CIBC
Cleary Gull

MARKET MONITOR

M&A and financing update
4th Quarter 2019

Finally! 2019 will represent the first growth year for deal volume since 2015.

2019 is finally linking an increase in deal volume with high prices after the M&A market experienced a three-year period of record EBITDA purchase price multiples and declining transaction volume.

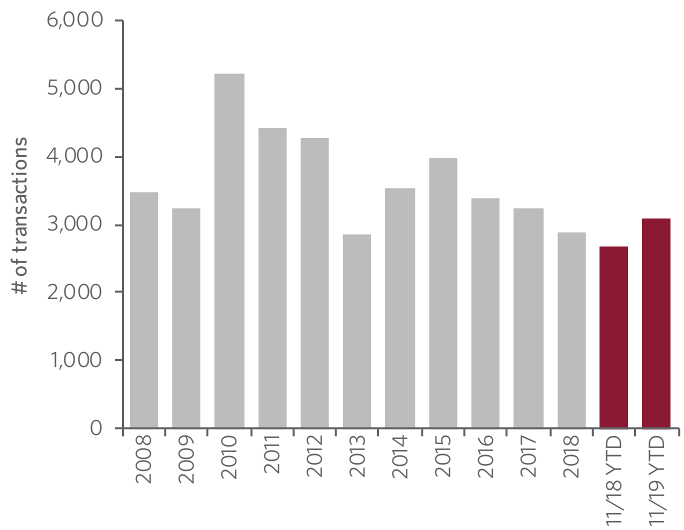
Through November 2019, the number of completed transactions under $500 million rose 15.1%, compared to the first eleven months of 2018, according to Robert W. Baird & Co. After a slow first quarter, the pace of completed deals increased dramatically later in the year. The increase in transaction volume was led by transactions under $100 million. In the year-to-date through November 2019, transactions under $100 million increased by 25.8% compared to the first eleven months of 2018, including a 76.9% increase in the month of November alone.

While lower middle market deal volume under $100 million sees a resurgence in 2019, deal volume in the $100 to $500 million category declined. Through November 2019, the year-over-year deal volume in this deal segment is down 12.0%, including a decline of 36.6% in November compared to November 2018.

We are not aware of any market factors that explain the disparity in deal volume by size category, although we have noticed distinct trends that affect how companies are currently valued. In 2019, we have seen the leveraged finance market continue to reward high-quality, recession resistant companies with high levels of debt availability and pass on deals or significantly reduce leverage multiples for high-quality, cyclical companies. Not surprisingly, these are precisely the companies acquirors want to buy, while some sellers are opting to hold them until a future date. Thus, "supply" is being restricted, while "demand" is high. Based on our dim and fading recollections of Econ 101, this should be a recipe for high prices.

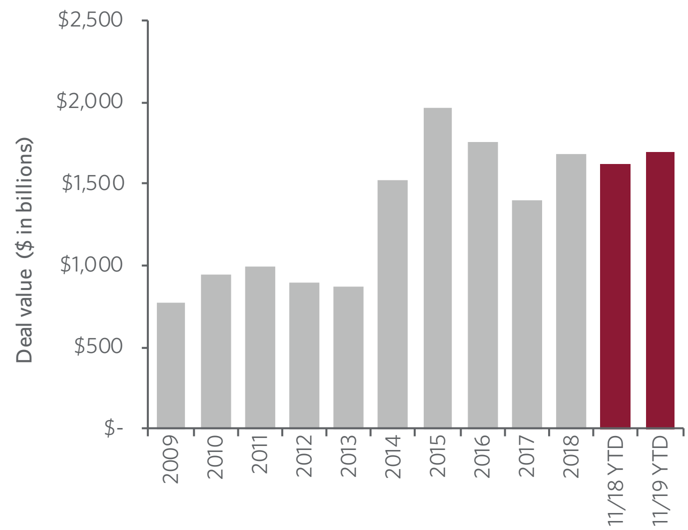
If we shift our focus from the number of deals to the dollar value of U.S. M&A, the data tells us that the size of "Mega Deals" continues to grow, according to Robert W. Baird & Co. Through November 2019, the dollar volume was $1.69 trillion, an increase of 4.5% over the first eleven months of 2018. In addition, the dollar volume through November would be the third-highest year on record excluding the December year-end exits which may cause the 2019 figure to challenge the 2015 record.

