Is it time to go private?

There's no time like a downturn to take a company private.

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Introduction

During recessions and bear markets, corporate acquisitions tend to ebb as companies focus on their core business. To do so, it is common to see companies cut costs or divest underperforming assets, yet one type of deal flourishes when the economic climate turns and valuations cool—a greater number of publicly traded companies are taken private. Companies make this transition for many reasons: they prefer to step back from the harsh scrutiny of quarterly reporting, want more scope to overhaul the firm's cost structure, or are ready to adopt a new business model to meet evolving market needs.

Going private is often an appealing option for public companies during or shortly after recessions, when valuations in some sectors tend to decline sharply. During 2022, the S&P 500 declined 20 percent and inflation lingered at its highest point since 1981. Interest rates also rose to a multiyear high as part of the Federal Reserve's inflation-fighting strategy, which led to higher borrowing costs and decreased returns, and created a real challenge for some public companies that are struggling to raise capital.

These factors have been major drivers in the market. During 2022—a period of heavy market sell-off, especially in the tech sector—the value of take-private deals announced was $258 billion. This surpassed the total annual value of take-private deals in 2021 and reflects the typical growth of deals noted in past downturns.[1] Deal volume is likely to increase further as private equity firms still have considerable cash available. If a transaction makes sense from a valuation and growth standpoint in the current environment, it is likely to proceed with the expectation of refinancing or recapitalizing the business when interest rates decline.

For public company boards looking to deliver shareholder value, take-private transactions provide premium valuations over the current market price to motivate current shareholders to sell. Maximizing value for existing shareholders means a sale price at a trading premium at a time when the firm's share price is likely under pressure. These premiums can exceed 35 percent of the trading price and can provide shareholders with a strong return in an otherwise challenged market.

As fears of an impending recession and surging interest rates are likely to further pressure valuations, it may be time for some public companies to consider a take-private transaction. Navigating the process can be complex for both management and boards, and the company must continue to operate independently, especially if the deal has contingent financing.

In this paper, we examine when a take-private provides the best alternative to execute a firm's strategy and maximize shareholder value. We outline when going private is a good option, explain the benefits of taking that option, identify the types of companies that typically go private, and describe how to best execute the take-private process. We also assess the common pitfalls of take-private deals and how to avoid them.

[1] Source: Institutional Investor website, "Take-Private Deals Are on a Record Pace," Hannah Zhang, July 27, 2022

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Exhibit 1. Transaction premium and change over time

Transaction date	# of transactions		TV ($MM)	1-day	1-week	4-weeks
			Acquisition premiums			
2017	46	Median	$ 312	26.75%	28.88%	32.84%
		Mean	$ 745	43.10%	46.05%	53.05%
2018	46	Median	$ 587	27.08%	26.54%	29.36%
		Mean	$ 1,282	36.16%	34.10%	33.35%
2019	60	Median	$ 438	24.45%	25.76%	30.03%
		Mean	$ 1,805	37.54%	39.57%	40.17%
2020	54	Median	$ 233	27.96%	33.15%	37.00%
		Mean	$ 1,090	33.69%	41.11%	47.06%
2021	81	Median	$ 656	26.79%	29.98%	34.15%
		Mean	$ 1,970	43.21%	43.95%	45.03%
2022	51	Median	$ 1,207	33.97%	39.47%	43.80%
		Mean	$ 3,525	52.61%	56.10%	51.85%

Source: Based on KPMG analysis of Global take-private transactions between 2017–2022 as sourced from S&P Capital IQ

The value premium expands in times of market disruption

Since 2017, there have been 338 publicly traded companies that have gone private based on KPMG's review of global transaction data obtained from S&P Capital IQ, i.e., existing or new investors acquired all the shares of the company, and that company no longer trades on a public exchange.[2] KPMG has reviewed take-private transactions from 2017 to 2022 to illustrate the relationship between deal value over time and respective acquisition premiums. Using data from S&P Capital IQ, we calculated the transaction value representing the costs to acquire all common equity, preferred equity, and convertible securities, plus the face value of all outstanding debt, less cash and marketable securities, as well as the percentage change from the offer price to the purchase price one day, one week, and four weeks prior to the transaction announcement date. A clear trend emerges indicating a significant increase in transaction premium at times of market volatility and decline in market valuations reaching a new apex in 2022.

[2] Source: KPMG analysis/PitchBook/CapIQ

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The benefits of going private

There are many benefits to becoming a private company. For one, it gives you an opportunity to step away from the harsh quarterly reporting spotlight. It also enables you to complete a strategic transformation program by taking difficult value-creation actions (either operational or through portfolio management). Examples of typical operational actions include improving the cost structure, modifying the business model, and shifting strategy or the go-to-market approach. Typical portfolio actions include selling a segment, spinning off an asset, merging with a rival, or revising the capital structure.

