollar volume of U.S. deals reached $788 billion by the end of May, according to data provider Dealogic, a record for this point in a year.

“I expect exit activity to remain extraordinarily strong because it’s the golden age of the strategic buyer,” KPS Capital Partners LP co-founder Michael Psaros told attendees at The Wall Street Journal’s Private Equity Analyst Conference on Tuesday.

Holding periods are even shorter for companies purchased and sold since 2010, which spent an average of about 2.7 years under private-equity control, according to Preqin. Some firms are considering selling or taking public high-performing companies they have owned for three years or less, said buyout executives and their bankers.

TPG this year agreed to sell Envision Pharmaceutical Holdings Inc. to Rite Aid Corp. for $2 billion, just 15 months after it purchased the pharmacy-benefit manager. The deal would nearly triple TPG's initial investment, according to a person familiar with the matter.

While these quick flips can undercut the argument that buyout firms create value by improving a company's operations over time, the pension funds and institutions that invest in private-equity funds don't mind them, as long as the price tag justifies the early exit, bankers and investors said. Buyout firms typically aim to double their money on the companies they buy, and their executives and deal-makers get a cut of the profit only after the return crosses a certain threshold.

"For investors, the return itself is more important than the timing and how the private-equity firms get it," said Erik Gordon, a professor at the Ross School of Business at the University of Michigan.

Private-equity firms reaped $442 billion cashing out of 1,686 investments in 2014, a record both by volume and number of deals, according to Preqin. They returned an average of about 11.3%, after fees, to investors, according to advisory firm Cambridge Associates LLC, trailing the S&P 500's total return, which includes dividends, of 13.7% in 2014.

Speedy sales and the profits they generate also can help private-equity firms persuade investors to pony up the cash they need to fund new deals. Investors plowed more than $197.4 billion into private-equity funds last year, according to Dow Jones LP Source, an 9.6% increase over 2013.

Plenty of companies aren't ready for a sale after a few years under private-equity control. Still, a mergers and acquisition boom has buyout firms fielding offers from deal-hungry corporate buyers. Sales of U.S. private-equity-backed companies to these strategic buyers were at $75 billion through the end of May, an all-time high for the first five months of the year, according to Dealogic.

Private-equity-owned telecommunications and health-care companies have been particularly attractive targets. Global health-care deal volume is at a record this year, and global telecom deals are at their highest level since 2006.

BC Partners Ltd. last month reached a deal to sell Suddenlink Communications to France's Altice SA, about 2½ years after buying the cable company. The European buyout firm more than doubled its money in the deal, according to a person familiar with the matter.

Last month, TPG agreed to sell Par Pharmaceutical Holdings Inc. to Endo International PLC for $8 billion, less than three years after it purchased the maker of generic drugs. TPG, which made roughly seven times its money in the deal, was first approached by Endo a year earlier, said a person familiar with the matter.

"If buyers are willing to pay up for assets, private-equity firms are selling assets sooner than they normally might," said Dipanjan Deb, the chief executive of San Francisco-based private-equity firm Francisco Partners.

Rising stock markets, meanwhile, have spurred private-equity firms to consider taking some of their more recent acquisitions public. Buyout firms often retain stakes when their companies go public and sell them over time.

Black Knight Financial Services Inc. went public in May, roughly 16 months after Thomas H. Lee Partners LP bought a 35% stake in the mortgage servicer. Party City Holdco Inc. made its public debut in April, less than three years after Boston-based Thomas H. Lee bought a controlling stake in the party-supply retailer.

“The recession extended out ownership periods, but I think what we’re seeing is a return to the norm,” said Thomas H. Lee co-President Scott Sperling.