U.S. M&A deal volume for transactions under $500mm



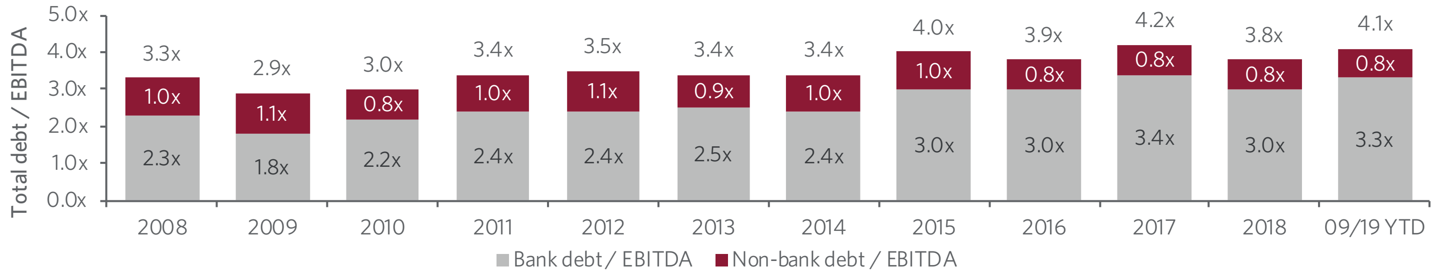
Source: Robert W. Baird & Co.

U.S. M&A deal value



Source: Robert W. Baird & Co.

Average platform LBO debt multiples for deals with $10mm – $250mm of enterprise value



Source: GF Data®.

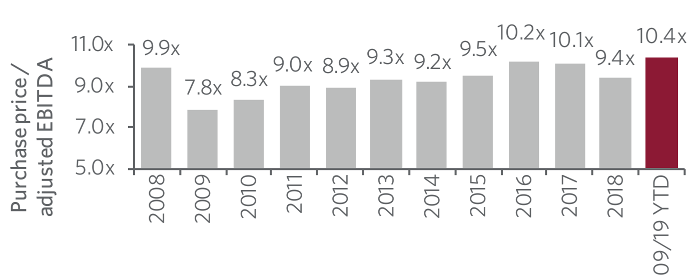
Debt availability remains strong

In 2019, banks, BDCs, and finance companies continue to support private equity-backed leveraged buyouts ("LBOs") and add-on acquisitions at peak levels. The average total debt/EBITDA multiple for private equity-backed LBOs from $10 to $250 million was 4.1x through Q3 2019, according to GF Data®. The high levels of debt availability continue to be a key component of new capital structures in support of record high EBITDA valuation multiples. The two primary drivers of the high levels of available debt are coming from non-traditional lenders, such as BDCs and those that support their existing clients with higher leverage multiples in support of add-on acquisitions. Through Q3 2019, the average total debt/EBITDA multiple for transactions supported by BDCs and provided by lenders in support of add-on acquisitions was 5.2x EBITDA, which is 1.1x EBITDA higher than the overall market average. These two categories are helping to offset the slight contraction of debt availability for $100 to $250 million LBOs, which is now 4.6x EBITDA, compared to the record level of 5.0x average total debt/EBITDA multiple achieved in 2017 and 2018.