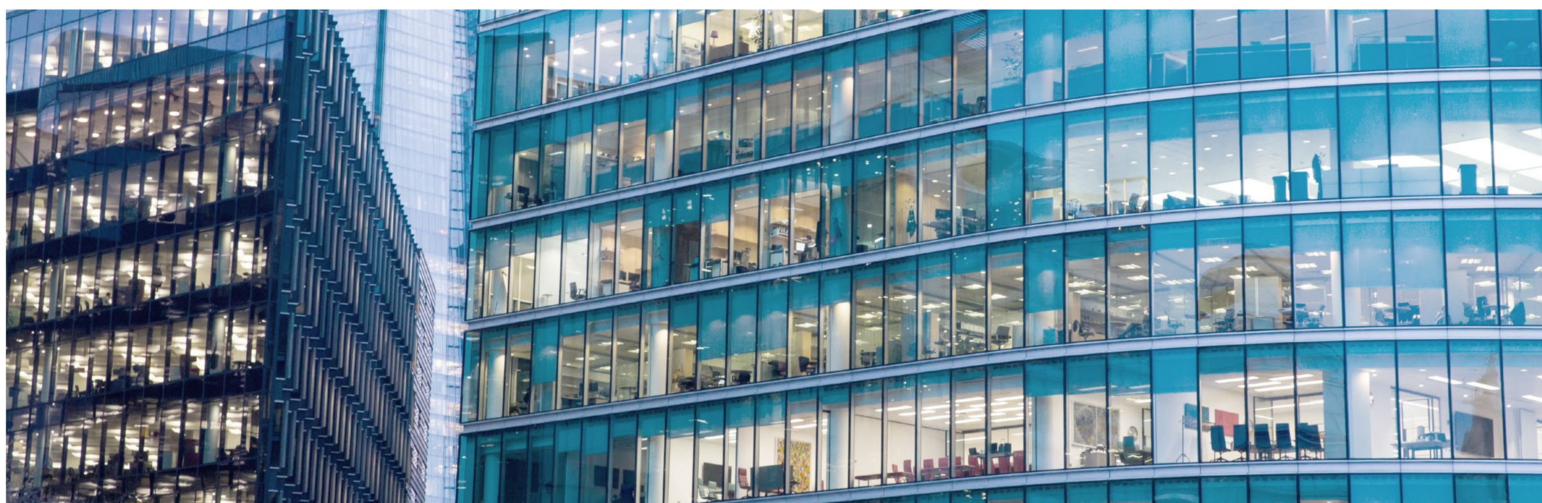
The digital revolution in the 21st century has caused massive disruptions in many industries and brought about the largest economic and social changes since the Industrial Revolution. It is changing the way we live and work. Many companies in different industries and geographies find themselves needing to launch strategic transformations to overhaul their business to meet rapidly evolving markets. These transformations often require major changes in how companies go to market, the products they offer, and even how the companies are organized and are likely to require multiyear investments funded through operational cost efficiencies.

Accurate forecasts for how long a transformation will take are difficult to make. Some companies find themselves missing forecasts, resulting in a significant impact to their stock price and valuation. Management teams often realize at this point that a take-private is a good option—it is much easier to complete a multiyear overhaul and focus on long-term strategic investments without having to consistently show investors improving quarterly results, as is expected from public companies.

Share value during a multiyear transformation tends to be volatile, and the typical public company shareholder has little appetite to stay the course. The public market also tends to have a smaller appetite in general for high-risk multiyear shifts.

The strategic or private equity (PE) investor that is willing to take a company private is often better suited to handle the risk. Once a multiyear transformation is complete, the PE investor is rewarded by having the option to take the healthier company public again with the potential to receive a high return on investment.

KPMG analyzed more than 1,000 transactions globally during 2005–2022. The years with the highest number of take-privates by volume were 2007, 2011, and 2021.[3] The data showed that a combination of factors contributed to an environment favorable to take-private transactions.



[3] Source: KPMG analysis/PitchBook/CapIQ

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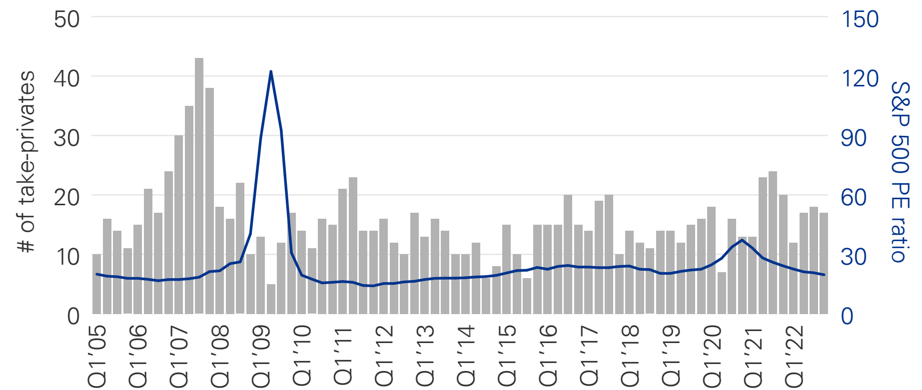
Low valuation multiples, which generally occurred after recessions (the Great Recession and COVID-19 downturn), were the driver most correlated to high take-private volumes. However, some industry specific concerns or regulatory changes may also spur take-private activity.

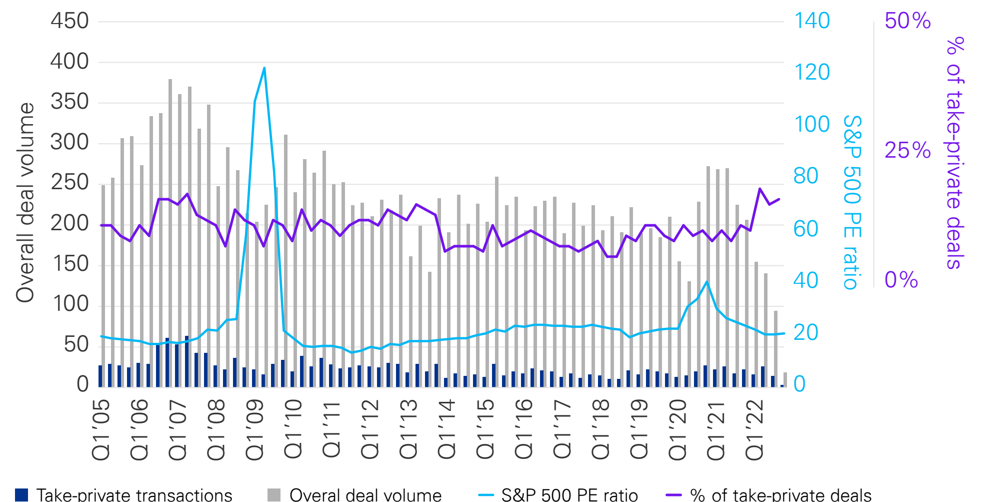
Exhibit 2. Number of take-privates and S&P 500 PE ratio by quarter



