CIBC
Cleary Gull

MARKET MONITOR

M&A and financing update
3rd Quarter 2019

Deal volume increases despite decline in private equity exits

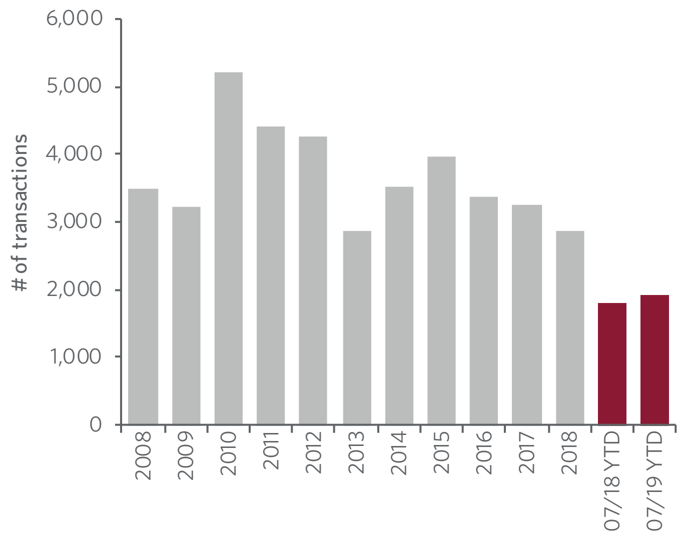
As middle market M&A transaction volume rose during the first half of 2019 there was a major shift in the "mix" of sellers.

The increase in transaction volume itself was remarkable. Through July 2019, completed transactions under $500 million rose 6.1% as compared to the first seven months of 2018, according to Robert W. Baird & Co., including a 10.1% increase in transactions under $100 million. The increase actually represented a dramatic trend reversal after deal volume had declined 5.2% year-over-year through April, driven by a 42.5% decline in private equity exits in Q1 2019 when compared to Q1 2018. The slow start to the year for private equity sellers continued with a 22.9% decline through Q2 2019.

The increase in total deal volume, despite a decline in private equity exits, can be attributed to increased activity by corporate and entrepreneurial sellers, which finally appear to be taking advantage of the peak level valuation multiples enjoyed by the more abundant private equity sellers in recent years. While a pick-up in their deal volume could be construed as overdue based on recent valuation multiples, it is not unprecedented to experience an uptick in deal volume from entrepreneurs and corporations late in an economic cycle. In 2007, the M&A markets experienced a surge in entrepreneurial sellers just before the last economic correction. Recently, we have heard from many deal professionals that "this market feels a lot like 2007".

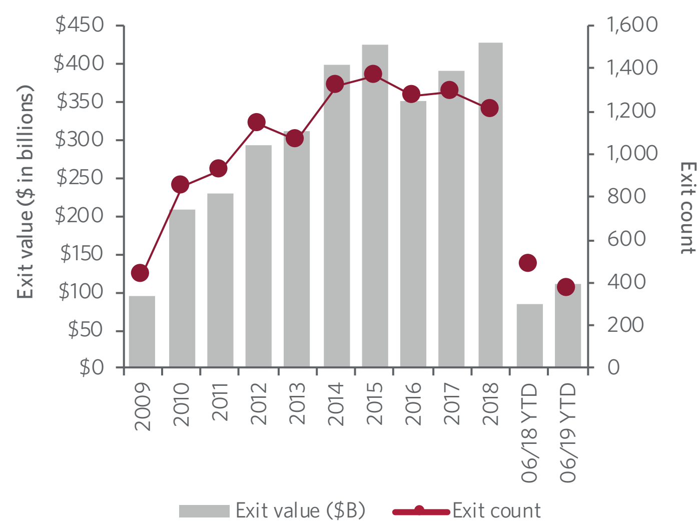
Whether the shift in mix of sellers in 2019 is a harbinger of the next recession remains to be seen. But there is at least one key difference in the current market, as compared to 2007, in that lenders and private equity buyers in 2019 are being more selective with reduced valuations and leverage in cyclical end markets. As examples, the transportation and building products sectors are experiencing an uptick in deal volume but lower than normal capital markets interest. While the window to sell companies serving cyclical end markets may be closing, the availability of debt and equity capital for deals in other sectors appears poised to remain strong for the remainder of 2019.

