

Fourth Quarter 2017

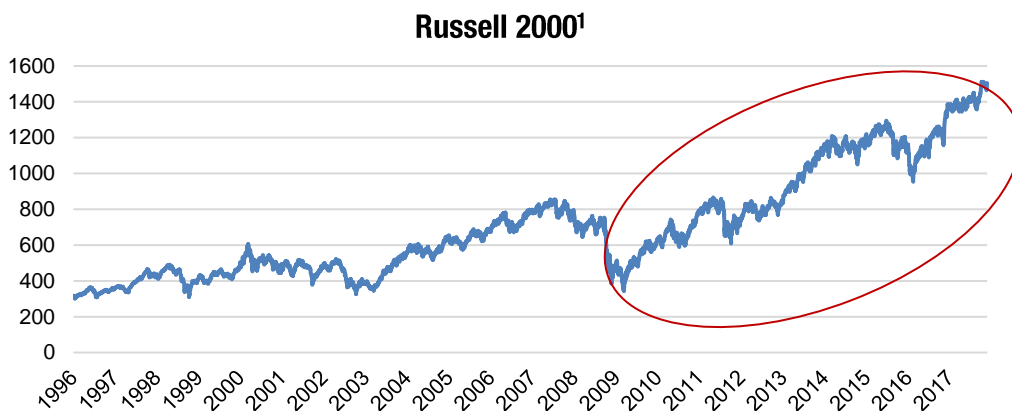
Quote of the Quarter:

“Bull markets are born in pessimism, grow on skepticism, mature on optimism and die in euphoria.”

-an oldie but a goodie
by Sir John Templeton
(1912-2008)

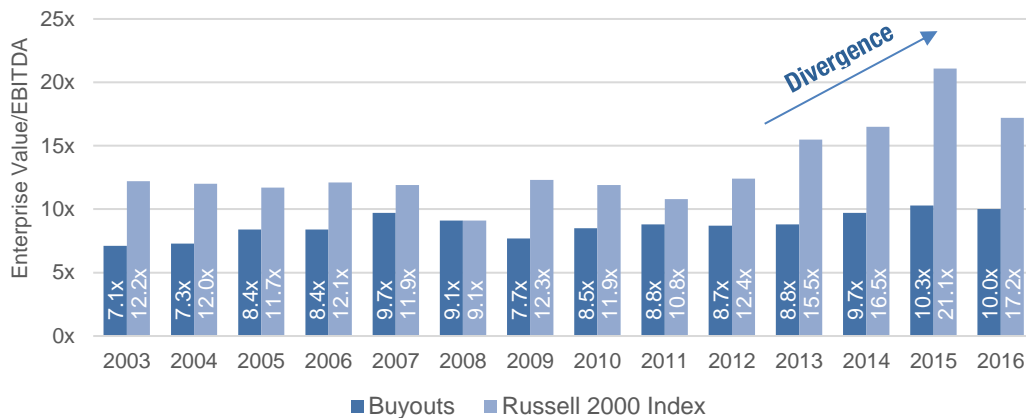
Stock Market Jitters

Anyone with a firm grasp of the obvious knows the stock market has been on a bull run since 2009. This roughly 3,200 day-long bull market is the second-longest in U.S. history (only the 12/4/1987 to 3/24/2000 bull market was longer at just shy of 4,500 days). Major U.S. stock indices gained another 25% in the last year too. Whether Congress passes tax cuts or not, at some point the stock market will stop defying gravity.



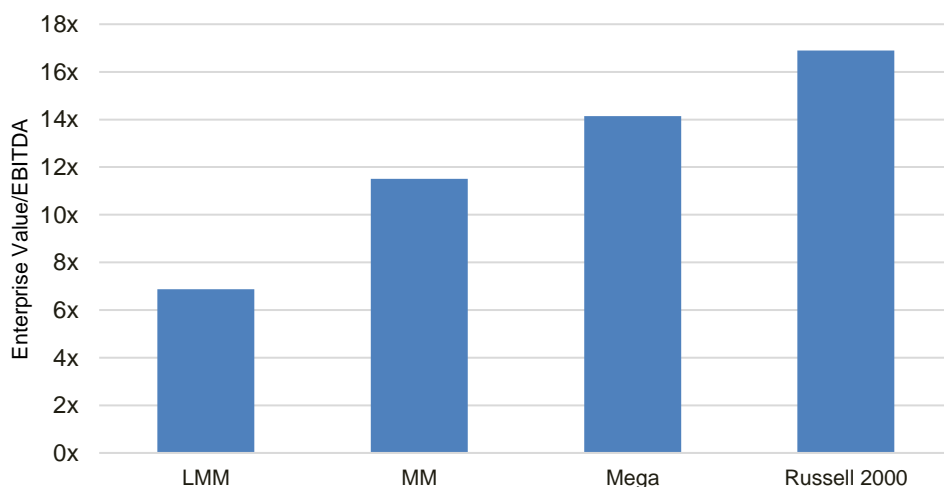
As private equity investors, we have noticed the relationship of public company valuations compared to private equity valuations has diverged since 2013. It is pretty typical for private companies to be valued at about 8.5x EBITDA² (plus or minus a turn or two based on size and growth prospects). Similarly, public companies often have an enterprise value of roughly 12x EBITDA. But in 2013, public equity valuations went above 15x and remain elevated. That looks frothy to us.

