

# Perspectives

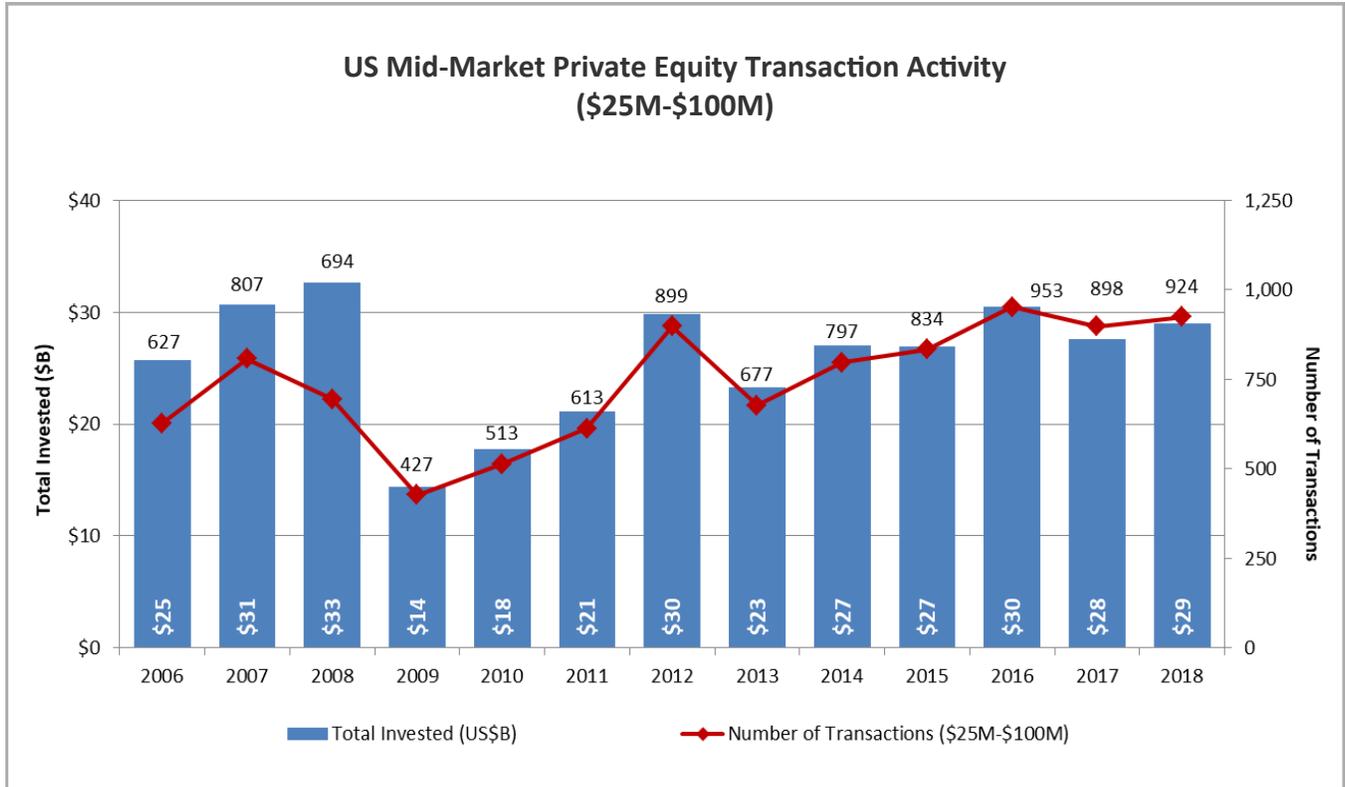
**SPOTLIGHT ON  
PRIVATE EQUITY**

VIEWS ON INDUSTRY TRENDS AND NEWS

## Private Equity in the Mid-Market

Time for a shoulder check.... In each of our last four annual Perspectives newsletters, the main themes consisted of increasing valuations and leverage, however in 2018 private equity buyers finally showed signs of restraint with valuations remaining in line with 2017 and leverage multiples decreasing. This has left us wondering whether we have reached the turning point in the extended seller's market or whether this is only a short lived pause before the next leg up in this remarkable cycle.