Source: KPMG analysis/PitchBook/CapIQ

The proportion of the take-private transactions relative to overall deal volume tends to increase during times of economic uncertainty and equity market volatility. This can be seen in Exhibit 3 which shows increase in take-private transactions in late 2000s during the time of high volatility around the financial crisis. We see a similar increase in take-private transactions in 2022 accompanying the economic uncertainty and equity price volatility.

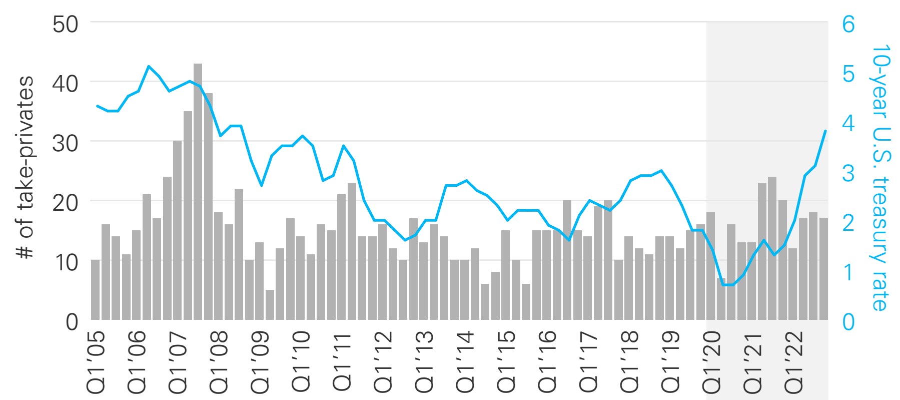
Exhibit 3. Take-private transactions versus overall deal volume



Source: KPMG analysis/PitchBook/CapIQ

Surprisingly, an increase in interest rates did not decrease the volume of take-private deals. It did change the financing construct of deals with leveraged loans that feature floating rates and are later refinanced when interest rates pressure relaxes. In aggregate, sponsor-backed companies are well-positioned to absorb the impact of rising rates. High interest rates actually pressure stock valuations and lower multiples, which tends to encourage take-private volumes.

Exhibit 4. Number of take-privates, S&P 500 PE ratio, and 10-year U.S. treasury rate by quarter



Source: KPMG analysis/PitchBook/CapIQ

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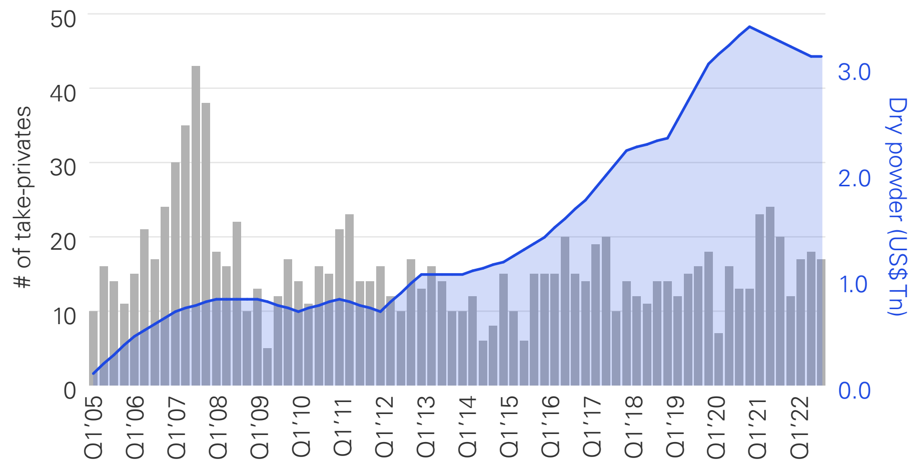
Another important driver of deal volume is available funding and there has been an influx of private equity "dry powder." Available but uncommitted funds have been on the rise, which enables PE firms to leverage equity, lower their dependency on debt, then rebalance or recapitalize companies once interest rates decline.

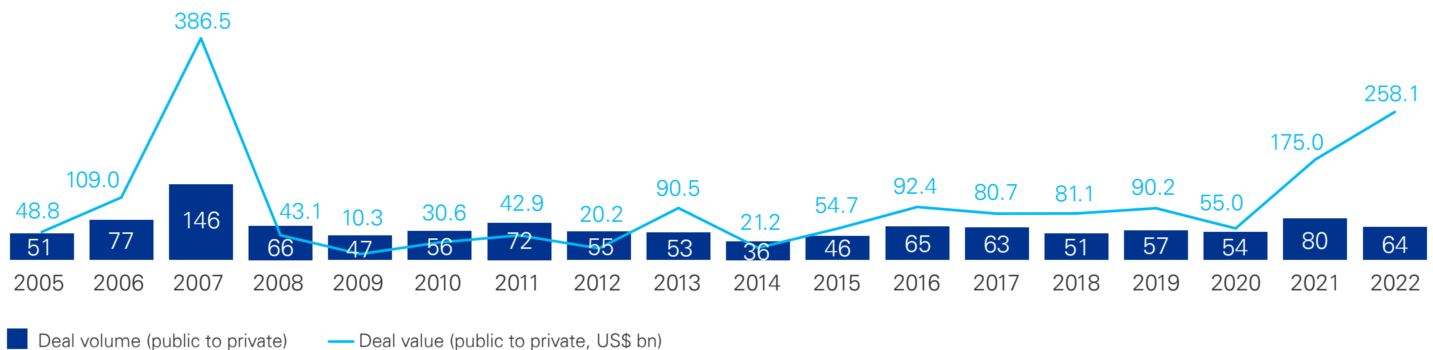
As another downturn is poised to emerge, take-private volumes are likely to accelerate—PE dry powder is estimated at $3.2 trillion according to data firm PitchBook,[4] which is close to all-time highs.

