MARCH 2018

Perspectives

VIEWS ON INDUSTRY TRENDS AND NEWS

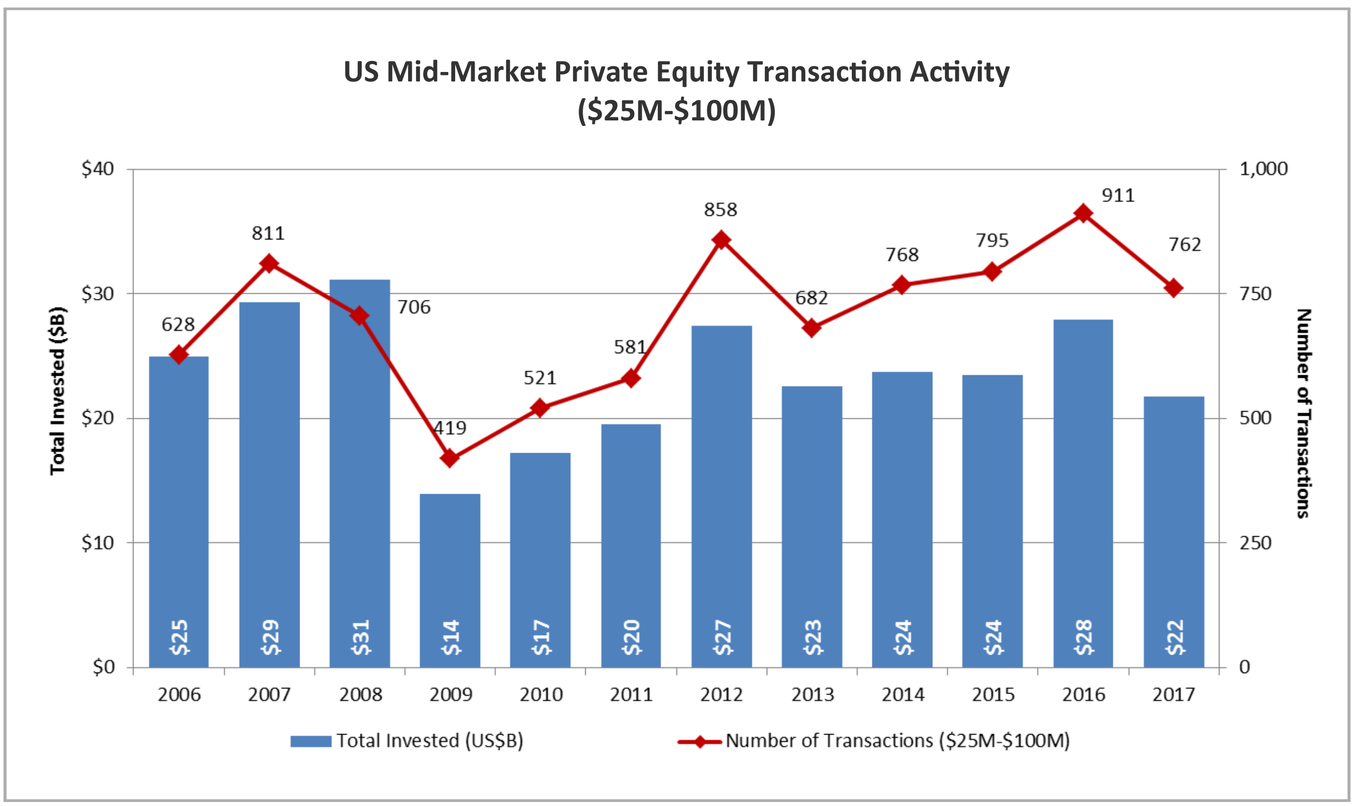
SPOTLIGHT ON PRIVATE EQUITY

Private Equity in the Mid-Market

"The more things change, the more they stay the same." - *Jean-Baptiste Alphonse Karr*

Queue the broken record….in our last three *Perspectives* newsletters dating back to 2015, we have highlighted that both valuation and leverage multiples for middle-market North American private equity transactions have approached or exceeded the highs from the period leading up to the 2008 financial crisis. This trend continued unabated in 2017 and has left us wondering what event or series of events will eventually cause the music to stop.

