

Middle Market Private Equity M&A Activity - Q3 2018

Lifting off the Gas Pedal

Executive Summary

Average Valuations are Slightly Down

The aggregate EV/EBITDA multiple of 7.3x for Q3 2018 is in line with the multiples observed over the last few quarters, but valuations have tapered off compared to the 7.5-8.0x seen in the latter half of 2017.

Leaning Towards Conservatism

It appears that private equity firms are preferring to use less debt in their acquisition efforts. Despite plenty of capital available in the leveraged finance market, total debt/EBITDA has decreased, and the percentage of deals using less than the maximum amount of leverage allowed is rising.

Headwinds for Sectors

Trying to Stay "In Favor"

Technology and health care were once again leaders in terms of highest average valuations, but their multiples in 2018 are lower compared to last year.

Also of note is the media & telecom sector. This industry had an average EV/EBITDA multiple of 8.2x in 2017 (second highest among all sectors) but sharply fell to just 5.0x in 2018 (lowest among all sectors).

Based on our review of GF Data's latest M&A Report, Q3 2018 was a mixed bag of indicators for the private equity transaction arena. 63 transactions were reported by more than 200 private equity firms in the quarter. This is an increase over the 47 transactions reported last quarter and the 53 transactions reported in Q3 a year ago. However, total transactions are slightly down from the 71 and 67 that were reported in Q4 2017 and Q1 2018, respectively. Just 177 transactions have been reported for 2018 thus far, so we will need to see a slightly faster pace if we are to keep up with 249 transactions reported last year.

We also note that multiples, in terms of total enterprise value (EV) to EBITDA, were slightly down. While two sectors reported higher multiples in Q3 than in Q2, most sectors declined. In aggregate, EV/EBITDA multiples averaged 7.3x for Q3 2018. This is down from 7.4x last quarter, 7.5x in the same quarter last year, and a high of 8.0x observed in Q4 2017. Not surprisingly, targets with larger enterprise values were acquired at higher multiples. In Q3, companies with enterprise values in the ranges of both \$50-100M and \$100-250M were acquired at 8.6x EBITDA, whereas companies in the \$10-25M range were acquired at 5.8x EBITDA and \$25-50M companies were acquired at 7.1x EBITDA.

EV / EBITDA Multiples					
Total EV (\$M)	2014	2015	2016	2017	YTD 2018
10 - 25	5.5	5.9	5.8	6.3	5.8
25 - 50	6.4	6.6	6.4	6.6	6.8
50 - 100	7.6	7.8	7.2	8.2	8.9
100 - 250	7.5	9.0	8.9	9.1	8.5
Avg.	6.4	6.7	6.7	7.3	7.1
N	213	244	233	249	177

Source: GF Data

Industry Analysis

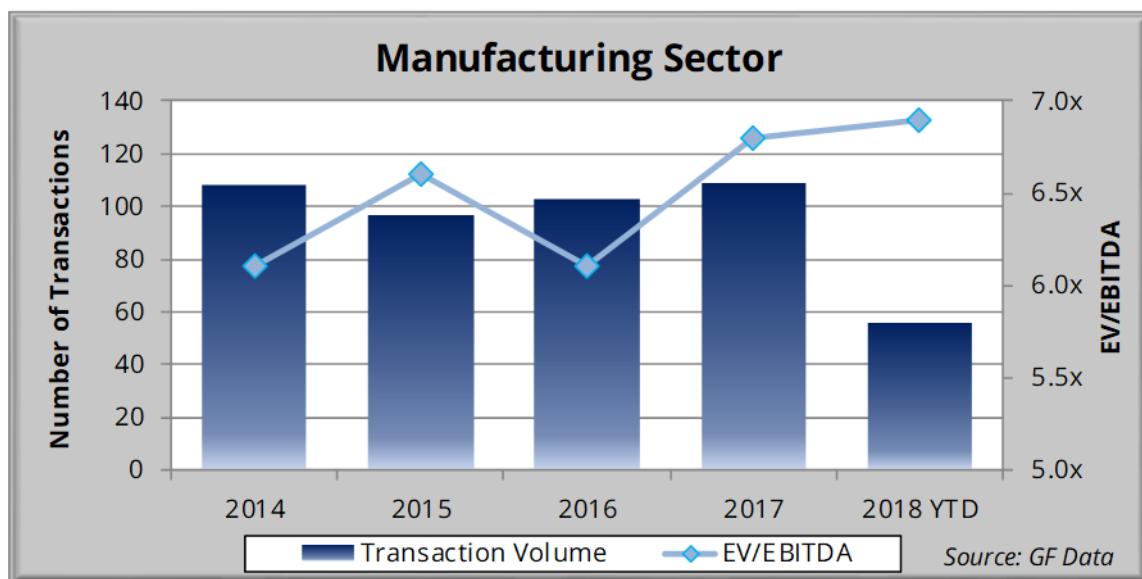
To get a better understanding of the mixed M&A trends, we took a deeper dive into the report and analyzed the various industry classifications of the acquisition targets.