Exhibit 5. Number and value of take-privates and dry powder by quarter



Source: KPMG analysis/PitchBook/CapIQ, Dry Powder Bain Capital Global Private Equity Report 2022

Exhibit 6. Global public to private deals (2005–2022)



Deal volume (public to private) — Deal value (public to private, US$ bn)

Source: KPMG analysis/PitchBook/CapIQ, Dry Powder Bain Capital Global Private Equity Report 2022

There are many advantages to taking a public company private. While a public company is subject to quarterly and yearly reviews, a private firm has the flexibility to execute a strategically complex, longer-term plan,[5] meaning that C-suite executives in private companies do not have to worry about meeting analysts' expectations or dealing with restless short-term shareholders.

Private companies also have fewer operational costs. Since the Sarbanes-Oxley Act was adopted in 2002, public companies incur compliance and reporting expenses, along with exchange listing and accounting fees related to filing their quarterly and annual reports. Even for small- to mid-cap companies, going private could save them $1 million in fees alone annually.[6]

[4] Source: PitchBook.com, "What dry powder levels mean for investors in a changing market," August 20, 2022

[5] Source: Market Realist website, "Public Companies Going Private in 2022—Twitter Isn't Alone," Ade Hennis, April 28, 2022

[6] Source: BDO Canada website, ¨5 reasons why public companies should go private," January 21, 2020

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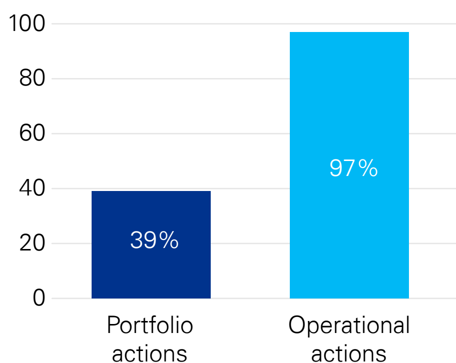
Assessing the take-private value-creation process

While companies obviously differ, often in significant ways, firms that are likely to be good candidates for being taken private tend to have a similar profile and key indicators. A significant factor in firms being taken private in the last five years was that they had already embarked on a multiyear transformation. Other financial indicators of take-private candidates include low price-to-equity ratios, a performance below the sector index, missing guidance, and strong recurring cash flows.

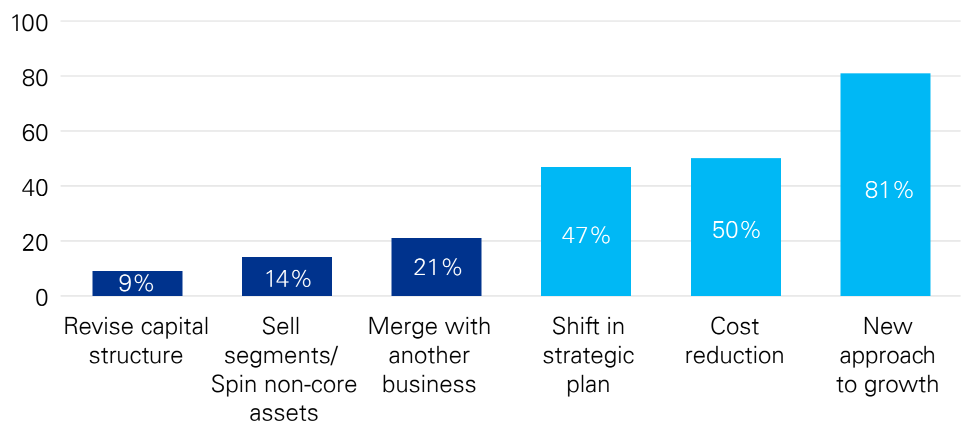
According to KPMG research, the new investors took actions involving the acquired company's operations in 97 percent of take-private deals, and in approximately 40 percent of take-private, they also used portfolio management, to shift the company's direction inorganically.[7]

Exhibit 7. Common investor profiles and key indicators for take-private candidates[8]

Expected actions by new investors



Potential options and actions to increase shareholder value



Source: KPMG analysis/PitchBook/CapIQ

On average, the new investors held companies for **4.3 years** before exiting their investments

In **65 percent** of the deals, the companies returned to being public firms

33 percent were sold to a different private company

5 percent ended up in bankruptcy

Source: KPMG analysis/PitchBook/CapIQ

When CEOs and boards decide to explore a take-private deal, it is critical for the firm to conduct analysis from the potential buyers' point of view. Building an investor's internal valuation hypothesis—including identifying what potential actions the buyer may take as part of managing the portfolio—is critical to assessing the potential shareholder value. These actions may include analyses of how to create value or reverse value destruction that may be accruing as a public company.