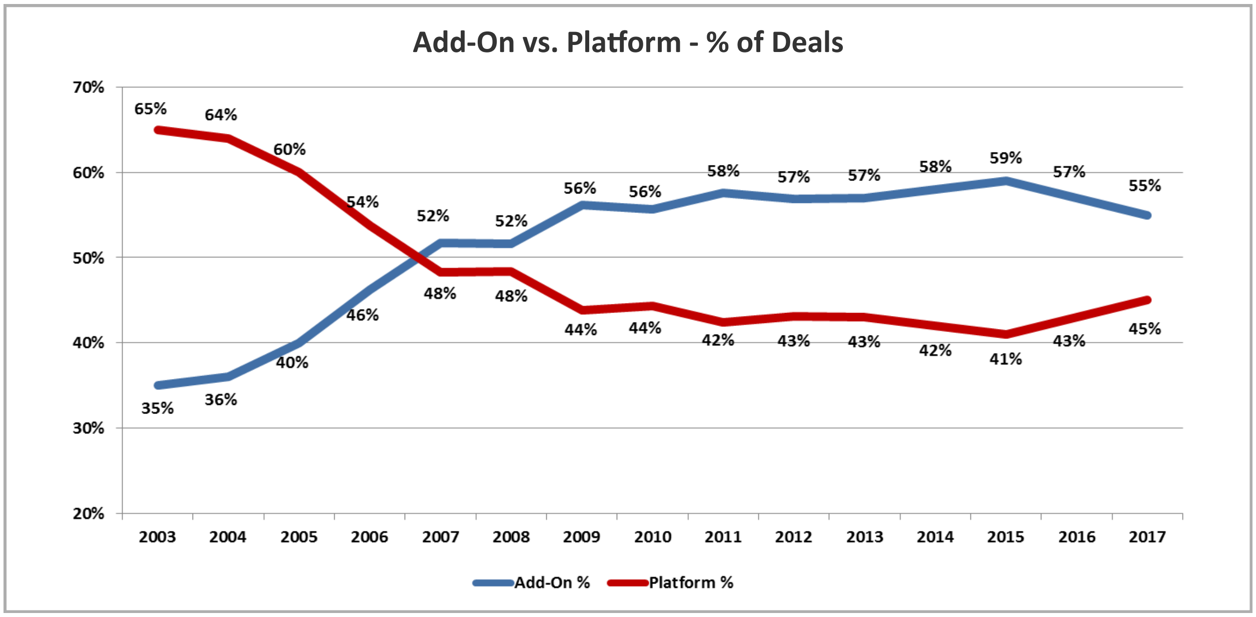
Lofty valuations appear to have had a material impact on the pace of deals in the lower middle-market (TEV $25 million to $100 million), with total PE activity declining in 2017 by 16% year over year to 762 transactions and aggregate deal value also declining 21% to $22 billion, according to Pitchbook. The mountain of dry powder in PE funds (over $550 billion) continues to grow as investors commit more capital to the asset class. When combined with the availability of cheap bank financing, it will be challenging for PE sponsors to remain on the sidelines for an extended period of time.



Source: Pitchbook

Private Equity in the Mid-Market (cont'd)

The majority of PE buy-out activity (55%) in 2017 is represented by add-on acquisitions as sponsors seek out opportunities to drive growth for their platforms and look to deploy additional capital during the relatively short lifecycles of their funds.



