MAY 2021

Perspectives

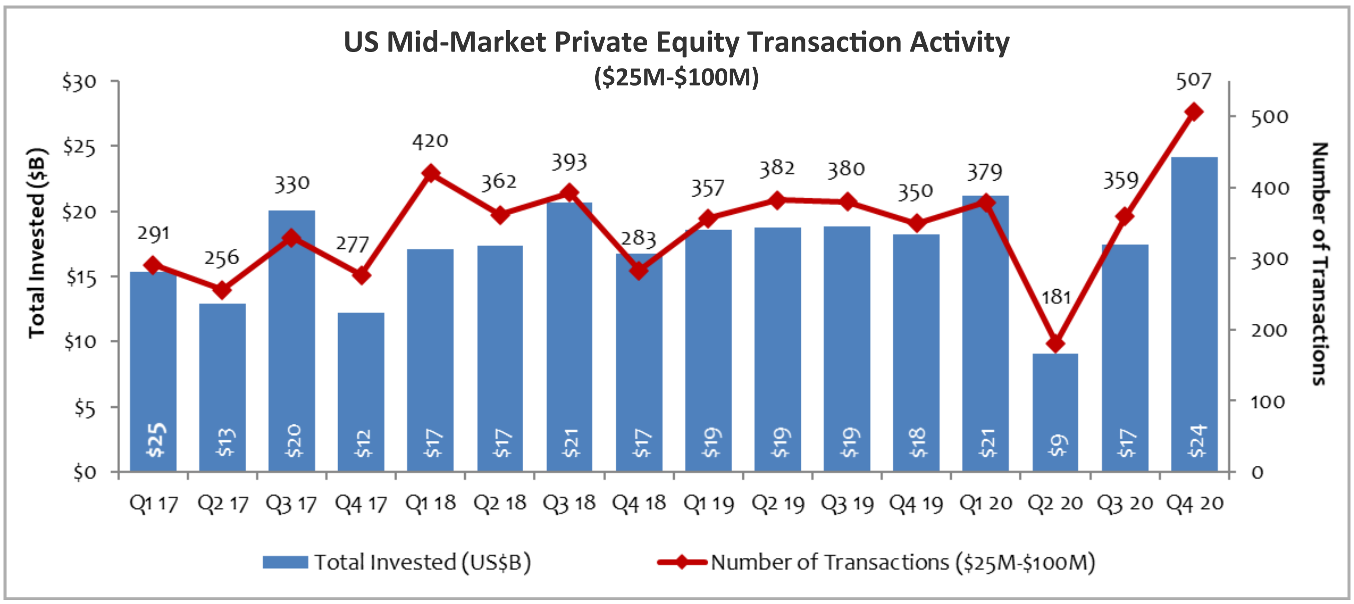
SPOTLIGHT ON PRIVATE EQUITY

VIEWS ON INDUSTRY TRENDS AND NEWS

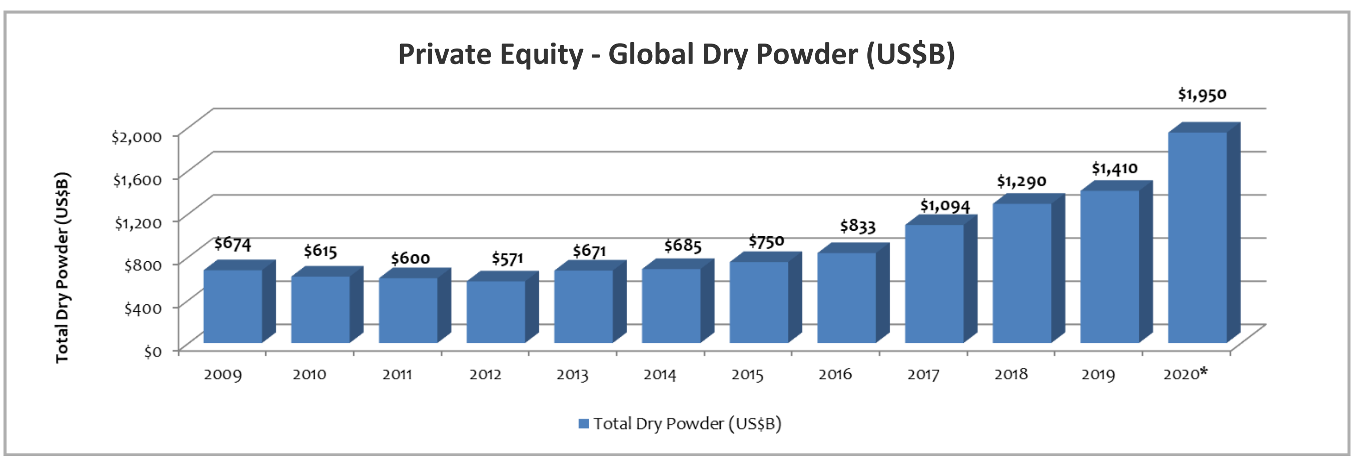
Private Equity in the Mid-Market

Last year at this time, we decided to forego our annual Perspectives newsletter as the world had just plunged into COVID-19 and private equity data from 2019 didn't seemed very relevant at the time. A year later, we now look back at a 2020 year that featured a dramatic downturn in private equity activity in the second quarter followed by a remarkable recovery in the second half of the year as deals previously put on hold came back to life and were closed. While this recovery in private equity activity varied by industry sector, demand surged for businesses that demonstrated resiliency in the face of the extraordinary demands of 2020.

As outlined in the graph below, private equity transaction activity in the lower mid-market (TEV $25 million to $100 million) dropped by roughly half in the second quarter in terms of both the number of transactions and total dollars invested but activity recovered quickly and the year ended with a record fourth quarter. Overall, there were 1,426 lower mid-market private equity transactions in 2020 with an aggregate value of $72 billion which is very much in-line with strong 2018 and 2019 activity levels. The enormous amount of dry powder ($1.95 trillion) looking for a home and the return to very supportive debt markets have been key drivers of the fast recovery in deal activity.



