KEYNOTE INTERVIEW

Private equity's future is bright

Growing capital flows are helping to increase sellers' understanding of the PE ownership model and widen the pool of potential targets, say Clayton, Dubilier & Rice CEO Nate Sleeper and co-presidents Dave Novak and Rick Schnall

Q Valuations are extremely high. How can private equity investors secure transactions that will deliver across market cycles?

Rick Schnall: I think if you would have asked us about valuations pre-pandemic, we would have said we are at a market peak or really close to that. If you ask us today, the answer is probably the same. To invest in this environment, you better know what you are buying and understand the markets where it operates. It comes down to our ability to source attractive transactions and work exclusively with sellers.

CLAYTON, DUBILIER & RICE

Nate Sleeper: A thematic approach is important. Take the value-based primary physician healthcare market in the US, as an example. That is a space we have been working in for six years. In 2016, CD&R formed agilon health, which partners with physicians to provide high-quality, value-based healthcare. This provided us with the insight, access and network to secure exclusive deals with two primary care-centred, value-based businesses, Millennium Physician Group and Vera Whole Health, this year.

Dave Novak: In Europe, meanwhile, we identified pharma services as a key investment theme and have been working on that for four years. In 2017, we engaged Liam FitzGerald, former CEO of UDG Healthcare, as an operating adviser to CD&R funds. Over the past two years, we have acquired three companies, including UDG, to create a global pharma services leader.

By pursuing those themes in a purposeful way with an experienced

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NATE SLEEPER

operating and financial team, we were able to effectively position ourselves in these attractive markets.

Q Beyond high valuations, what are the biggest macro-economic risks facing the market? How do you factor those into decision-making?

NS: Although we are very cognisant of geopolitical risks, climate change, income inequality, populism and other risks, we tend not to take a macro top-down approach to our investing. We believe it is difficult to create a differentiated point of view around a set of macro trends that are well understood and that tend to be directionally priced into transactions.

Instead, we are laser-focused on the micro and spend an enormous amount of time thinking about the individual companies and the specific risks that exist for those businesses. This approach incorporates macro risks and trends, but the macro does not drive a top-down mandate for how we invest.

Q How is the digitisation trend impacting investment and how can you mitigate technology risk in a fast-paced world?

RS: Technology is impacting us across the firm, and it is impacting every one of our portfolio companies. We need to understand technology-related risks, as well as technology-related opportunities.

NS: We assess disruption risk and disruption opportunity in every investment that we make. There are some parts of the investing industry that have been completely disrupted by big data – take the hedge fund world, for example. We do not expect the impact on private equity to be as significant. However, big data and data analytics can be important tools to help us form better investment decisions.

RS: To that end, we have invested significantly in technology-related capabilities. Today we have a team of operating resources with experience leading large tech services and software organisations, in addition to an operating principal, Chris Satchell, who sits across CD&R's portfolio, working on due diligence and technology innovation.

DN: Not every investment needs cutting-edge technology to be successful, mind you. We owned the largest discount retailer in the UK by revenues from 2013 to 2018. This business did not have a transactional website where consumers can go to buy groceries and merchandise when we were an investor in the business, and it still does not have one today. It is incredible to think that in 2021, you cannot buy products online there. Yet that business has thrived. It comes down to the thematic work and the detailed due diligence required to really figure out what is going on at a micro level within an industry and what it takes to compete successfully.

Q As private equity activity grows, scrutiny on the industry has increased. How are you seeing public perception evolve?

DN: There is no doubt that scrutiny of the asset class has increased. We have seen that in a transaction that we recently completed with UK supermarket group Morrisons. It is a consumer brand, and consumer brands typically attract more attention.

I think the increase in scrutiny comes down to the growing prominence of private equity within society and the economy. I believe, as an industry, we need to own that. We need to acknowledge that role comes with responsibility, including the need for more effective communication.

Private equity, as an ownership model, remains misunderstood. And many of the concerns raised by the press and public reflect this. If you look at factors such as revenue growth, innovation, employment growth and ESG, in many cases, we believe private equity-owned businesses are significantly ahead of their peers.

Q Might the weight of new capital coming into the market compress returns?

NS: We remain positive about the asset class overall. There are two main reasons for that. First, all the additional capital that is coming into the market – and the additional transactions that have resulted from that – mean private equity is now better understood amongst sellers.

Second, with more capital, larger companies are becoming more accessible. Due to the combination of those two factors, the pool of potential investments available to us is now much larger.

Q What have been the biggest changes to your investment approach since you have been in the industry and what do you expect to be the most significant changes in the years to come?

RS: I would say that we have become more sophisticated. Many of us have now been doing this for over 20 years and so we have been through a number of different cycles. We have seen what makes a good deal and we have seen what makes a deal less successful.

We have also become sector specialists, and our due diligence approach is more advanced. I would say we are more decisive in terms of what fits our model – what is worth spending time on and what is not. This is all supported by our more diverse team with a broader range of backgrounds and industry expertise. So, I would say that overall, we are better at what we do than we were 20 years ago, or even 10 years ago for that matter.

Looking ahead, meanwhile, we have all bought into the idea that we want to continue to be a firm solely focused on private equity. We invest out of one fund at a time and are fully owned by the partnership. We believe these things define who CD&R is as a firm.

We also believe that there is plenty of opportunity to grow within that construct. That starts with the meaningful opportunity to grow in our existing verticals. Today, we have around a 1 percent share across the areas where we invest, so we are certainly not limited by the market.

Q Where do you see opportunities going forward?

DN: There are several industries, including financial services and media, where we believe there are opportunities to create the kinds of transactions that CD&R is known for. As Rick said, we are not limited by the market, and therefore when we think about how we can consistently, methodically and predictably grow the firm, the opportunity is very clear.

I believe we will continue to get better, continue to grow and continue to take advantage of those opportunities. ■

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