[7] Source: KPMG analysis/PitchBook/CapIQ

[8] Source: KPMG took a sample set of transactions, representing 80 percent of the total take-private transactions by value to analyze the value of going private. Based on our analysis, the companies generally experienced improvement in revenue growth and margins after going private. This, in turn, increased enterprise values and valuation multiples, such as EV/EBITDA and EV/Revenue.

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Gauge your readiness for a transition to a private market

As a CEO or CFO, it is important to ask if your company exhibits the attributes that most closely fit a candidate to go private.

- Does the company have a depressed share price relative to its intrinsic value?
- How does the company's performance, capital allocation, and valuation multiple compare to its industry peers?
- Is there a path to increased profitability through a take-private?
- Can the company accelerate its strategic plan or reposition itself in the market more rapidly?
- Is there execution risk in this type of transaction, and if so, to what extent?
- What is the potential impact on the company's capital allocation and financing alternatives under a PE firm ownership?
- What is the impact of a change in the existing and future investor base?

The equity story is key to the success of a transaction. As part of the diligence process, the management team needs to explain its strategy and market position. It must also articulate the value-creation actions it has already taken to improve its financial performance and meet its strategic goals, and what other steps could be taken once taken private. In addition, the management team should also provide details on its capital structure, allocation process, and main areas of focus.

If a company decides to pursue a transition to the private market, it is important to understand the process and expected timing, as well as the accompanying challenges. Prior to the company delisting from the public stock exchange, management and a team of advisers will likely engage in due diligence to determine whether the take-private deal is feasible. To ensure a successful diligence and negotiation process, management should embed an effective deal team to manage diligence as a way to balance the need to represent all functional operations while maintaining confidentiality.

Additional considerations include the necessity of conducting a shareholder vote, obtaining board approval, fairness opinions, various disclosures, and SEC filings. State law, taxes, and timing issues should also be included in the evaluation process. Placing safeguards around the appropriate risks to avoid the potential for litigation also needs to be considered.

At the same time, management needs to consider what would happen if the take-private doesn't occur. This includes alternative plans that the management team can implement in order to meet its transformational objectives. The self-assessment should include an analysis of historical financial data, top holdings, and benchmarking the share price and equity value against peers.

A board special committee should be established to carefully weigh the pros and cons of going private. This committee should review any formal proposals and consider the status of any ongoing strategic initiatives and the feasibility of any unfunded strategic plans. The board should also compare company- and segment-specific EBITDA and revenue results to their forecasted or budgeted numbers. In addition, a formal valuation will generally be required if the potential buyer is an insider or acting jointly with an insider of the company.[6]

[6] Source: Bennett Jones, "Key Considerations for Going-Private Transactions in Canada," June 17, 2020

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Take-private deals in practice

Looking at 2005–2022 from an industry perspective, technology, media, and telecommunications (TMT) is the leading sector, followed by consumer & retail, business services, financial services, and healthcare and life sciences.

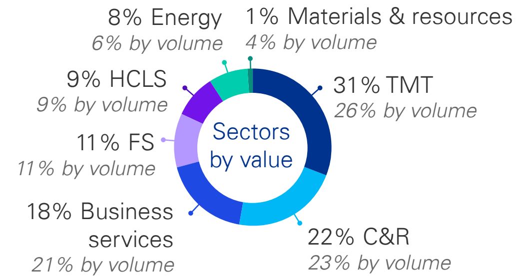
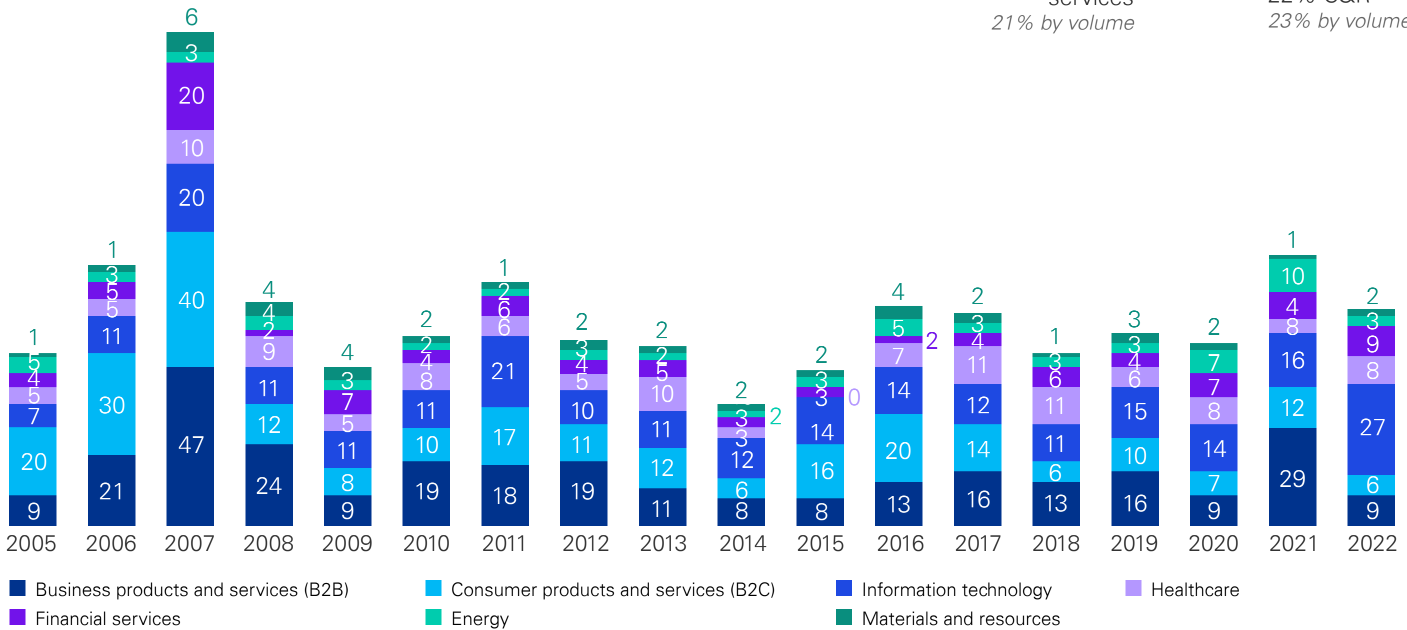