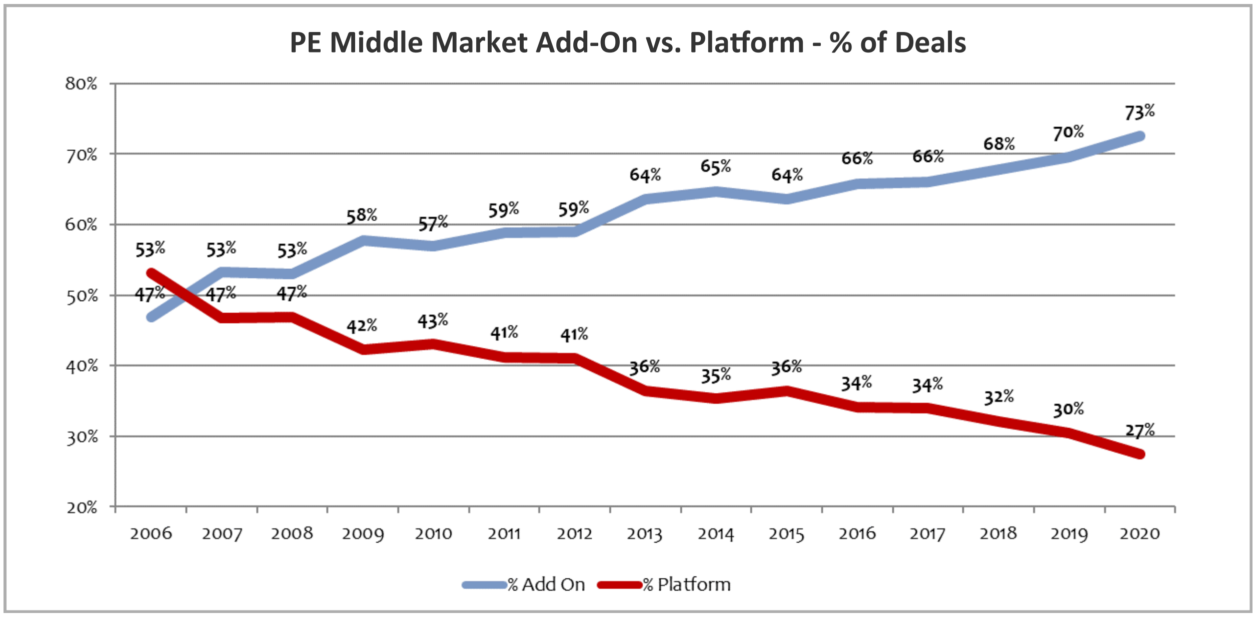
Source: Pitchbook



Source: Preqin Ltd.
** Estimate*

Platform vs. Add-ons

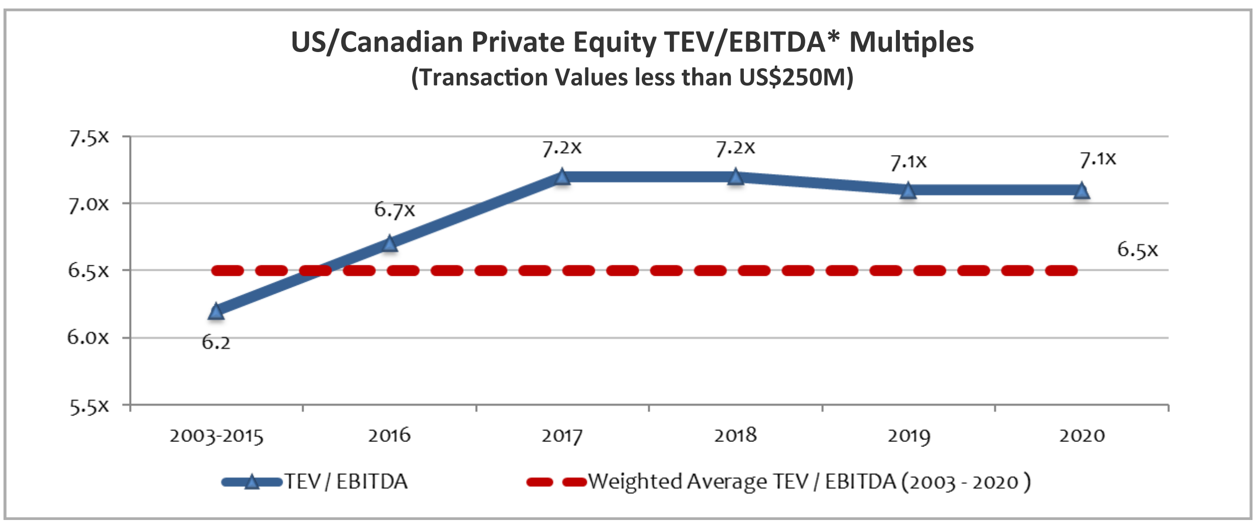
In 2020, the mix of deals continued the long-term trend of an increasing proportion of add-on deals versus platform investments. Add-on transactions represented 73% of PE acquisitions, indicating that many private equity firms are continuing to pursue aggressive acquisition strategies to drive the growth of their platform companies.



Source: Pitchbook

Valuations: No End to the Seller's Market

Valuation multiples held up remarkably well in 2020 with an average mid-market TEV/EBITDA multiple of 7.1x essentially unchanged from the previous three years and well above the long-term average of 6.5x. Unlike previous economic downturns, we have not seen a shift from a seller's market to a buyer's market.