While private equity buyers are finally showing signs of restraint on valuation and leverage, the feverish pace of activity continues in the lower mid-market (TEV \$25 million to \$100 million) with 924 transactions and aggregate deal value of \$29 billion. This level of activity is consistent with the elevated levels of activity experienced in 2017 and 2018. In North America alone, there is more than \$1 trillion of dry powder looking for a home and the availability of cheap bank financing continue to be key drivers of deal activity.

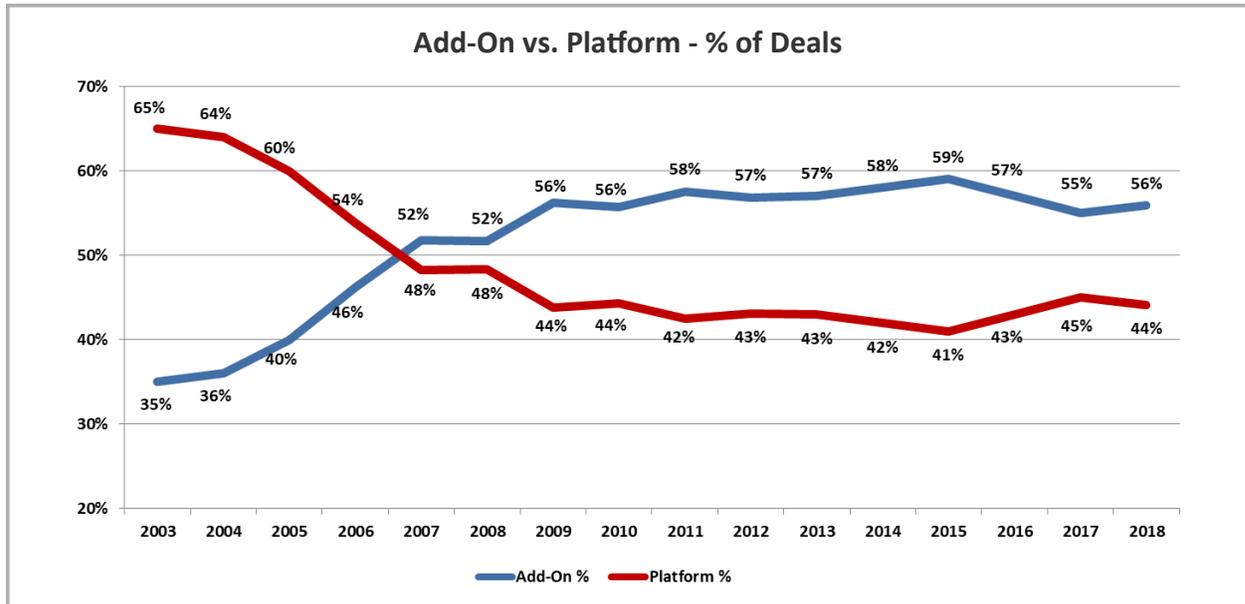


Source: Pitchbook

# Platform vs. Add-ons

In 2018, the mix of deals between new platform investments and add-on deals remained in line with recent years. Add-on transactions represented 56% of PE acquisitions, indicating that many

private equity firms are pursuing acquisition strategies to drive the growth of their platform companies.