Exhibit 8. Global public to private deals by sector (2005-2022), volume in number



Source: KPMG analysis/PitchBook/CapIQ

Dell: A well-executed take-private

An example of a take-private success story is Dell Computer, which had been a technological leader when it went public in 1988. Prior to going private, Dell saw its share price crumble by more than 30 percent because of sinking PC sales. In response in 2013, founder Michael Dell partnered with PE firm Silver Lake and Microsoft to take the company private in a leveraged buyout valued at $28.1 billion, 34 percent premium versus enterprise value prior to announcement. Dell and Silver Lake paid down $15 billion of the debt and in 2016, arranged a $67 billion merger with data storage firm EMC, which was then twice Dell's size.

The merger added scale to Dell's infrastructure businesses and gave it control of a handful of valuable subsidiaries like cybersecurity company RSA, cloud software company Pivotal, and EMC's 81 percent ownership of VMware, a pioneer in the virtualization of corporate technology infrastructure. In 2018, Dell returned to the public markets, bypassing the traditional IPO process by buying back shares that tracked the financial performance of VMware. Dell's implied enterprise value was approximately $38 billion, roughly $10 billion up from prior to going private.

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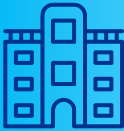
Paysafe

Paysafe, the integrated payments platform, was acquired by a consortium of funds led by Blackstone and CVC Capital Partners in December 2017 for $4.3 billion. As part of the deal, Paysafe divested its Asia Gateway subsidiary to Spectrum Global Limited for $308 million according to Reuters. After separation, the firm was able to refocus on growth in its core operations and in March 2021, after about three years as a private company, the consortium merged Paysafe with a special-purpose acquisition company named Foley Trasimene Acquisition Corp., landing a market cap of $10 billion and enterprise value of $13 billion.



Hilton

Hilton Worldwide (NYSE: HLT), one of the largest hospitality companies in the world, was acquired by The Blackstone Group in October 2007 for approximately $25 billion, including debt. The prudence of the transaction was questioned in 2008 when the economic recession decimated the real estate and hospitality industries. Hilton and Blackstone weathered the storm and their partnership continued until Blackstone's ultimate exit in 2018. During that time, Hilton made strategic decisions to relocate its headquarters, restructure its debt, and shift toward a franchising model increasing its portfolio number of properties from 2,935 in 2006 to 4,115 by 2013, or 40 percent, and increasing their assets book value from $15.6 billion to $26.6 billion, an approximately 70 percent increase.

Hilton returned to the public exchange through an IPO in December 2013, with market cap of ~$21.9 billion and enterprise value of approximately $34 billion, up from roughly $6 billion. The IPO valued Blackstone's stake in the company at about $15 billion after having invested roughly $6.4 billion in total. Blackstone retained a majority stake in the company until 2015 and exited completely in 2018.

Transaction timeline

The lifecycle of a take-private transaction generally comprises three phases: preparation/strategy, closing the deal, and private-company transformation, as shown in Exhibit 8. Each phase has a number of steps and key activities—some of which are the responsibility of the acquirer, while others are the responsibility of the target public company's management, and still others are shared responsibilities.

After the announcement, a take-private deal typically closes on average within 104 days, giving it very little time to prepare to operate as a private company. During this period there are often "go shop" periods where the company can openly evaluate and consider other proposals to be acquired by other interested parties. Any offer is usually subject to shareholder approval, meaning that existing shareholders must believe that "cashing out" is the right move for them at this time.

The timeline can vary depending on the going-private transaction structure, which is most commonly a one- or two-step merger. It could also take the form of an asset sale, a reverse stock split, or a self-tender. A one-step—or "statutory" or "traditional"—merger takes place when two companies jointly negotiate an acquisition through a tender offer and a shareholder vote. (See the timeline in Figure 8 for the timing of key activities that need to be undertaken in a one-step exchange offer.)

A two-step merger requires the acquiror's subsidiary to commence a tender offer for all the target's shares within a few days of the merger agreement. If the merger consideration includes securities, additional time will be required for the SEC review process of the share exchange offer documents.