LBO valuation multiples remain strong for non-cyclical industries

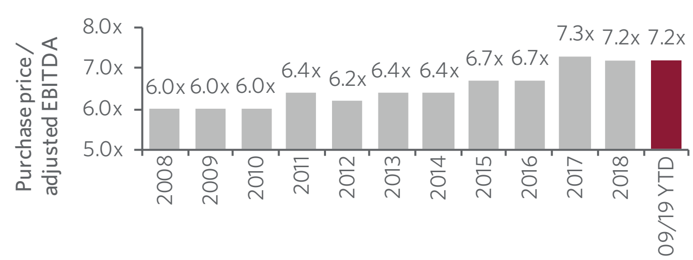
According to GF Data®, average enterprise value/EBITDA multiples for $10 to $250 million enterprise value LBOs averaged 7.2x EBITDA for the first three quarters of 2019. However, near the end of 2019, two trends have emerged that we believe are correlated. The first is the 1.4x EBITDA decline of LBO transaction multiples in the $50 to $100 million transaction segment, when compared to the peak average EBITDA multiple of 8.9x achieved for transactions of this size in 2018. The second is the companies operating in cyclical industries that receive more modest LTM valuation multiples. Notwithstanding concerns about the next economic downturn, there may be shared expectations between buyers and sellers that "normal" levels of profitability over a cycle are lower in relation to LTM EBITDA than they have been earlier in the cycle. Buyers may be less willing to believe in growth, and sellers more anxious to exit. Through Q3 2019, average EBITDA multiples for manufacturing companies in the $50 to $100 transaction segment, which tends to be influenced more than other sectors by a recession, are averaging 7.2x EBITDA, a 1.2x EBITDA lower than the 2018 average of 8.4x EBITDA. While the late cycle trend of lower valuation multiples is not unprecedented, the lack of economic indicators pointing to an impending downturn makes the decline potentially premature. It will be interesting to monitor the trends to determine if a successful M&A process for cyclical businesses continues to be defined by liquidity at a low LTM multiple today rather than waiting for greener pastures in the next economic cycle.

U.S. M&A transaction multiples



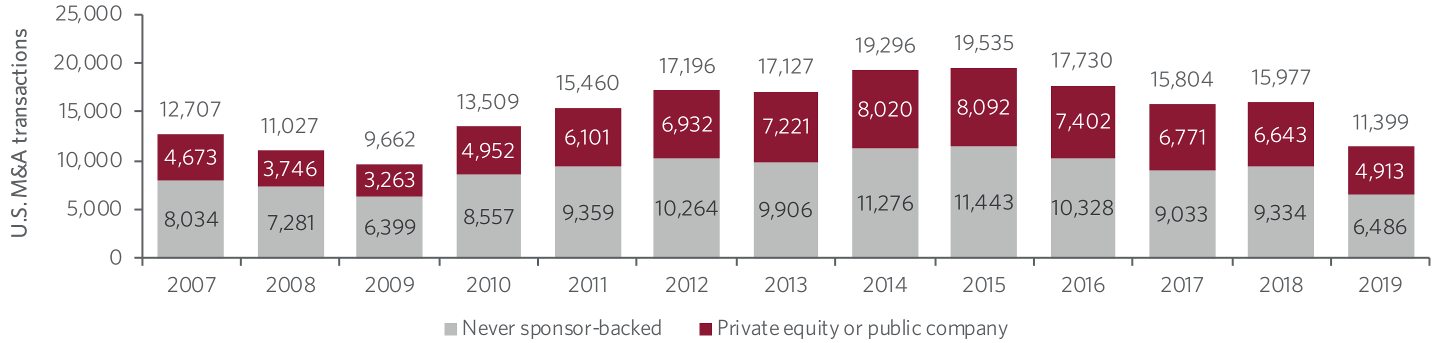
Source: PitchBook.

Average purchase price/adjusted EBITDA multiples for private equity-backed LBOs with $10mm – $250mm of enterprise value



Source: GF Data®.

Historical trend of private equity and public company sellers and entrepreneurs



Source: CapitalIQ.

Do elections influence seller behavior?