EV / EBITDA Multiples					
Industry	2014	2015	2016	2017	YTD 2018
Manufacturing	6.1	6.6	6.1	6.8	6.9
Business Services	6.1	6.4	7.3	7.4	7.0
Health Care Services	7.2	7.8	7.6	8.1	7.5
Retail	6.0	5.5	7.0	7.6	6.7
Distribution	7.2	6.7	7.5	7.7	7.0
Media & Telecom	-	6.4	6.6	8.2	5.0
Technology	7.7	8.0	7.4	10.2	9.8
Other	6.6	5.6	6.9	6.5	6.9

Source: GF Data

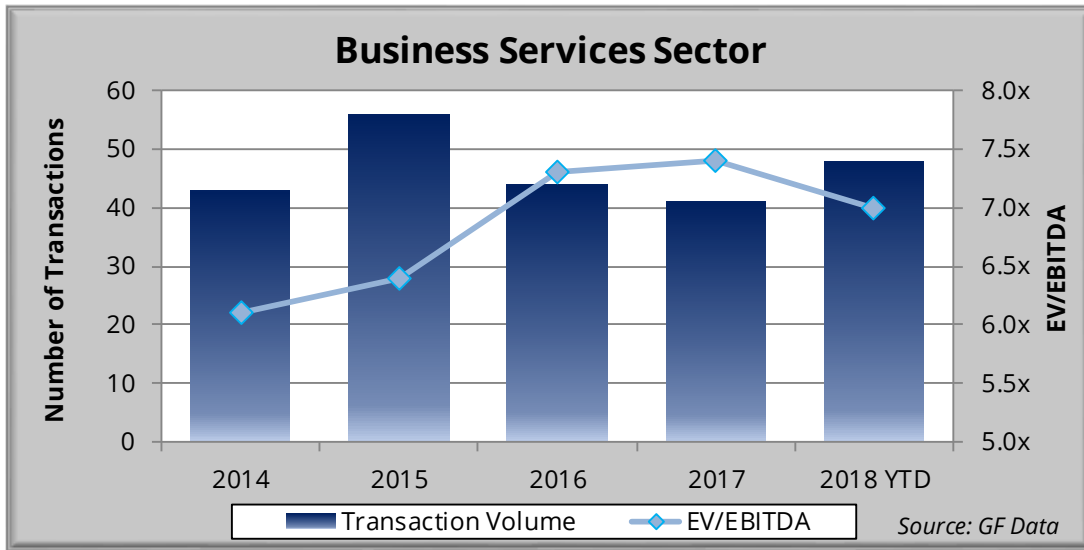
Manufacturing

Manufacturing valuations have largely hovered in the low-to-mid 6x range since 2014, although they have trended upwards in the past two years. Recent EV/EBITDA multiples observed include 6.8x in 2017 and 6.9x in 2018. This is in comparison to an average of just 6.3x from 2014 to 2016. However, there has been an apparent drop in recent deal volume. Only 56 transactions have been reported in 2018 thus far, compared to an average of over 100 from 2014 to 2017. Time will tell if Q4 activity will pick up and get manufacturing M&A volume back to historical levels.



