PitchBook

Global PE Deal Multiples Report

2017
Part II

PitchBook

Contents

The PitchBook Platform

The data in this report comes from the PitchBook Platform–our data software for VC, PE and M&A. Contact sales@pitchbook.com to request a free trial.

GLOBAL
PE DEAL MULTIPLES
REPORT

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Introduction

Key Takeaways

- Private equity firms are targeting companies with strong top-line growth. 50% of survey respondents reported trailing-12-month (TTM) revenue growth of at least 10% for target companies in 2Q 2017.
- Monitoring fees remain seldom used. Just 19% of PE deals included monitoring fees through the first five months of the year.
- 68% of managers believe that current deal multiples are within a range that allows for typical PE returns, nearly equivalent to the 69% of managers who believed the same last quarter.

Each quarter, we survey PE investors to get an inside look at deal terms, multiples and investor sentiment. In this edition, which normally would have included only those transactions completed in 1Q 2017, we decided to extend our scope, including deals completed through May 23 of this year to make the datasets timelier and ultimately more useful.

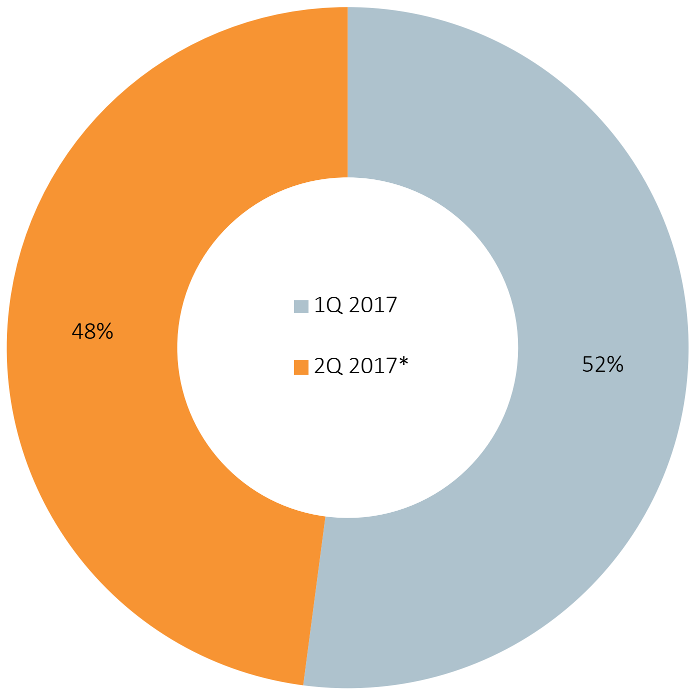
We hope this report is useful in your practice. As always, feel free to send any questions or comments to reports@pitchbook.com.

DYLAN E. COX
Analyst

Survey Population & Market Sentiment

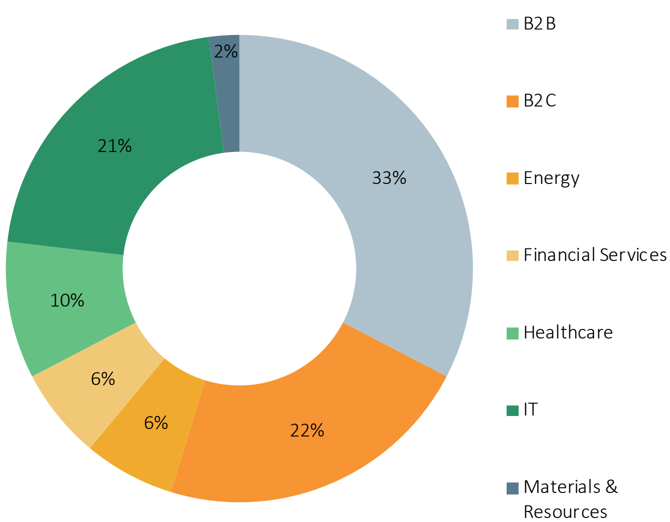
The data in this survey, which has been updated to include transactions completed between January and May 2017, includes a broad swath of PE deals. Of the 96 respondents, 48% completed deals in 1Q 2017 versus 52% in 2Q. Industry involvement largely reflects that of the overall PE landscape, with a plurality (33%) taking place in the B2B sector. Notably, 22% of transactions in this survey involved companies in the IT sector, compared to just 15% during the last survey period, mirroring a major industry shift toward tech investments in the last year. Add-ons made up just 27% of buyouts in this survey, compared to 66% in our most recent survey data, which could explain some of the discrepancies between this and other reports.