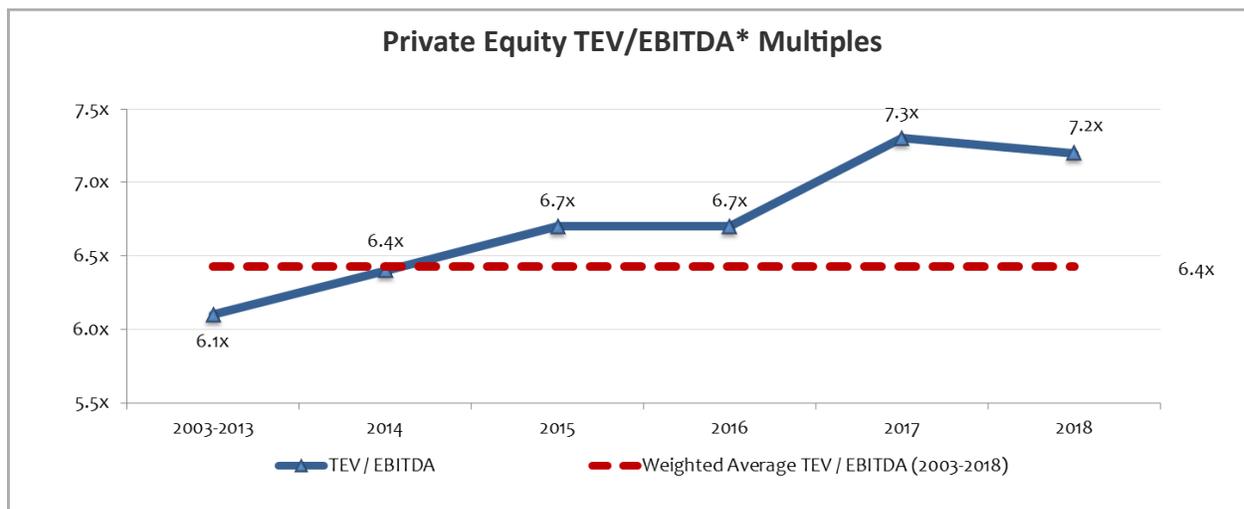


Source: Pitchbook

# Valuations: No End to the Seller's Market

The multi-year trend of increasing valuation multiples paused in 2018 with the average mid-market TEV/EBITDA multiple of 7.2x essentially unchanged from 7.3x in 2017. While this pause is

noteworthy, the 2018 average multiple remains well above the long term average of 6.4x which indicates that market conditions are still very favourable to sellers.



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

Source: GF Data®

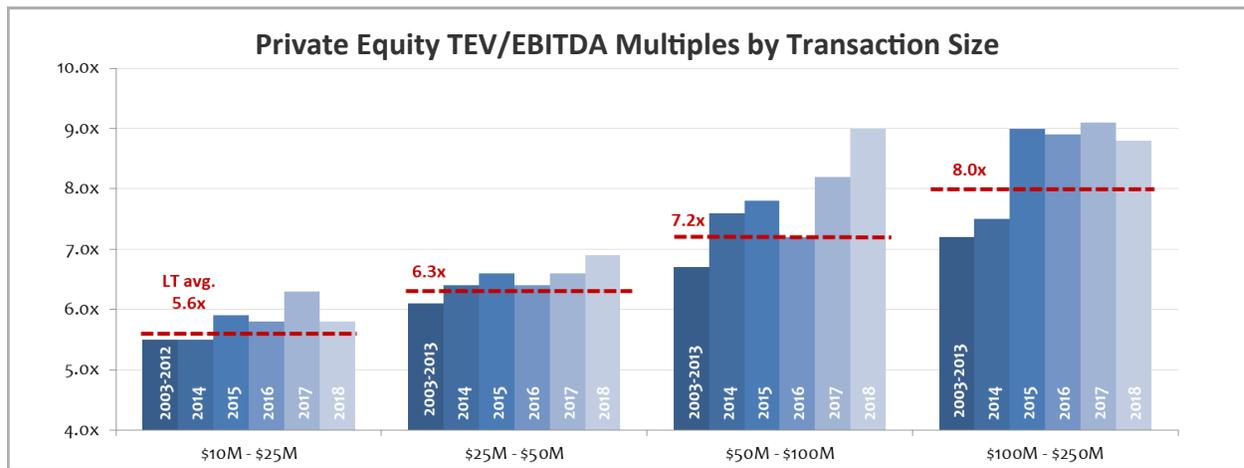
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# Valuations: Size and Quality Premiums

Breaking down the valuation multiples by transaction size, larger companies continue to trade at higher valuation multiples. However, the average transaction multiple (9.0x) in 2018 for companies in the TEV range of \$50-100M is essentially the same as the average multiple (8.8x) for those in the \$100-250M TEV range. We view this as a symptom of the ultra-competitive market for deals which is causing private equity groups to move down market and pay premium multiples for some of these smaller opportunities.