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

Source: GF Data®

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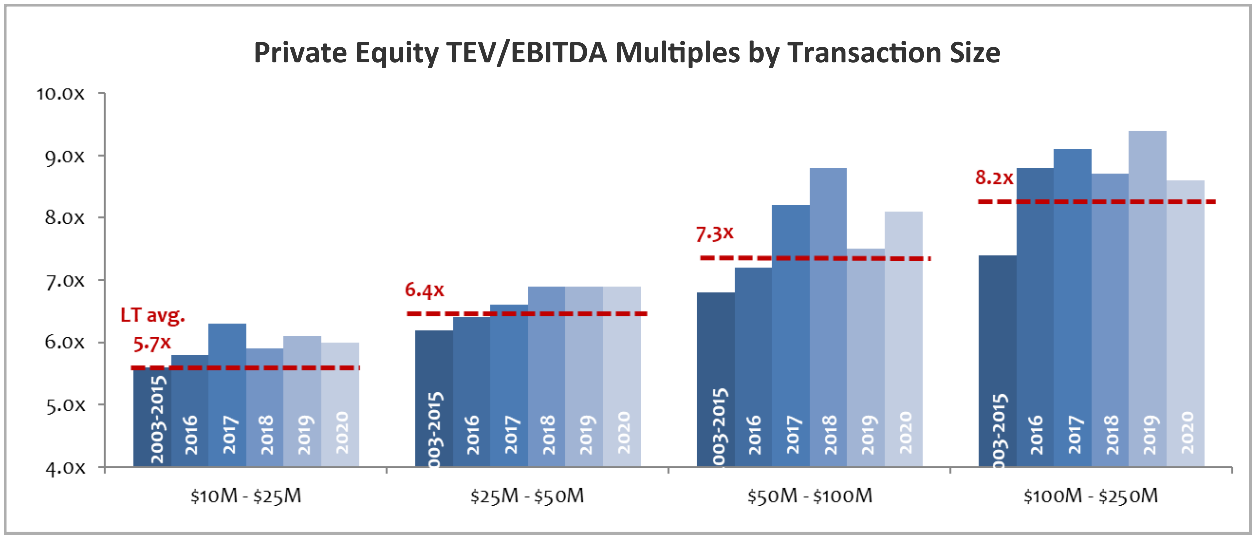
Valuations: Size and Quality Premiums

Breaking down the valuation multiples by transaction size, larger companies (TEV of $100-250M) traded at an average of 8.6x, a premium of 43% to smaller companies (TEV of $10-25M) which traded at an average of 6.0x. Interestingly, valuation multiples for larger companies in recent years are also higher relative to their long-term averages than for smaller companies indicating that larger companies have benefited more from increases in valuation multiples in recent years.

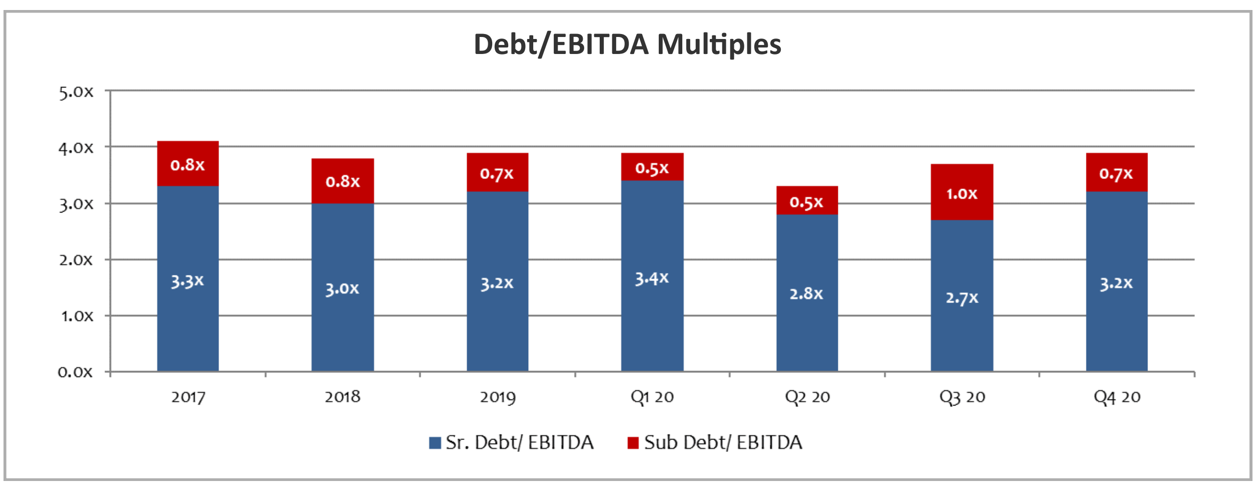
The data also shows that buyers continue to pay a premium for companies with superior financial metrics. For example, buyers pay a premium for companies that have TTM revenue and EBITDA margin growth exceeding 10%. The average premium paid for these companies has ranged from 20% to 24% over the period from 2016 to 2019 but this spread increased to 27% in 2020. This confirms that private equity groups are competing aggressively for companies that have continued to perform well through the pandemic.