U.S. M&A deal volume for transactions under $500mm



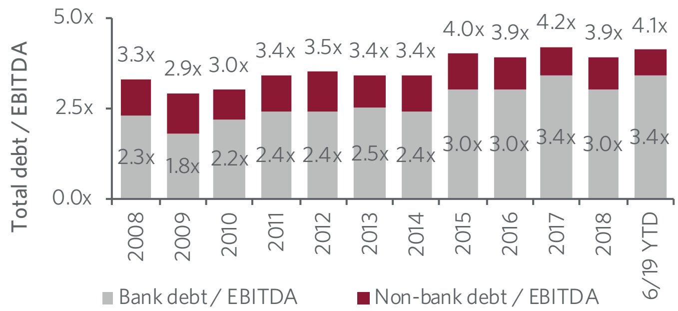
Source: Robert W. Baird & Co.

U.S. PE-backed exit activity



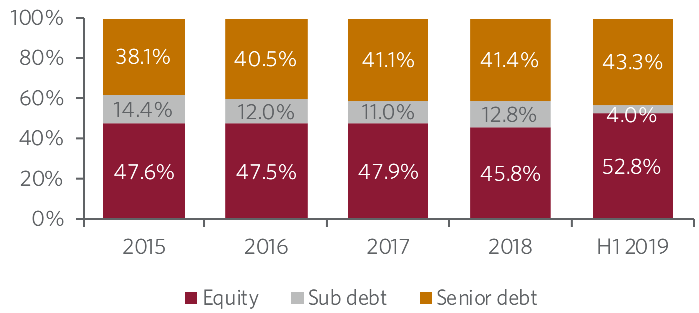
Source: PitchBook.

Average platform LBO debt multiples for deals with $10mm – $250mm of enterprise value



Source: GF Data®.

Equity and debt contribution for $100mm – $250mm enterprise value transactions



Source: GF Data®.

Plenty of debt for LBOs

In 2019, the debt markets have continued to support buyers with record levels of availability. The average total debt/EBITDA multiple for private equity-backed leveraged buyouts ("LBOs") from $10 to $250 million was 4.1x for H1 2019, according to GF Data®, putting 2019 on pace to be the fifth straight year with total debt/EBITDA at peak levels supporting the continuation of high purchase price multiples for LBOs. Total debt/EBITDA levels continue to remain strong, despite the challenges emerging in certain traditionally cyclical end markets.

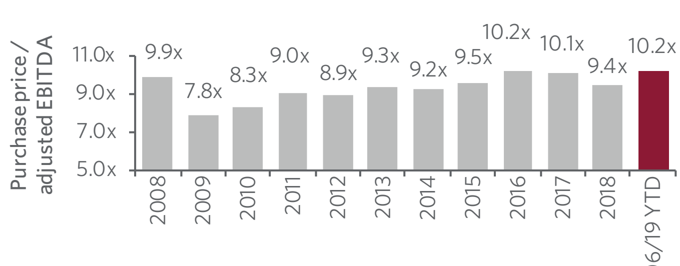
A chief catalyst for the continuation of peak debt levels is the strong competition among traditional lenders (banks), BDCs, and finance companies to finance LBOs. Lenders are aggressively using price, low amortization levels, and "covenant light" credit agreements, and accepting significant "pro forma" EBITDA adjustments in their leverage calculations to win deals and grow their loan portfolios. If it continues, competition and lenders' desires to support their existing borrowers with additional debt for add-on acquisitions may result in total debt/EBITDA availability continuing at the five year trend of peak levels throughout 2019.

