
M&A AND FINANCING UPDATE 4th QUARTER 2018

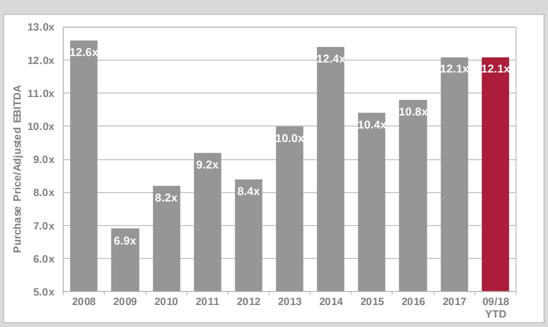
# Valuation Multiples Sending Mixed Signals

The wave of rising valuation multiples may finally have reached its crest at a lofty average enterprise value/EBITDA multiple of 12.1x for all 2018 reported transactions in the U.S. through September, according to PitchBook. GF Data® reports the average enterprise value/EBITDA multiples paid in private equity-backed leveraged buyouts from $10 to $250 million ("LBOs") during the first three quarters of 2018 declined slightly to 7.1x compared to 7.3x in 2017. Still, at 7.1x, the average YTD 2018 enterprise value/EBITDA multiples from LBOs is approximately 10% above the long term (15 year) average. As is frequently the case, some important details are embedded in and concealed by the averages. For example, size matters as much as ever. During 2018, businesses sold in LBOs that were valued at $50 to $250 million traded at an average EBITDA multiple of 9.3x, an all-time high of 3.1x above the 6.2x average for $10 to $50 million companies sold in LBOs during the same period.

Quality also matters. GF Data® breaks out transaction multiples separately for companies with outstanding financial performance, which they define as having both EBITDA margins and TTM revenue growth above 10%, or one metric above 12% and the other above 8%. Using this definition, GF Data® calculated a 24% "quality premium" in the LBO enterprise value multiple for these high-performing companies as compared to all others.

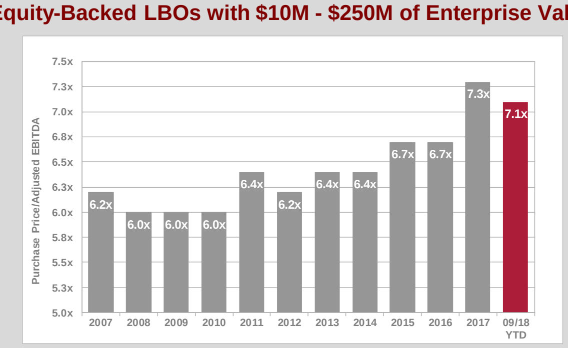
As we approach 2019, it will be interesting to see if purchase price multiples have truly crested, or if the plethora of "dry powder" in PE coffers will continue to fuel high valuations.

**U.S. M&A Transaction Multiples**



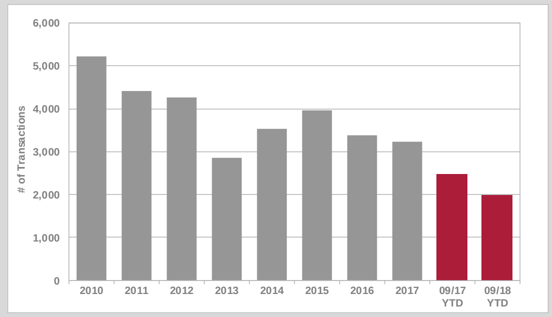

Source: PitchBook

**Average Purchase Price/Adjusted EBITDA Multiples for Private Equity-Backed LBOs with $10M - $250M of Enterprise Value**




Source: GF Data®

## *High purchase price multiples are not enticing potential sellers into the market*




Source: Robert W. Baird & Co.