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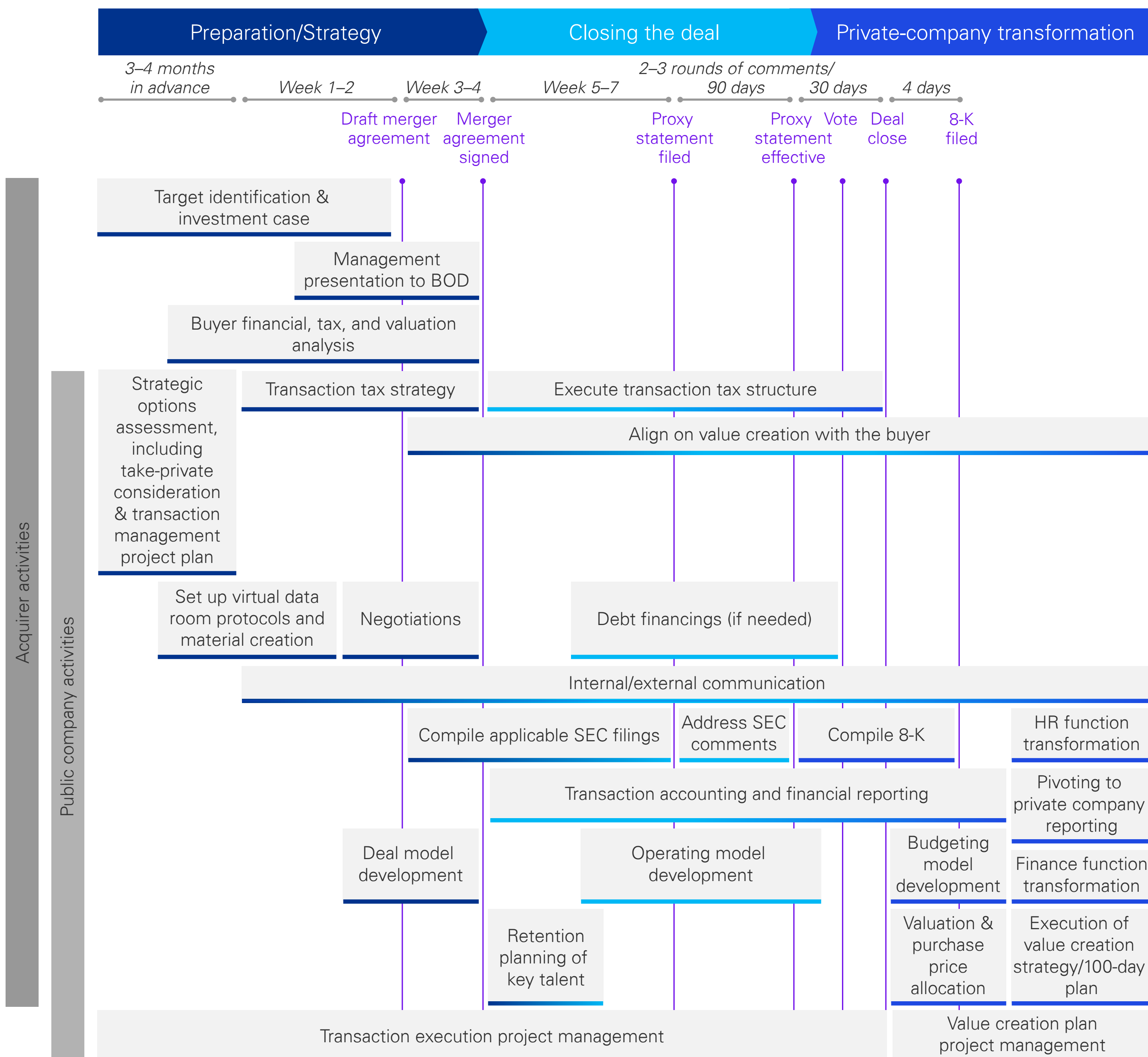
Exhibit 9. Going private transaction lifecycle—one step exchange offer



The tasks performed during the preparation and strategy phase begin with analyzing the viability of going private and possible alternatives. A take-private readiness assessment should be performed in preparation for due diligence, deal structuring, and negotiations.

Closing the deal follows the signing of the merger agreement, and includes the drafting of proxy statements, internal/external communications, and addressing SEC comments. It concludes with the shareholder vote, if necessary, and the deal close.

The last phase will begin with preparations for a strategic alignment with the buyer and changes that need to be made to allow effective communication and reporting with the buyer as well as the execution of a value-creation strategy.

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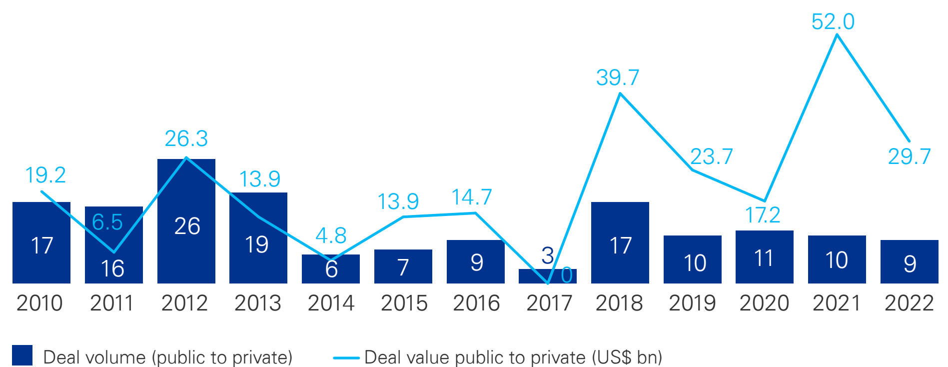
Why take-private deals are complicated

Take-private transactions can be complex, with KPMG proprietary data showing that around 18 percent of take-private deals announced were canceled during the 2010-2022 period. More recently, there have been fewer deals cancelled post-announcement, but challenges remain, especially for financing in a higher-interest-rate environment.

Among the problems that can undermine a take private's successful completion are public leaks about the negotiations, which can impact the share price, equity and golden parachute tax questions, and large numbers of employees leaving the company about to be sold. A more recent problem has been consumer boycotts related to ESG concerns, which can potentially damage the value of the target company's brand.