LBO valuation multiples rebound to peak levels

According to GF Data®, average enterprise value/EBITDA multiples for $10 to $250 million enterprise value LBOs rebounded sharply to an average of 7.6x EBITDA for Q2 2019 after posting an average of 6.9x EBITDA for Q1 2019. The strong second quarter lifted the year-to-date average LBO valuation multiple to 7.2x, returning to the peak level of enterprise value/EBITDA multiples achieved in 2017 and 2018.

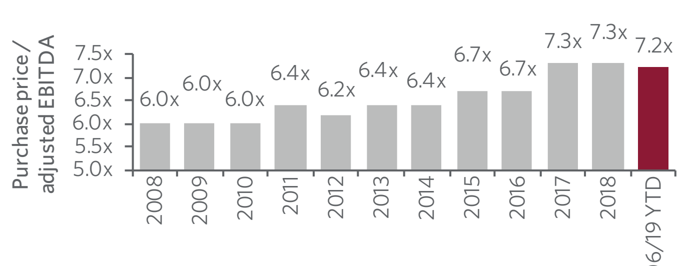
In Q2 2019, average valuations in all LBO size categories increased over their respective averages in Q1 2019, suggesting that Q1 2019's lower valuation multiples may have been a one-time occurrence not an emerging trend. The increase was not uniform, however. LBO transaction multiples in the $50 to $100 million transaction segment trailed the average EBITDA multiple achieved in this size segment from 2015 to 2018 by 1.0x to 2.0x EBITDA. GF Data® also noted that YTD average equity contributions for the $100 to $250 million transaction segment increased to 52.8% in H1 2019, further supporting high LBO valuation multiples.

U.S. M&A transaction multiples



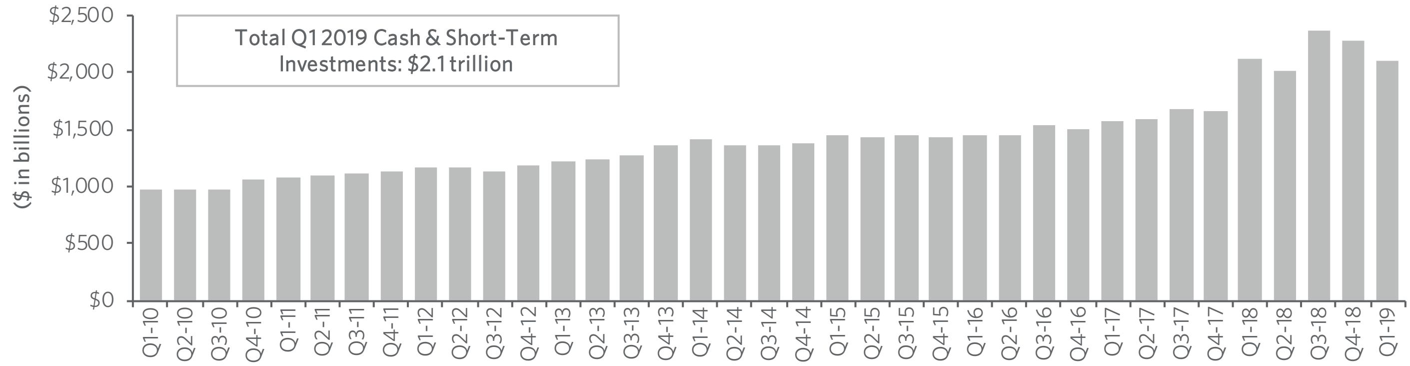
Source: PitchBook.

Average purchase price/adjusted EBITDA multiples for private equity-backed LBOs with $10mm – $250mm of enterprise value



Source: GF Data®.

$2.1 trillion of corporate balance sheet cash plus $1.5 trillion in private equity capital



Source: CapitalIQ.

Buyers seek "angles" in auction processes

A management presentation typically begins with the buyer providing the management team with a general overview of the buyer's company or private equity fund. In today's competitive marketplace, a key aspect of each introduction is the buyer's description of why or how they are differentiated from others the seller may be considering.