Despite the transaction size anomaly mentioned above, the overall concept of size premiums still holds true. Platform acquisitions

within the TEV range of \$50-250M transacted at an average of 9.2x EBITDA while platform acquisitions within the \$10-50M TEV range transacted at only 6.3x. This spread of 2.9x is the largest spread we have seen in recent years. The data also shows buyers often pay a premium for companies with superior financial metrics. For example, buyers pay a premium for companies that have TTM revenue and EBITDA margin growth exceeding 10%. The premium paid for these companies has historically averaged 12% but in 2018 this spread increased to 26%. It appears that private equity groups are competing aggressively for companies with above average growth and profitability.

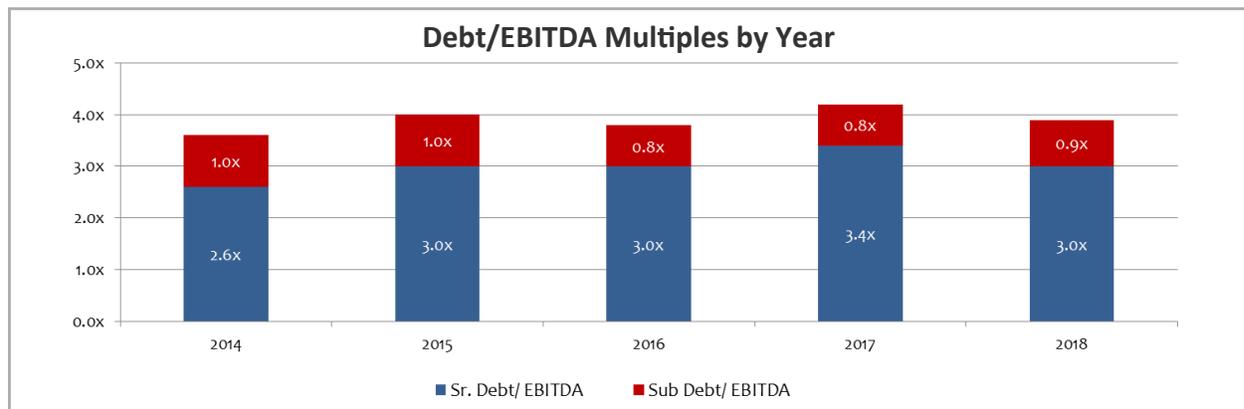


Source: GF Data®

# Leverage Analysis: Risk Tolerance Declines

Private Equity buyers have become more conservative with their financing strategies with the amount of leverage utilized in transactions declining to an average Total Debt/EBITDA multiple for 2018 transactions of 3.9x down from an average of 4.2x in 2017. Interestingly, this decline in leverage multiples appears to be a result of more conservative capitalization decisions rather than a decrease in debt availability. The percentage of deals completed with debt at or close to the maximum available debt crested at 42.3% of all deals in 2016 before declining modestly to 39.2% in 2017 and falling more

significantly to 31.3% in 2018. Meanwhile, the average maximum leverage remained largely unchanged at 4.4x in 2018 versus 4.5x in 2017. This decline in financing risk tolerance is likely a reflection of the expectation of rising interest rates that persisted for most of 2018 as well as increased concerns about a possible economic downturn. Another factor may be the limit of interest deductibility to 30% of EBITDA that came into effect in 2018 as part of US tax reform.