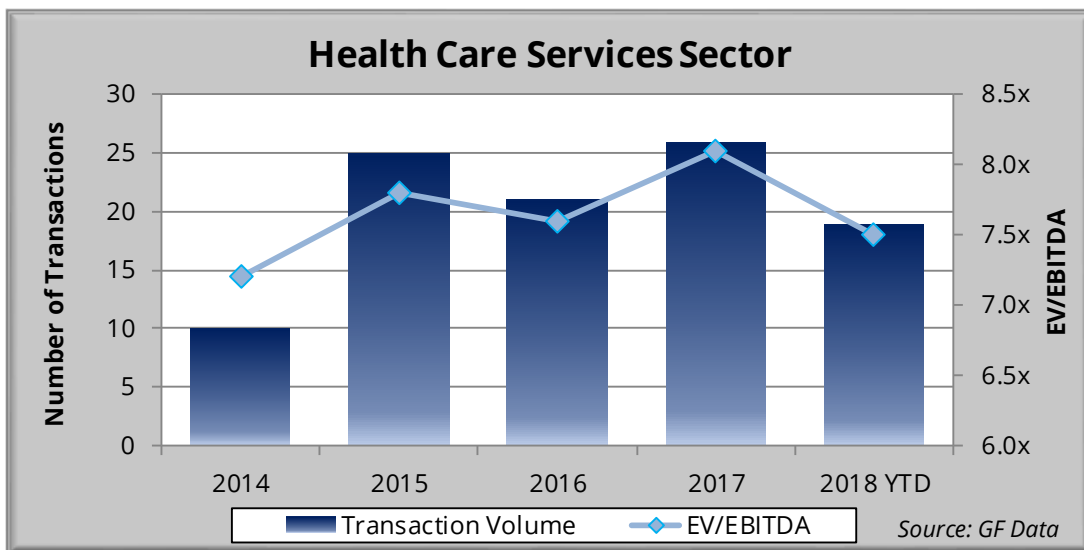
Business Services

While the average EV/EBITDA multiple of 7.0x for 2018 dipped slightly compared to the 7.3x in 2016 and 7.4x in 2017, EV/EBITDA multiples for the business services sector are still higher than their 2014 to 2017 average of 6.8x. As another positive, volume is up for this sector in 2018 with 48 transactions already reported through just three quarters compared to only 44 and 41 in each of the previous two years.