With the United States reaching another election year in 2020 we decided to analyze the composition of historical seller types to determine if we could draw conclusions on how specific external factors with known timing, such as Presidential elections, influenced their behavior. Practically every M&A transaction is influenced by multiple economic and geopolitical facts and uncertainties that buyers and sellers take into consideration to determine whether or not to submit an indication of interest or a letter of intent for a deal. The question we are attempting to address today is: Do sellers behave differently based on the tax, trade, and foreign policies of the presumed winner of a Presidential election? More importantly, does the data reveal any "tells" as it relates to how political policies influence private equity, corporate, and entrepreneur seller behavior either before or after an election? As we analyze the seller trends around the last three Presidential elections, the data does not highlight any overwhelming trends of private equity/corporate or entrepreneur sellers accelerating or deferring a sale process based on the sole fact that it was an election year. Here is a quick overview of the data findings by year.

2008 Election – The election was focused on "Hope" and a search for a President to lead the country out of the economic recession. From 2007 to 2009, deal volume declined 24.0%, which is not a surprise considering that the U.S. economy was in the midst of the greatest recession that we have experienced in our lifetime. One interesting statistic in the data of 2008 and 2009 is that entrepreneur sellers represented 66.0% and 66.2%, respectively, of the seller mix. These two years represent the years with the highest mix of entrepreneur sellers in the last 12+ years. However, the data does not tell us if entrepreneurs were forced to sell because of economic hardship or if the recession influenced them. In contrast, private equity/corporate sellers tended to hold and wait for the economic rebound.

2012 Election – We expected to see a pretty significant increase in deal volume in 2012 as sellers tried to sell in advance of the tax law changes that were enacted after the election. However, we only saw a 9.7% increase in entrepreneur sellers and a 13.6% increase in PE/corporate sellers from 2011 to 2012 similar to the increased deal volume from 2010 to 2011. In 2013, the "talk" within the deal community was focused on the "pull forward" of deals into 2012 and the big deal lull in Q1 2013. The transaction volume for entrepreneurs tends to support this in 2013 based on the 3.5% decline in deal volume. In contrast, 2013 deal volume for PE/corporate's was up a modest 4.2%, showing that market conditions and company performance may outweigh tax law changes for professional investors.

2016 Election – After the 2016 election we saw a meaningful decline in deal volume. From 2015 to 2017, deal volume declined 19.1% while tax rates were lowered, the economy was stable, debt availability increased, and EBITDA purchase price multiples shot up. Nevertheless an uptick in deal volume did not occur. Uncertainty, brought about by potential and then announced changes in foreign trade policies and tariffs, may have influenced the decline in both buyers and sellers in certain end markets. Most buyers, sellers, and lenders are capable of making investment decisions when they can probability weight a forecast, whether it projects growth or contraction. However, it is very challenging to probability weight a forecast, making it hard for all parties to proceed with a M&A transaction when buyer, seller, and lender cannot determine if certain material costs could increase 10%, 25%, or 35% for a day, a month or a year. As a result,M&A transactions tend to stall during periods of uncertainty.

Over the decades, we have heard sellers say during election year pitches they want assurances that the deal process will lead to a successful close in advance of the election. However, based on the data, it appears that the outcome of Presidential elections is less influential on a seller's decision to sell when compared to the overall performance of the economy, their business, or the influence of personal goals, ambitions, or corporate strategies at a specific point in time.

Firm overview

CIBC Cleary Gull is a nationally recognized boutique investment banking firm with a global reach. We advise private equity funds, entrepreneurs, and small publicly traded companies on mergers and acquisitions, private debt and equity financings and recapitalizations and other transactions.

Our talented team has completed hundreds of middle market transactions delivering more than $8 billion in value. With an average of more than 20 years of deal experience, our skilled senior investment bankers bring knowledge, integrity and relentless determination to deliver great outcomes for our clients.

Global reach

CIBC Cleary Gull is a member of the International Association of Investment Bankers. The IAIB (iaib.org) is a global network of investment banking firms in Asia, Australia, Europe, and North and South America working together to broaden their reach and leverage their expertise.

Contact us for more information on CIBC Cleary Gull and our Investment Banking services.

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