Source: GF Data®

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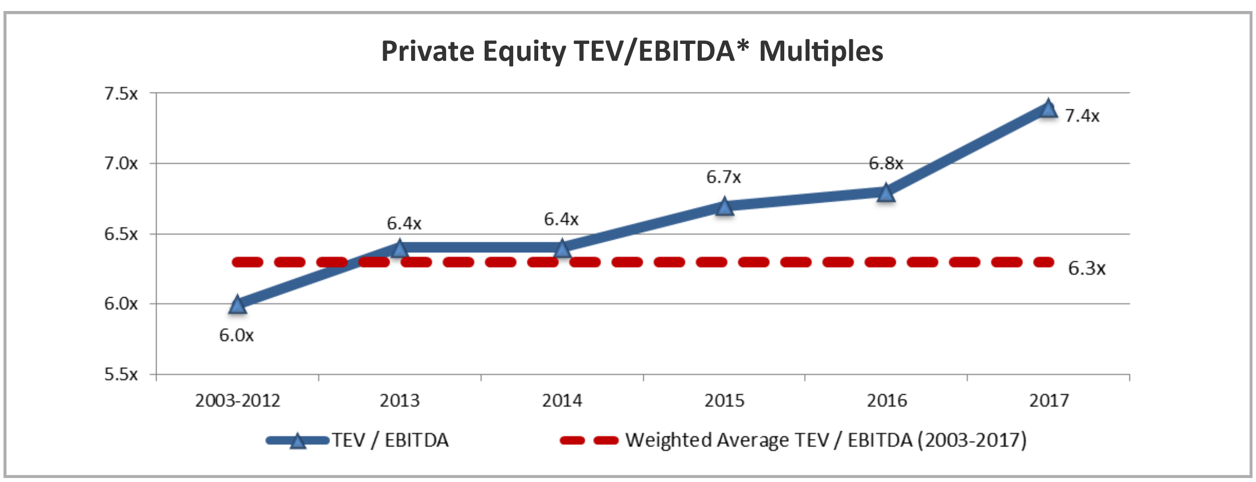
Valuations: A Seller's Market

"Too much of a good thing can be wonderful." - Mae West

Frothy market conditions continued in 2017 as valuation multiples rose further above their long term average. Average transaction multiples for the year were 7.4x EBITDA (Earnings Before Interest, Taxes, Depreciation & Amortization), up from 6.8x the prior year and well above the long term average of 6.3x.

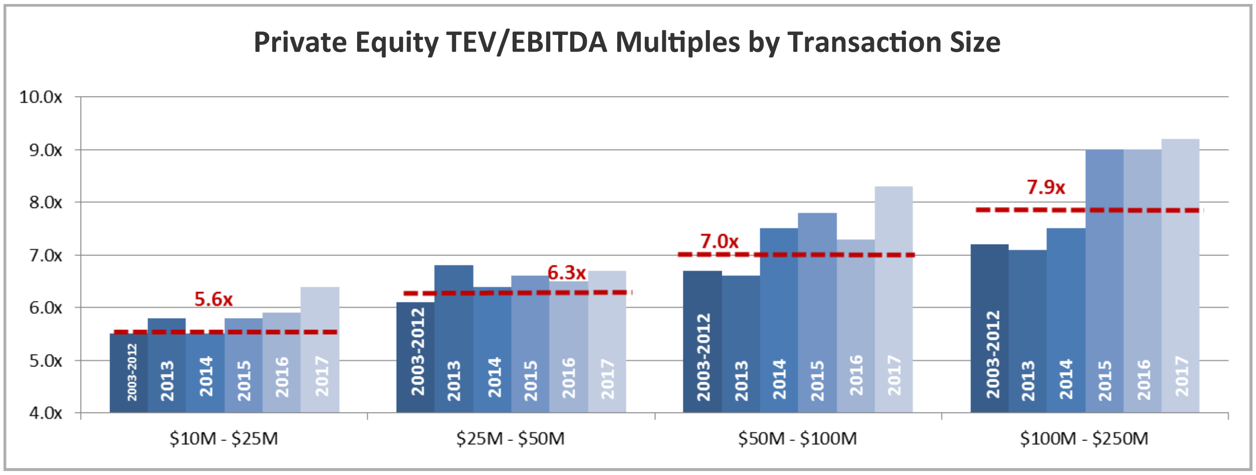


**Total enterprise value / earnings before interest, taxes, depreciation and amortization*

Source: GF Data®

Valuations: A Seller's Market (cont'd)

Breaking down the valuation multiples by transaction size, larger companies (TEV $100 million to $250 million) traded at an average of 9.2x, a 44% premium to smaller companies (TEV $10 million to $25 million) which traded at an average of 6.4x. This size premium was down from 53% in 2016 but still above the long term average of 41%.