Responses (#) by timeframe



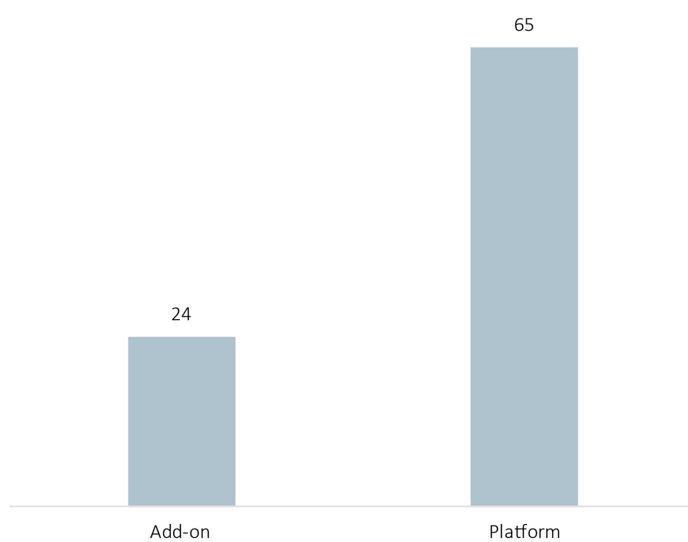
Source: PitchBook. *As of 5/23/2017

Responses (#) indicating sector of target company



Source: PitchBook

Responses (#) indicating type of transaction

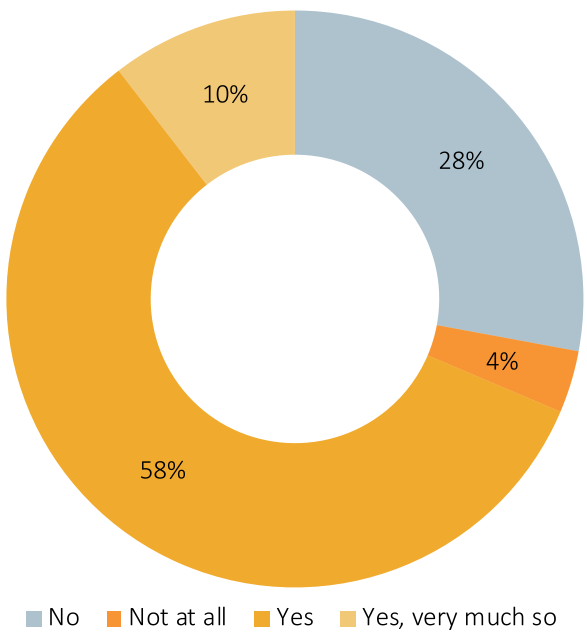


Source: PitchBook

68% of managers believe that current deal multiples are within a range that allows for typical PE returns, nearly equivalent to the 69% of managers who believed the same last quarter. As noted on page 7 of this report, PE firms are targeting companies with faster top-line growth, which could help maintain this confidence.

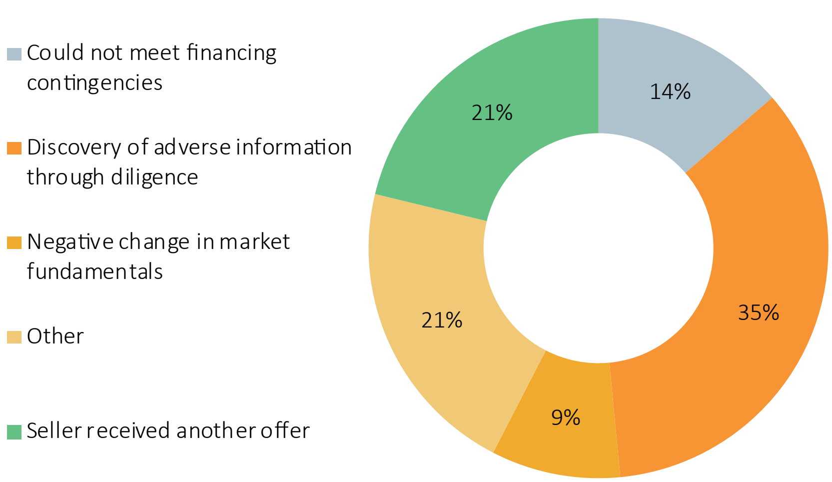
The causes of cancelling or renegotiating deals after the signing of an LOI remain largely unchanged. Discovery of adverse information through diligence accounts for 35% of those cases, while the seller receiving another offer is representative of 21%.

In your opinion, are current deal multiples within a range that allows for typical PE fund returns?