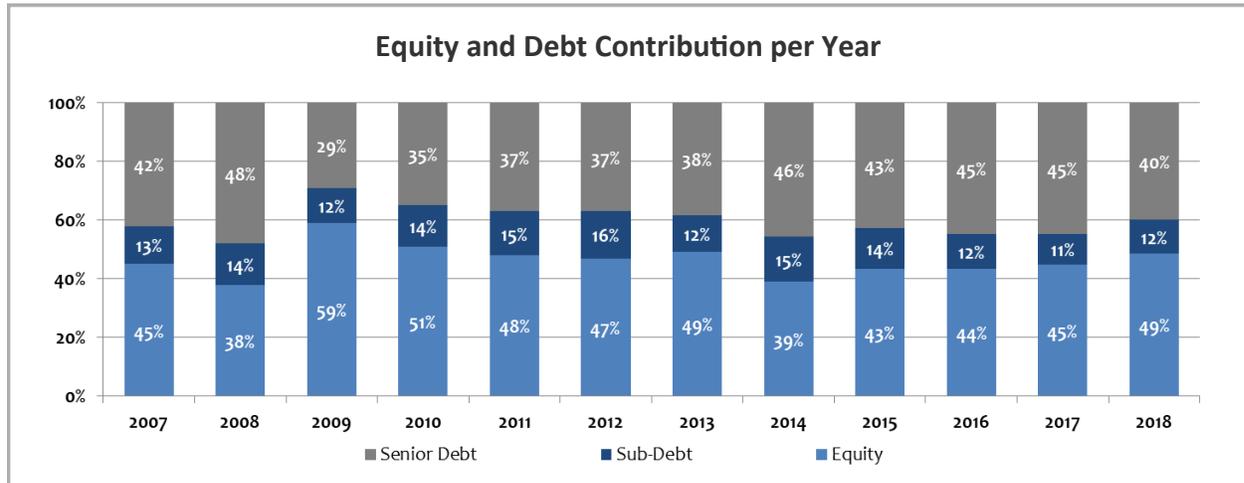


Source: GF Data®

# Leverage Analysis: Increased Equity Contributions

The following chart compares the average breakdown of capital used to finance North American mid-market private equity acquisitions. A further indication of more conservative capitalization structures for these transactions is that equity comprised nearly 49% of all

transaction value, up significantly from 45% in 2017 and well above the 39% low point of the cycle in 2014. This high proportion of equity capital is the result of continued lofty valuation multiples and lower Total Debt/EBITDA leverage multiples.



Source: GF Data®

The use of rep and warranty insurance continues to increase with 52.0% of North American mid-market private equity transactions in 2018 employing rep and warranty insurance, up from 42.9% in 2017. This is particularly the case with larger, higher valuation multiple

transactions. The average TEV/EBITDA multiple for transactions where rep and warranty insurance was employed was 7.8x versus 6.7x for transactions with no rep and warranty insurance.

# Valuation by Industry Sector: Technology and Media & Telecom Lead the Way

Valuation multiples remain above the long term averages for each of the industry sectors below. The technology and media and telecom sectors continue to post the highest average TEV/EBITDA multiples

at 9.6x and 8.6x respectively. Interestingly, five of the seven industry sectors showed declines in average valuation multiples for 2018 versus 2017.

TEV/EBITDA by Industry							
	2003-2013	2014	2015	2016	2017	2018	Long Run Avg
Manufacturing	5.9x	6.1x	6.6x	6.1x	6.8x	6.9x	6.1x
Business Services	6.1x	6.1x	6.4x	7.3x	7.4x	7.2x	6.4x
Health Care Services	6.8x	7.2x	7.8x	7.6x	8.1x	7.8x	7.2x
Retail	6.4x	6.0x	5.5x	7.0x	7.6x	7.0x	6.6x
Distribution	6.0x	7.2x	6.7x	7.5x	7.7x	7.1x	6.5x
Media and Telecom	7.2x	na	6.4x	6.6x	8.2x	8.6x	7.2x
Technology	6.6x	7.7x	8.0x	7.4x	10.2x	9.6x	7.7x

Source: GF Data®



*Contributing Editor:*

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## RECENT TRANSACTIONS



A privately-owned fast casual restaurant business has been acquired by



**SALE ADVISORY**



Canada's leading strategic health information consulting firm has been acquired by



**SALE ADVISORY**



A Canadian logistics company specializing in the transloading, storage and transportation of food grade liquids, has been acquired by



**SALE ADVISORY**



A technology, product development and engineering company, has sold its Emergency Locator Transmitter (ELT) Beacon business, the exclusive supplier to Honeywell, to



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## ABOUT CROSBIE

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