Source: GF Data®

The size premium is the result of a number of factors that allow buyers to attribute higher valuations to larger companies:

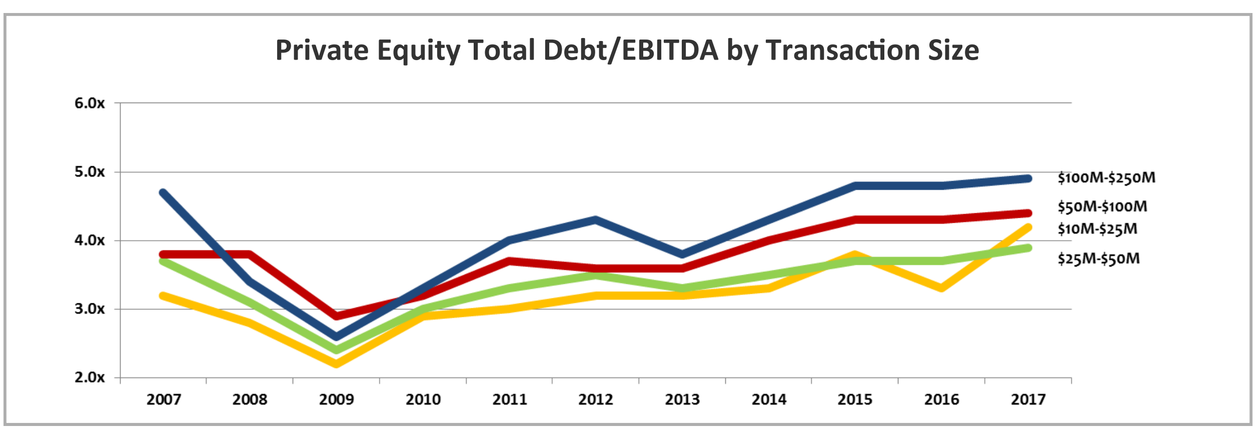
- Generally more stable and professionally managed operations
- Lower concentration risk (customers, geography, products/ services, etc.)
- A more competitive deal landscape
- Greater credit availability from lenders
- Better ability to finance and integrate future bolt-on acquisitions

For some time, private equity sponsors have been expressing frustration with how competitive the market has been for larger, more attractive properties. We have heard numerous anecdotes of PE groups participating in auction processes, submitting initial expressions of interest in excess of 10x EBITDA and not getting a management meeting.

Transaction Leverage

"History repeats itself, first as tragedy, second as farce." - Karl Marx

In 2017, we saw total debt to EBITDA multiples rise to 4.3x, up from 3.9x in 2016 and in excess of where they were pre-financial crisis in 2007. These higher debt levels have been driven by a highly competitive financing environment. Financing has been plentiful and "covenant-lite" deals are coming back into fashion as banks and private lenders are desperate to put money to work, maintain market share and achieve their growth targets. These conditions have created a positive feedback loop where higher valuations depend on increased leverage in order to maintain investment returns, and increased debt availability supports more aggressive bidding by buyers.



Source: GF Data®

Valuation by Industry Sector: Tech and Healthcare Leading the Pack

"Price is what you pay. Value is what you get." - Warren Buffet

Valuations in 2017 were above the long term averages for each industry group, including the beleaguered retail sector which is undergoing a tremendous shift from bricks and mortar business models to online and mobile platforms.

The technology sector rebounded strongly with an average multiple of 10.2x, the highest of all sectors, up from 7.4x the prior year and well above its long-term average of 7.5x. Healthcare deals averaged 8.1x, above the sector's long term average of 7.1x, as PE groups seek to back businesses that will capitalize on the aging demographic trends in North America.