Source: PitchBook

Reasons for cancelling or renegotiating deals



Source: PitchBook

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Investment Multiples

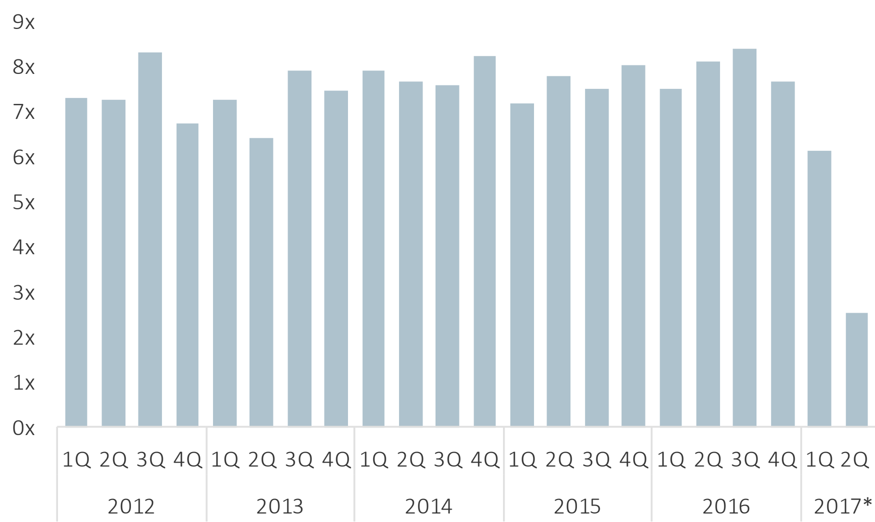
Divergence in multiples unforeseen

After recording consistently high figures through 2016, the median EV/EBITDA multiple for PE transactions completed in 1Q or 2Q 2017 has waned. As they stand currently, the median multiples for those quarters are lower than any other in our dataset. More intriguing, revenue multiples for transactions in the same time frame have moved in the opposite direction. The median EV/revenue multiple for 2Q 2017 clocked in at a low 2.1x. Granted, this figure reflects partial-quarter data (through May 23), and will likely regress toward the mean as more data is collected. Nonetheless, the divergence in EBITDA and revenue multiples this quarter is striking. One factor that could partially explain this trend would be increasing EBITDA margins across PE target companies. If company revenues were decreasing, but earnings somehow growing, then we might expect to see this divergence in multiples if purchase prices remain constant. However, the data points to the opposite. Preliminary numbers point to both sales and earnings growth for the S&P 500 in 1Q 2017. Furthermore, middle-market revenues grew by 8.45% while earnings decreased by 1.64% in 1Q 2017, according to the Golub Capital Altman Index (GCAI). Along these lines, the higher concentration of PE investments in tech companies could also be contributing to the divergence in multiples.

Competition is still present

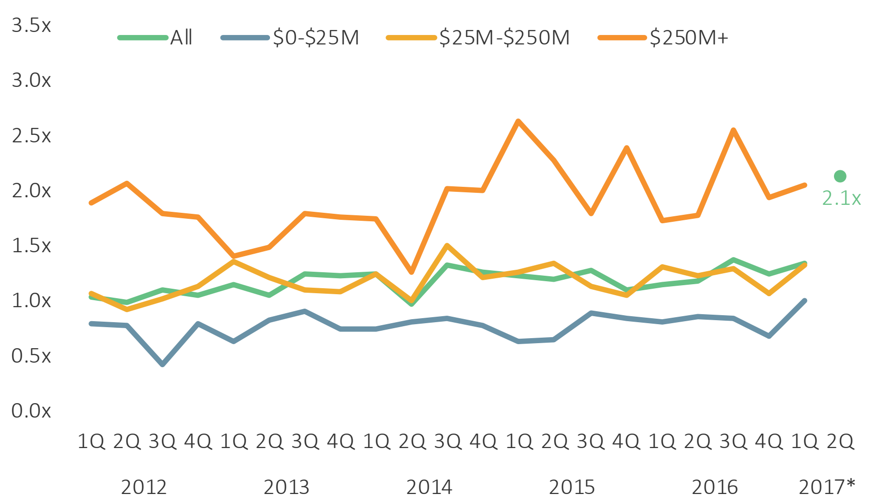
There is, without a doubt, still plenty of competition present in today's PE market. Though there are bargains to be found, the most desirable acquisition targets continue to demand historically high multiples from financial sponsors and strategic acquirers alike. This puts PE deal teams in a bit of a predicament, and we continue to hear of stories about the difficulties of deploying so much recently raised capital. We expect it's likely we'll look back at 2017 as the year when the most diligent and patient capital deployment teams outperformed their peers even more than usual.