Public Company Multiple Expansion³

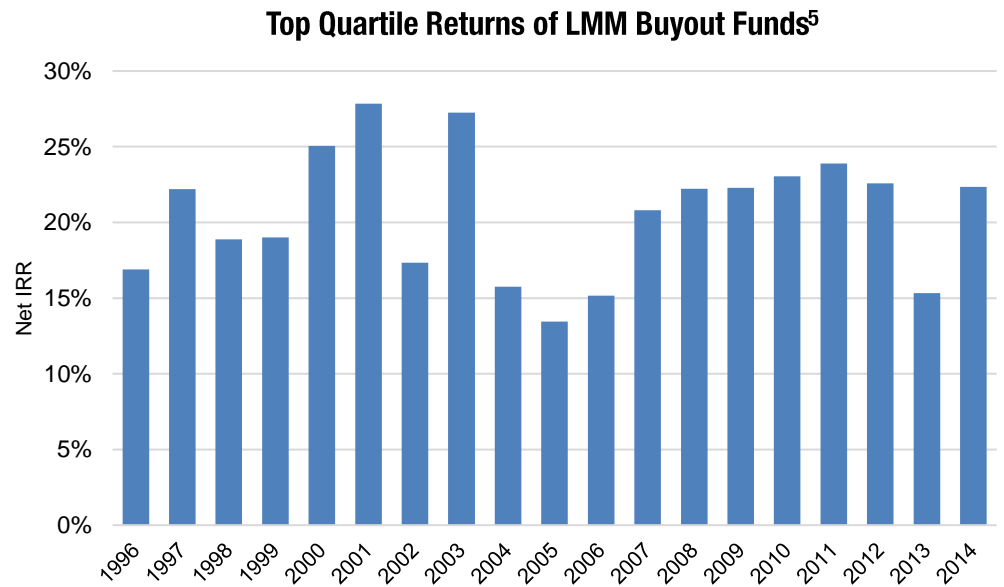


The chart below shows the most recent valuation multiple data available and is as of October 2017. While the average Enterprise Value/EBITDA multiple for private companies for 2016 in the preceding chart was 10x, when we parse the 2017 data below we see that Lower Middle Market buyouts (i.e., smaller deals) are valued at just over 6x EBITDA, Middle Market deals are valued at over 11x and Mega deals (think Apollo, Blackstone, Carlyle and KKR) are valued at 14x. Public company valuations, as measured here by the Russell 2000, are still by far the highest at a very lofty 17x. We love this chart because it illustrates the essence of the investment strategy in our Private Equity Partners series of funds: we want to buy companies for 6-7x EBITDA, grow them for 4-5 years and then sell them to a bigger fish who is willing to pay 8-12x EBITDA for the now bigger company. It is particularly relevant today because of the euphoria in the public markets. We think this is an opportunity for investors to rebalance their portfolios by trimming stocks and redeploying that capital in small buyouts and other less frothy investment areas.

YTD U.S. Buyouts vs. Public Company Multiples⁴



Finally, we note that private equity returns for small buyouts have remained pretty steady—and pretty darn good—across the ups and downs of recent economic cycles. Below are top quartile net IRRs for Lower Middle Market buyout funds since before the dot com boom and bust. Recall that the dot com bubble burst in 2001 and the Great Recession was 2008-9. The strength of top quartile LMM buyout returns over the last 20 years might come as a surprise to some but not to us.



Upcoming Events

We are regular speakers and attendees at key industry conferences. We hope to see you at these upcoming events:

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|----------------|--|
| December 5-6 | New York Summit – Infrastructure Investor , New York City
infrastructureinvestor.com/events/new-york-summit/ |
| December 6 | FOX Wealth Advisor Briefing , New York City
familyoffice.com/learning-programs/briefings/ |
| December 11-13 | Solar Power New York Conference , New York City
events.solar/newyork/ |
| January 8-10 | Private Markets Investment Forum , Scottsdale, AZ
opalgroup.net/conference/private-markets-investment-forum-2018 |
| January 25-26 | IBEW-NECA Employee Benefits Conference , Naples, FL
necanet.org/about-us/calendar/at-a-glance |

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1 Source: *Yahoo Finance*, 11/20/17.

2 Footnote: EBITDA means Earnings Before Interest, Taxes, Depreciation and Amortization and is often utilized as a proxy for cash flow.

3 Source: *S&P Leveraged Commentary & Data (Buyouts)*, March 2017. *Bloomberg (Russell 2000 Index)*, April 2017.

4 Source: *PitchBook (LMM: <\$150 million EV; MM: \$150 million-\$1B EV; Mega: \$1B+ EV)*, 10/19/17. EV refers to Enterprise Value (equity value (i.e. market capitalization) plus debt minus cash). *Bloomberg (Russell 2000 Index)*, 10/30/17.

5 Source: *PitchBook (LMM buyout fund size means <\$300 million for vintages 1995-2004 and <\$500 million for vintages 2005-2014)*, 11/2/2017.

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