



news from the middle

deal perspectives for middle market companies and their advisors

Q4 2018

UNTUCK MY HEART

With all of this talk of tuck-ins, you'd think that private equity pros across the middle market were obsessive bed-makers.

In the past two years, private equity firms have taken advantage of a period of elevated valuations to harvest investments made following the financial crisis of 2008-2009, selling companies at a faster rate than they are buying. Of course, many of these sales are to other financial sponsors. To justify the investment case for rich multiples for platform investments (currently 0.5x-0.7x more than non-platform buyouts), sponsors plan to pursue bolt-on acquisitions of smaller firms to "average down" the purchase price over time. Valuations of smaller firms are materially lower and less volatile. Indeed, buy-and-build has become a dominant strategy across middle market private equity.

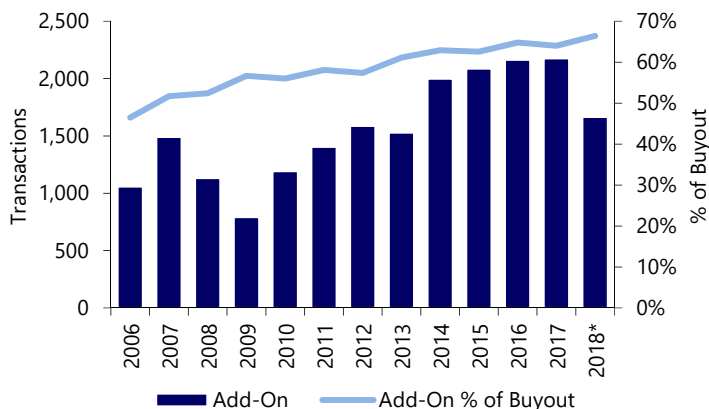
The industry data corroborates this phenomenon. Per Pitchbook, add-on acquisitions have reached all-time highs as a percentage of total buy-outs, constituting two-thirds of all deals.

There are two interesting follow-on effects that we have observed throughout the market:

1. A rise in valuations for small private companies. For companies below \$50.0 million in enterprise value, multiples are up between 0.5x and 1.0x versus historical valuations in what is normally a very stable universe. With the average platform investment valuation multiples now reaching into the double digits, tuck-in investments in the 6.0-7.0x range are still wildly accretive if integrated properly.
2. "Private Equity BD Professional" is the fastest growing job category in our industry. Our friends at BraddockMatthews (a leading executive search firm for the asset management industry) cleverly conduct a compensation survey amongst buy-side origination professionals. In 2015, they found 200 folks to participate in their survey. Just two years later, in 2017, that number had grown to 500! Apparently, someone has to go and find all of these tuck-in deals.

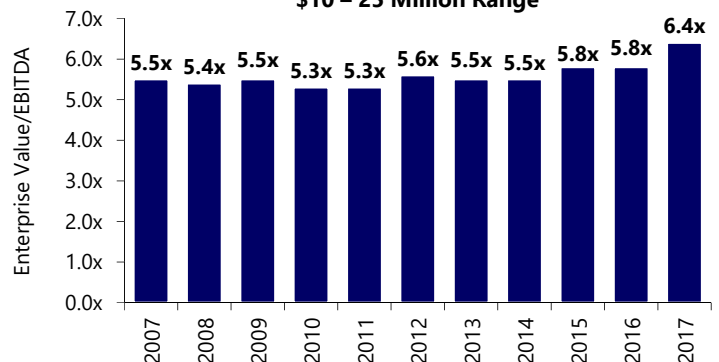
Happy hunting.

Add-ons Hit Record Percentage of Buyouts



*As of September 30, 2018
Source: Pitchbook

Valuations Rising for PE Deals in \$10 – 25 Million Range



Source: GF Data®
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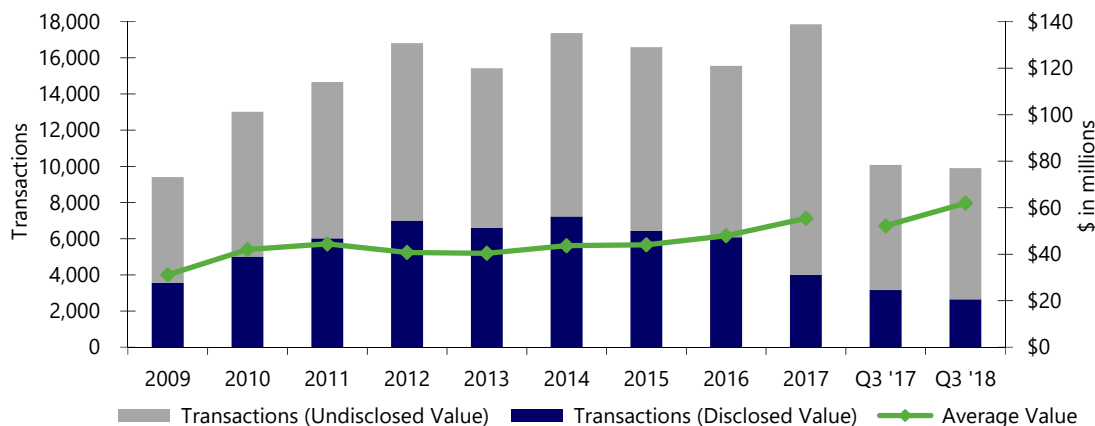
M&A