Typically, these types of transactions have agreed-upon breakup fees that apply if either party seeks to walk away after a deal is signed. When an investor offers to buy a company, they often want the ability to cancel or renegotiate the deal based on what they learn through the due diligence process or even post-signing. These breakup fees usually are waived when regulatory approval is not forthcoming, but this is not the case in all transactions.

Exhibit 10. Global cancelled public to private deals (2010–2022)



Source: KPMG analysis/Pitchbook/CapIQ

Other common problems include antitrust actions and obtaining the existing shareholders' approval, as well as the buyer backing out after a deal has been agreed. Potential buyers can have a change of heart due to a sudden change in market conditions and a rapid decline in the equity markets associated with a bear market, making the agreed-upon deal price higher than current market price.

From a regulatory standpoint, the SEC is typically focused on antitrust concerns—companies are generally required to disclose the following information:

- Summary and key terms of the take-private take-private transaction
- Description of any prior relationships or transactions between the target and the acquirer
- Description of the purpose of the transaction and plans for the future of the target
- Strategic alternatives to the proposed take-private transaction
- Existing ownership interests of the acquirer in the target
- Information regarding who is working with the company to provide external advice and recommendations for the selling stockholders

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Corporate governance and internal control

When a public company decides to go private, it often requires a shareholder vote, board consideration, fairness opinions, various disclosures, and SEC filings. Along with the transaction type, state law, taxes, and timing issues should also be included in the evaluation process. Safeguards need to be considered around the appropriate risks to avoid potential litigation as a result of the process.

Under SEC rules, public companies need to comply with the requirements under the Sarbanes-Oxley Act. While management's assertions over Internal Control Over Financial Reporting effectiveness (ICFR) may no longer be required, ICFR implications to the organization remain. The private company will continue to prepare financial statements and may retain the independent auditor and the audit committee. Although the independent auditor will no longer need to evaluate the effectiveness of the company's ICFR, reliance on those internal controls may reduce the amount of substantive testing necessary.

Tax

To understand the tax risks and opportunities of take-private transactions, both the selling and acquiring entities should engage in tax diligence and structuring. Tax diligence should be performed from both a buy- and sell-side perspective to ensure the proper identification of, and if necessary, mitigation of historical tax exposures.

Tax structuring is the process in which acquiring and selling entities analyze the tax impacts of potential transactions to reach an optimized transaction and go-forward tax result. As a generalization, the most common goal of tax structuring is tax deferral for selling shareholders (e.g., to avoid taxable income without the receipt of cash), and to optimize the tax profile of the go-forward entity. The most critical focus areas will vary depending on the type of public company structure, including a traditional C corporation, multinational corporation, and UP-C (Umbrella Partnership C-Corporation) structure.

The golden parachute problem

Key employees of companies often receive accelerated vesting of equity awards, retention, severance, transaction bonuses, and other benefits when a company is acquired or otherwise experiences a change in control. Commonly referred to as "golden parachute payments," the benefits can be significant, but they also come with complex tax implications under Internal Revenue Code Sections 280G and 4999.

Potential parachute payments (sometimes referred to as contingent payments), do not necessarily result in adverse tax consequences. However, excess parachute payments do have negative tax consequences. Under Section 280G, a corporation may not deduct excess parachute payments.

Not only should the tax consequences for key executives be considered, but the windfall payments for other key employees upon the acceleration of equity may also put them at risk. Ahead of the transaction, the treatment of equity should be well-documented in anticipation of employee questions; the magnitude of payments should be evaluated across the workforce, and a review should be conducted to determine whether one-time retention payments are necessary to retain key employees in the short term.

Buyer alignment

Before the transaction closes, it is imperative that management and new investors be on the same page as to expectations, particularly on a reporting basis, in order to maintain a strong relationship. Unlike in public markets, where there are consistent quarterly and annual reporting periods enforced by the SEC, private companies do not necessarily follow that process.

Investors will frequently reach out looking for progress updates that reflect both daily operations and future strategic growth plans. A PE firm will typically have fewer investors versus a traditionally diverse shareholder base. A key element to this is aligning reporting metrics to growth strategy.

A strong growth strategy includes an assessment of profitability, pricing, selling, general and administrative expenses, working capital, and industry trends. Post-deal, it is also important to drive the initial opportunities and synergies discussed pre-transaction so that there is urgency to implement change and prioritize success.[6] If both parties are not aligned before the deal closes, there may be negative operational and financial consequences.

[6] Source: Cicero Group website, "Post-Deal Strategy: Creating Value and Building Success for Private Equity Investments," August 26, 2022

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How KPMG can help

KPMG brings an extensive suite of services tailored to large scale, complex transactions. Our team of transaction specialists is deeply experienced in the full lifecycle of take-private deals—this includes sell-side operational and financial due diligence, accounting support, tax diligence, valuation, deal transaction management, and post-deal value creation that encompasses restructuring and performance improvement.

During diligence, we can help simplify the take-private processes. We use our proprietary tools and technologies to consider themes such as (i) data hygiene—we assess whether the data provided to bidders supports your story, and if it is clean, robust, and supports the narrative in prior investor communications and/or filings; (ii) we provide analysis and help articulate historical and prospective trading and cash flow dynamics; and (iii) we collaborate with management to help develop its viewpoint on potential value levers in a private environment.

The KPMG Transaction Management team, Accounting Advisory and Valuation teams, M&A Tax Group, and People Strategy team, supplemented by functional subject matter professionals, can assist management with the entire take-private process, from the readiness assessment to post-transaction services to help the client with value assessments and future strategic initiatives after the deal closes.

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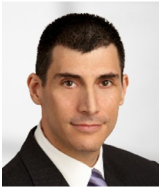

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