Source: GF Data®

Leverage Analysis: Disruption and Recovery in Debt Markets

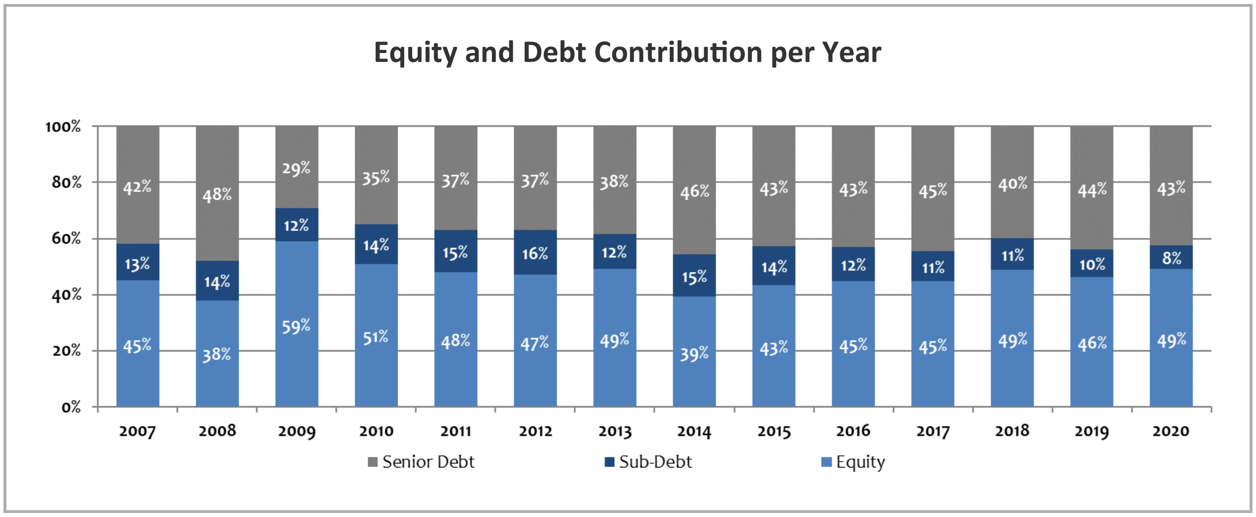
With the disruption in private debt markets in the second quarter of 2020, we saw a significant decline in leverage with the average Total Debt/EBITDA multiple for mid-market private equity deals dropping to 3.3x. However, with the recovery in these markets, leverage returned to pre-pandemic levels with an average Total Debt/EBITDA multiple for the fourth quarter of 3.9x



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. While the average equity portion of the capital structure increased to 49% of all transaction value in 2020 as a whole, up modestly from 46% in 2019, we suspect this is partly a reflection of higher equity components required to complete transactions in the second quarter when debt availability was limited by market turmoil.



Source: GF Data®

Valuation by Industry Sector: Media & Telecom and Health Care Lead the Way

Valuation multiples in 2020 remained above the long-term averages for each of the industry sectors below with the exception of the heavily COVID19 impacted retail sector. The media and telecom and health care services sectors posted the highest average TEV/EBITDA multiples at 8.3x and 7.9x respectively.

TEV/EBITDA by Industry							
	2003-2015	2016	2017	2018	2019	2020	Long Run Average
Manufacturing	6.0x	6.1x	6.8x	6.9x	6.6x	6.7x	6.2x
Business Services	6.1x	7.3x	7.3x	7.1x	7.1x	7.1x	6.6x
Health Care Services	6.9x	7.6x	8.1x	7.8x	8.4x	7.9x	7.3x
Retail	6.3x	7.0x	7.3x	7.5x	9.3x	6.9x	6.8x
Distribution	6.2x	7.2x	7.6x	7.0x	7.1x	7.7x	6.6x
Media and Telecom	7.1x	6.5x	7.7x	7.8x	7.0x	8.3x	7.2x

Source: GF Data®

Contributing Editor:

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