snapshot

Middle Market M&A Volume

MIDDLE MARKET M&A VOLUME

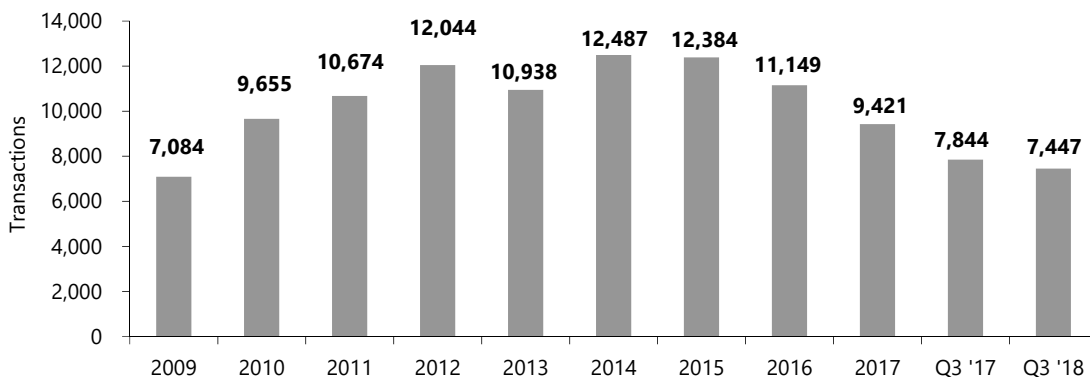
Deal volume closely mirrored Q3 2017, while average deal value climbed to a historic high of \$62.0 million.



Source: Capital IQ and Capstone Headwaters Research
Note: Enterprise Value < \$500mm

CORPORATE BUYER ACTIVITY

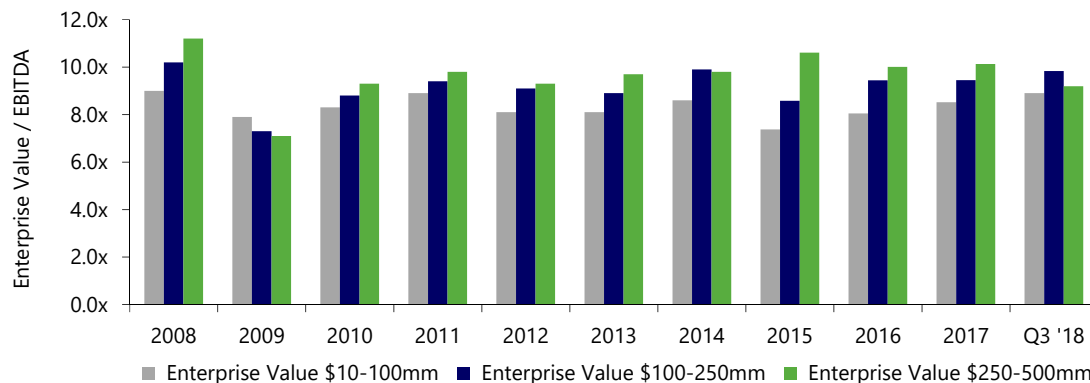
Corporate buyer activity has slipped 5.1% year-over-year as strategic buyers have faced competition from PEGs



Source: Capital IQ and Capstone Headwaters Research
Note: includes multiples 3x-16x

AVERAGE MULTIPLES BY TRANSACTION SIZE

Deals with a disclosed Enterprise Values of \$100mm to \$250mm reached a four-year high of 9.8x EBITDA



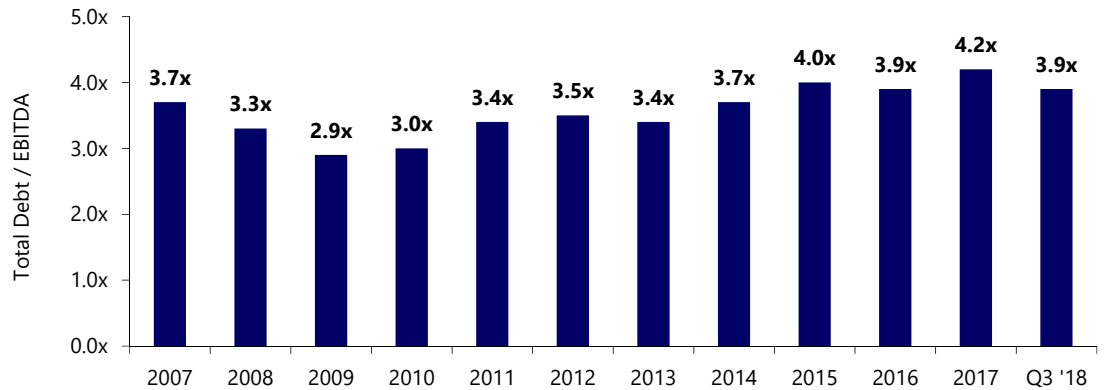
Source: Capital IQ and Capstone Headwaters Research
Note: includes multiples 3x-16x