### Transaction Volume Remains Low

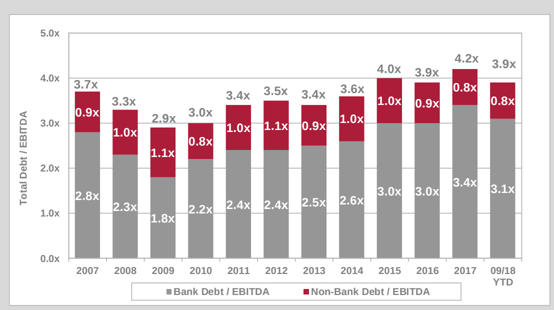
The current monthly and annual trend of declining deal volume will eventually reverse course, but probably not in 2018. Through September, the number of completed transactions under $500 million fell 19.8%, compared to the first nine months of 2017, according to Robert W. Baird & Co., with the decline accelerating into the 3rd quarter ("Q3") of 2018. There are a variety of sector-specific factors influencing the lower deal volume in specific industries. However, the only overarching factor touching every sector seems to be the increasingly widespread sense that we are in the later stages of an economic expansion. The growing list of general economic factors influencing future uncertainty includes: tariffs, the prospect for political gridlock due to the mid-term elections, interest rates, taxes, inflation, employment, equity markets, and foreign markets. If the uncertainty surrounding these factors continues, it will not be a surprise to see deal volume sag again in 2019.

### Debt Availability Remains Strong, but LBO Buyers are Choosing Lower Leverage

The average total debt/EBITDA multiple for $10 to $250 million enterprise value LBOs was 3.9x year-to-date through Q3 2018, a decline from 4.2x EBITDA in 2017, according to GF Data®. Earlier this year, the Market Monitor noted that lenders were beginning to reduce available debt levels for $10 to $50 million platform deals. As we analyzed the Q3 2018 data, it now appears that private equity firms have absorbed some of the lenders' conservatism and are now funding deals with more equity and less debt. In Q3 2018, equity accounted for 50.7% of the capital structure in the average LBO compared to 43.5% in Q3 2017, a 16.6% increase in just a year's time that is particularly significant during a period of economic expansion. During this same period, private equity groups acquiring companies in the $50 to $100 million enterprise value range increased their equity contribution percentage to 54.2%, and over 54% of private equity groups reported funding their deals with less than maximum available debt levels. Are these signs that buyers expect a recession will occur during their hold period for new investments?

## *54% of PE deals in Q3 2018 used less than the maximum available leverage to support their LBOs*

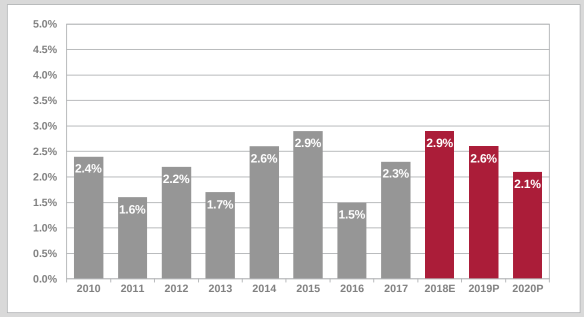
**Average LBO Debt Multiples for Deals with $10M - $250M of Enterprise Value**




Source: GF Data®


# U.S. economy remains resilient

**Real U.S. GDP**




Source: Wells Fargo Securities

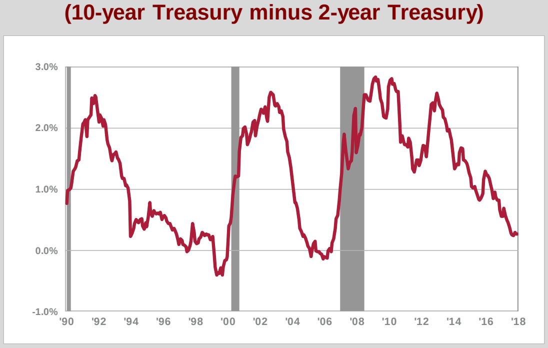
## U.S. Economy Remains Strong Well Into its Current Expansion

As we near the modern day record (just shy of ten years) with the length of the current U.S. economic expansion, the bandwagon predicting the end of the current bull run by U.S. economy is beginning to fill as more and more economists are commenting about indicators that have yet to turn but might or could – based on some current or future event. Since 1949, there has only been one economic expansion that lasted longer than the one we are experiencing now – over 1991 to 2000 – which ended with the crash of the Internet Bubble. When the music stops and the current economic expansion ends, at least one economist will be able to say, "I told you so."