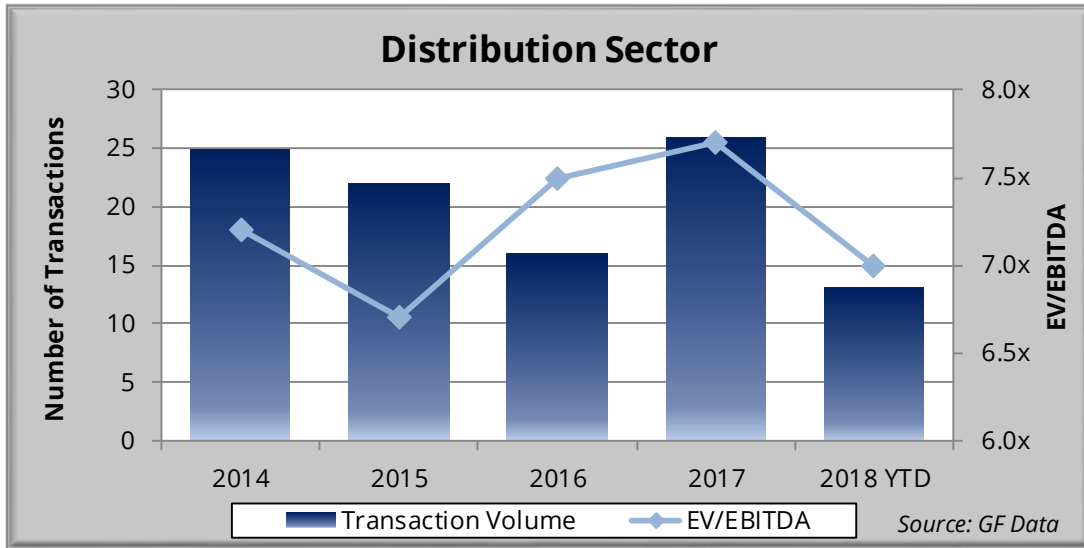
Health Care Services

Both M&A multiples and volume are down for the health care sector. EV/EBITDA multiples have averaged just 7.5x so far in 2018. This is lower than the 7.8x, 7.6x, and 8.1x multiples observed in the last three years. Volume is also down, with just 19 reported transactions in 2018 thus far compared to an average of 24 over the past three years. However, if Q4 can keep the same pace as the first three quarters, 2018 could finish in line with average volume.



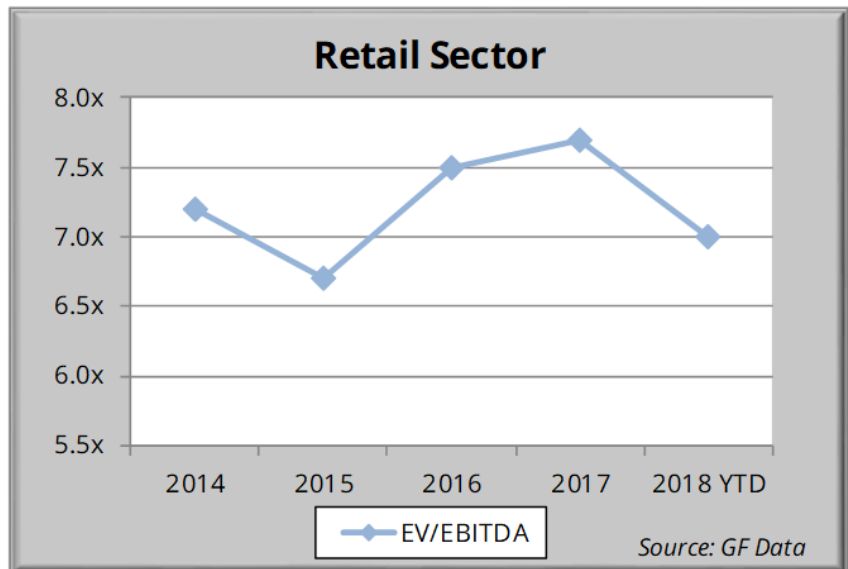
Distribution

As of now, 2018 appears to be a lackluster year for M&A activity within the distribution industry. The average EV/EBITDA multiple of 7.0x so far in 2018 is moderately lower than the 7.5x and 7.7x seen in 2016 and 2017, respectively. Volume is also down thus far, with just 13 transactions reported in 2018 compared to twice as many (26) reported last year. We still have one more quarter of data to digest, but with multiples and volume both appearing lower, we won't be holding our breath for any magic in the distribution sector in 2018.