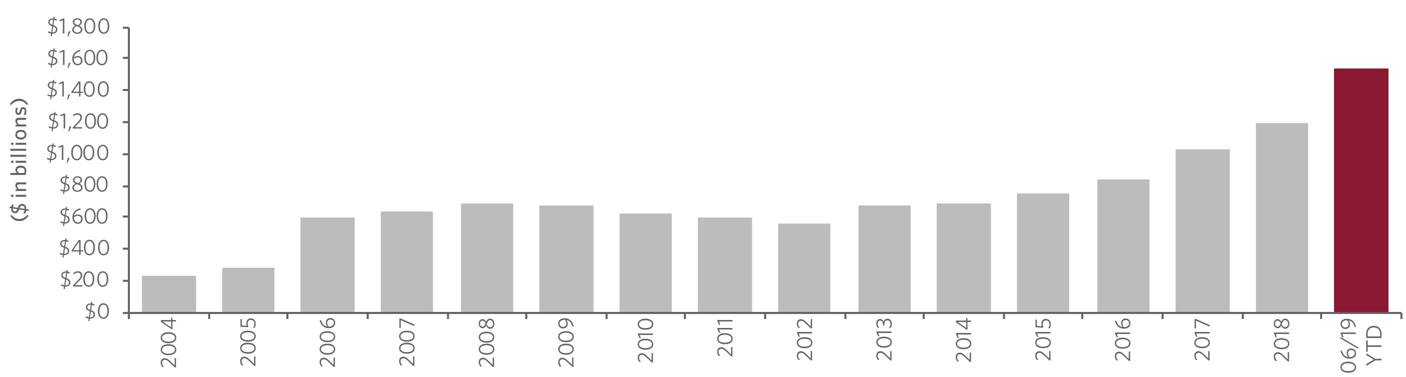
Availability of capital, while obviously necessary to complete a deal, has become less important in today's market with $2.1 trillion of cash on corporate balance sheets and over $1.5 trillion of uninvested private equity capital. Five years ago, a "no financing contingency" provision was often considered a major point of differentiation in a letter of intent. Today, it is not uncommon to receive multiple bids without a financing contingency, switching it from a major competitive advantage to almost "table stakes" in hyper-competitive auctions.

Increasingly, we see buyers seek to differentiate themselves through their industry knowledge, connections, and business partners. The knowledge angle is very important to sellers because it reduces the risk a buyer will "discover" something in diligence. It can be important to the management team as well because they want to begin executing their growth strategy immediately without waiting for the buyer to gain a better understanding of their business.

In addition to money and industry knowledge and expertise, some buyers are beginning to use speed coupled with aggressive valuations to preempt auction processes for "hot" deals. Successful preemptive buyers are spending money earlier in processes to accelerate or complete diligence before other buyers, giving sellers the choice of closing quickly or letting the process unfold. So far in 2019, CIBC Cleary Gull has engaged in more discussions with buyers about using speed and valuation to preempt a process (at various stages), and we have closed more transactions with preemptive buyers than ever before.

We expect that the uptick in buyers pairing a market clearing, premium valuation with a two to four week timeline to close to attempt to preempt competitive auction processes will continue as long as there is abundant amounts of capital to invest in deals and the scarcity of great companies remains.

Uninvested private equity capital has doubled since 2015



Source: Prequin Ltd.

Firm overview

CIBC Cleary Gull is a nationally recognized boutique investment banking firm with a global reach. We advise private equity funds, entrepreneurs, and small publicly traded companies on mergers and acquisitions, private debt and equity financings and recapitalizations and other transactions.

Our talented team has completed hundreds of middle market transactions delivering more than $8 billion in value. With an average of more than 20 years of deal experience, our skilled senior investment bankers bring knowledge, integrity and relentless determination to deliver great outcomes for our clients.

Global reach

CIBC Cleary Gull is a member of the International Association of Investment Bankers. The IAIB (iaib.org) is a global network of investment banking firms in Asia, Australia, Europe, and North and South America working together to broaden their reach and leverage their expertise.

Contact us for more information on CIBC Cleary Gull and our Investment Banking services.

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