Some pessimists are calling for an economic downturn in the general U.S. economy in the second half of 2019, pointing to declines in housing permits, housing starts, and nondefense capital goods new orders, while expressing concern that retail sales could disappoint this season – based on the "Google Interest" leading indicator and the yield curve could invert (see chart below), as it has before every U.S. recession in the past 60 years. While not all economists are pessimistic about 2019, many are forecasting some sort of a correction between 2020 and 2022.

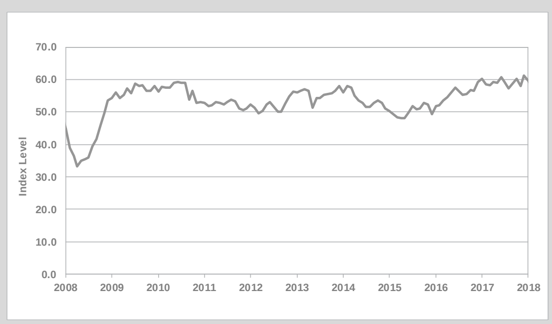
In spite of economists posturing to call the next economic downturn (after the consensus failed to predict the downturn in 2009), the economy continues to show some signs of strengths. Currently, there are at least two indicators shining in the face of growing adversity. GDP grew 4.2% in Q2 2018 and 3.4% in Q3 2018, which was the fastest since 2014. Wells Fargo is forecasting GDP in Q4 2018 to grow at 2.2% and to continue at this slower rate into 2019 and 2020. The PMI also remains high, growing to 59.3 in November, which was slightly higher than the 58.2 average for YTD 2018. The current outlook for the PMI remains strong for the coming months, although labor shortages and tariffs could change this positive outlook.

**Yield Curve**
**(10-year Treasury minus 2-year Treasury)**

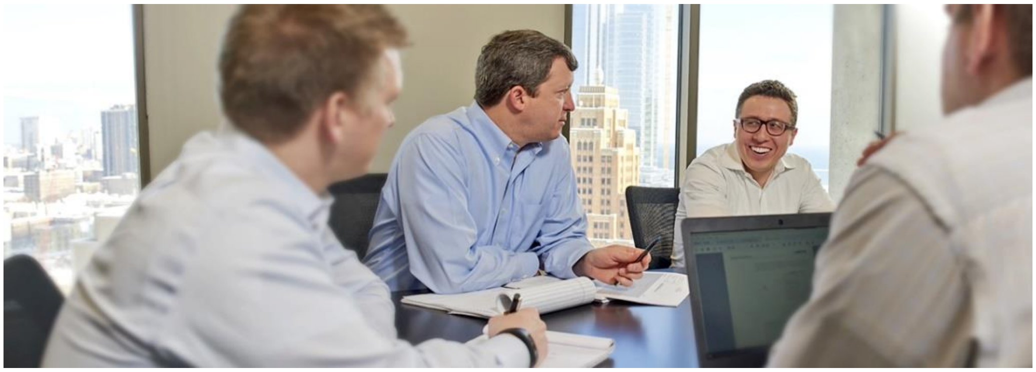



Source: Federal Reserve Bank of St. Louis

**Purchasing Managers' Index**




Source: Institute for Supply Management



IAIB

International Association of Investment Bankers

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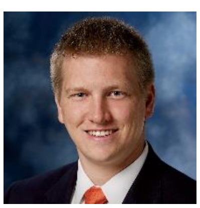

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