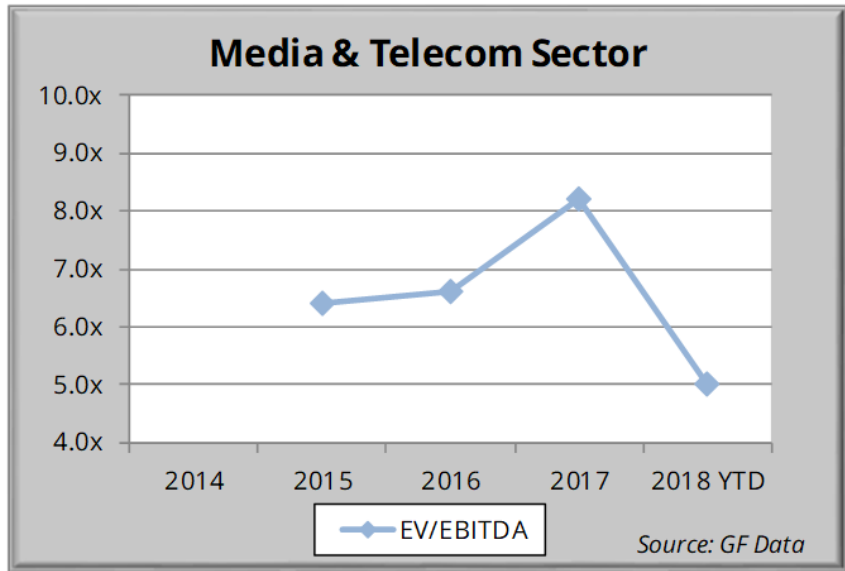
Retail

Retail showed signs of recovering with EV/EBITDA multiples of 7.0x and 7.6x in 2016 and 2017, respectively. However, multiples have dropped to just 6.7x thus far in 2018. On a positive note though, this is still higher than the EV/EBITDA multiples of 6.0x in 2015 and 5.5x in 2016. Retail will be a key industry to watch regarding growth for the overall economy.



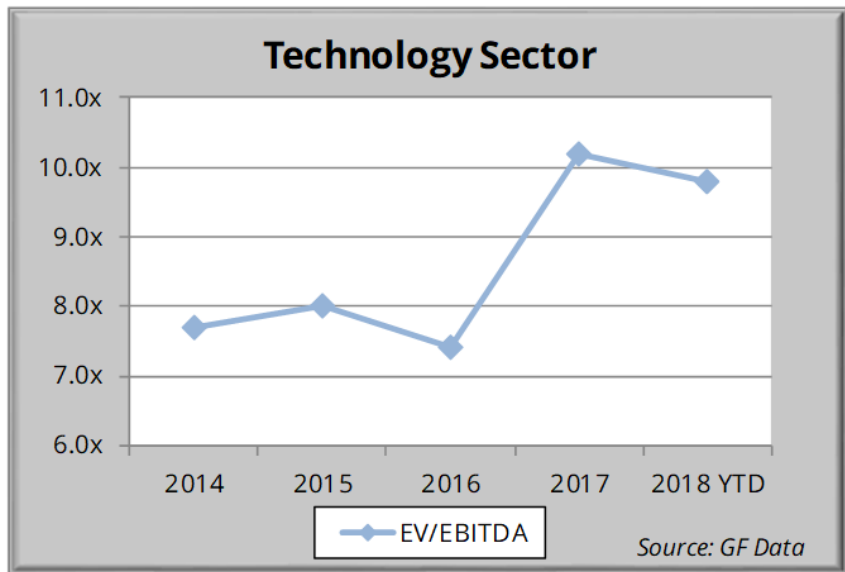
Media & Telecom

At first glance, the media & telecom sector had a significant drop in its average EV/EBITDA multiple. However, a closer look reveals that the average multiple of 8.2x for 2017 was largely inflated compared to the sector's average EV/EBITDA multiple of 6.5x for 2015 and 2016. This perhaps could have been influenced by numerous large mergers in the industry including Disney and Fox, AT&T and Time Warner, and others.



Technology

From 2014 to 2016, technology EV/EBITDA multiples averaged a respectable 7.7x. Multiples then rocketed to an average of 10.2x in 2017. It appears that this was not an anomaly as 2018 multiples have averaged 9.8x through Q3. As "fin-tech", cyber security, and data analytics continue to grow in popularity, we expect technology multiples to finish 2018 on a strong note and remain elevated into 2019.



Information in this article is based on the GF Data November MA Report dated November 19, 2018. GF Data provides private equity sponsored merger and acquisition information for middle market companies with enterprise values between \$10M - \$250M.

About ValueScope

ValueScope is a leading firm specializing in valuations for a variety of transaction advisory, litigation, and financial reporting purposes.

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