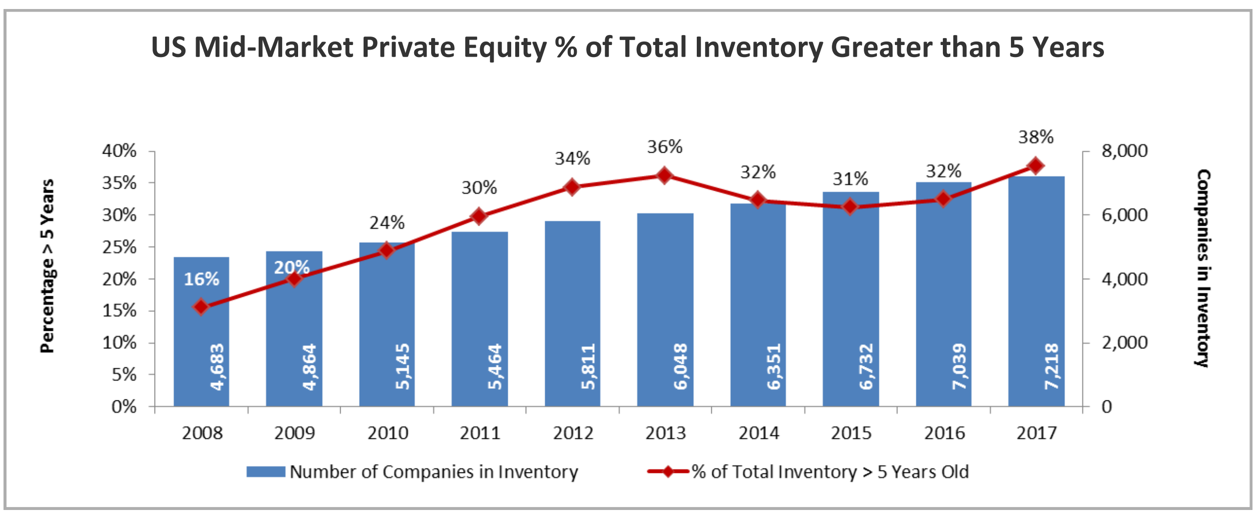
TEV/EBITDA by Industry

	2003-2012	2013	2014	2015	2016	2017	Long Run Average
Manufacturing	5.9x	5.9x	6.1x	6.6x	6.2x	6.9x	6.1x
Business Services	6.0x	6.5x	6.1x	6.3x	7.3x	7.5x	6.3x
Health Care Services	6.8x	7.2x	7.2x	7.8x	7.6x	8.1x	7.1x
Retail	6.3x	7.4x	6.0x	5.5x	7.1x	7.6x	6.5x
Distribution	6.0x	6.5x	7.1x	6.7x	7.4x	7.6x	6.4x
Media and Telecom	7.3x	5.5x	na	6.4x	6.7x	8.2x	7.2x
Technology	6.3x	9.5x	7.7x	8.0x	7.4x	10.2x	7.5x

Source: GF Data®

PE Portfolio Inventory: Which Way to the Exit?

The inventory of companies held by mid-market private equity groups edged up slightly in 2017 to approximately 7,200 companies. Interestingly, the proportion of these companies that have been held in inventory greater than 5 years reached an all-time high of 38%. This significant increase in inventory age is curious given the numerous exit opportunities available to sponsors: a receptive IPO market as well as a reasonably active corporate M&A and secondary buyout market (PE group selling to another PE group). Secondary buyouts now represent approximately 51% of exits completed by PE groups, as the inventory matures and other PE's with dry powder seek to deploy capital. One possible explanation for the aging portfolio inventory is the plentiful availability of debt financing, which allows PE's to be obtain liquidity for their LPs via dividend recaps while still retaining ownership of the portfolio companies.



Source: Pitchbook

Contributing Editor:

Richard Betsalel is a Managing Director at Crosbie & Company and has over 18 years of corporate finance and M&A advisory experience. Richard has a Bachelor of Science from McMaster University and an MBA from the Schulich School of Business.

PCMA AWARDS
PRIVATE CAPITAL
DEALS OF THE YEAR
2012, 2013, 2014 & 2015 AWARD WINNER

RECENT TRANSACTIONS

COYLE CORRUGATED CONTAINERS A privately-held packaging company and its associated interests in TenCorr Holdings and the Greenpac Mill have been sold to Cascades **SALE ADVISORY**	CHIEFS OF ONTARIO A group representing 129 First Nations in Ontario has acquired 2.4% of the shares of Hydro One Limited from the Province of Ontario hydro one **FINANCIAL ADVISORY**	kolmar Korea A KRX-listed manufacturer of cosmetics, health and pharmaceutical products has acquired CSR **ACQUISITION ADVISORY**	INUVIALUIT REGIONAL CORPORATION **Inuvialuit Regional Corporation** A company with industrial and other interests controlled by the Inuvialuit communities in the NWT has secured a $75 million senior loan facility from CIBC **FINANCING ADVISORY**

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Crosbie & Company Inc.
150 King Street West
15th Floor, P.O. Box 95
Toronto, ON M5H 1J9

Please visit our website at
www.crosbieco.com
or contact us at 416.362.7726

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