M&A snapshot

PRIVATE EQUITY DEBT MULTIPLES

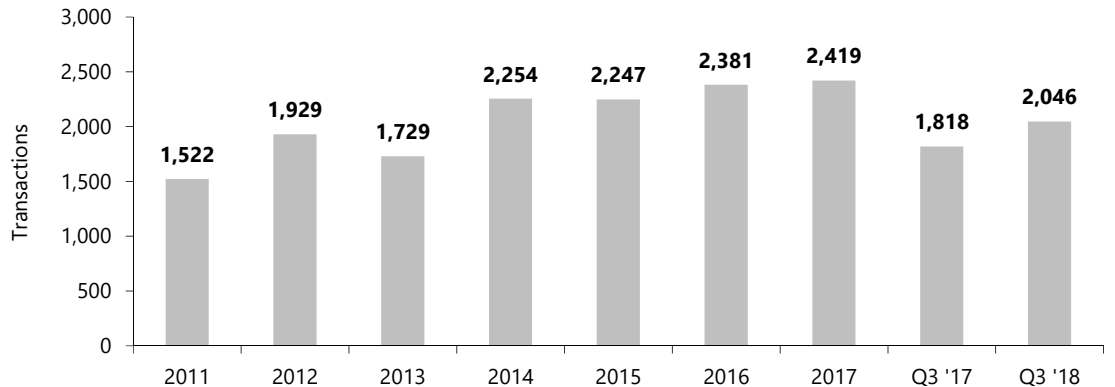
Leverage ratios have dipped slightly as acquirers have shifted to more cautious capitalization decisions



Source: GF Data
Note: includes multiples 3x-15x, Enterprise Value \$10-\$250mm

PRIVATE EQUITY BUYER ACTIVITY

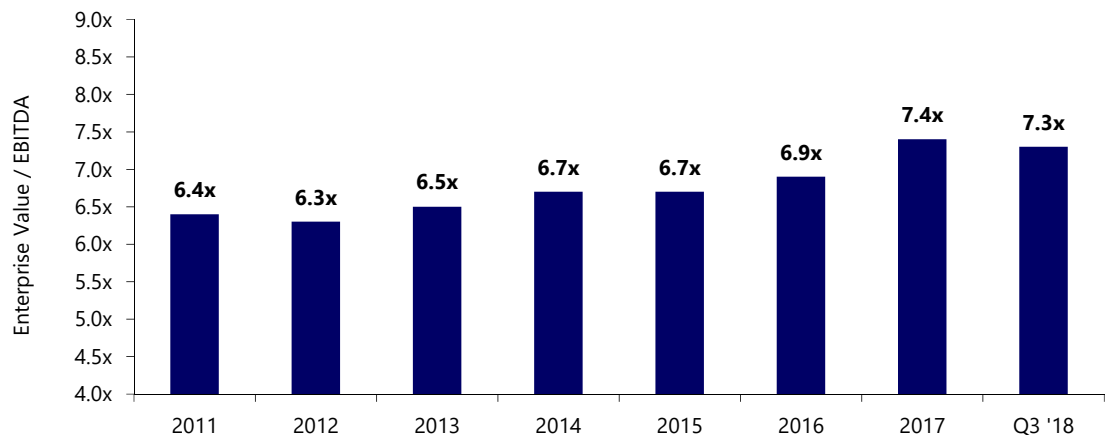
Despite a slight decline in overall transaction volume compared to Q3 2017, private equity activity has outpaced that of last year



Source: Pitchbook
Note: Pitchbook changed methodology to only include buyout deals as of Q3 2017. All data reflects new methodology.

PRIVATE EQUITY MULTIPLES

The average EBITDA multiple paid by private equity buyers is at a premium of 7.3x, slightly below record levels of Q2



Source: GF Data
Note: includes multiples 3x-15x, Enterprise Value \$10-\$250mm



BUILT FOR THE MIDDLE MARKET



Capstone Headwaters is an elite investment banking firm dedicated to serving the corporate finance needs of middle market business owners, investors and creditors. Capstone Headwaters provides merger & acquisition, private placement, corporate restructuring and financial advisory services across 16 industry verticals to meet the life cycle needs of emerging enterprises. Headquartered in Boston, MA and Denver, CO, Capstone Headwaters has 19 offices in the US, UK and Brazil with a global reach that includes over 300 professionals in 33 countries.