Median EV/EBITDA multiples



Source: PitchBook. *As of 5/23/2017

Median revenue multiples by transaction size bucket



Source: PitchBook. *As of 5/23/2017

Revenue Change

PE targets companies with strong top-line growth

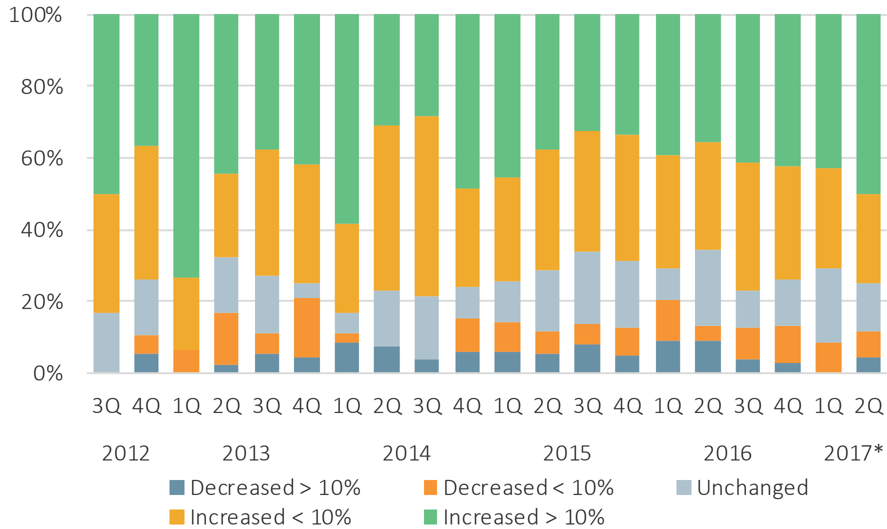
PE firms have increasingly targeted companies with strong revenue growth over the last two years as the global economy continues its moderate growth. 50% of survey respondents reported TTM revenue growth of at least 10% for target companies in 2Q 2017, up from a recent low of just 33% of respondents in 3Q 2015. This is consistent with other surveys of company health, such as the aforementioned GCAI, which reported strong US middle-market revenue growth of 8.5% in the first quarter. Revenue growth was strongest in the IT sector, which now constitutes about 20% of all PE deals.

The TTM revenue improvements for recent PE acquisitions could also be due to heightened selectivity in deal sourcing processes. Many PE firms, believing we are in the later innings of the expansion and having to compete with historically robust M&A multiples, are placing an extra emphasis on top-line revenue growth. In the event of a downturn, financing will dry up and exit multiples will likely decrease, leaving organic expansion as the only tool left in the box.

Investors remain optimistic

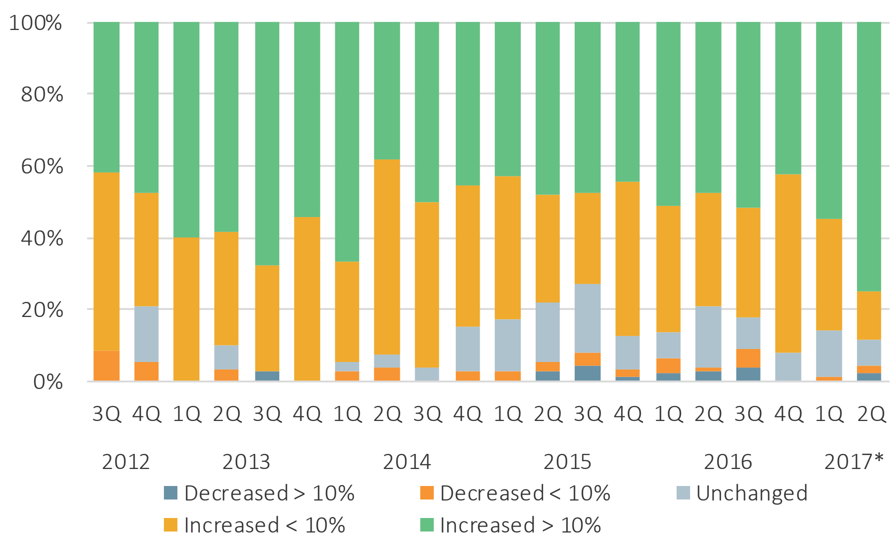
When it comes to predicting future revenue growth at their recently acquired portfolio companies, PE investors are increasingly optimistic. 75% of respondents who closed deals in 2Q 2017 predict future-12-month revenue growth of at least 10%, higher than any other quarter in the dataset. However, fewer managers predict moderate revenue growth between 0% and 10%, further supporting this idea of selectivity.

Revenue change 12 months prior to deal



Source: PitchBook
*As of 5/23/2017

Anticipated revenue change 12 months following deal



Source: PitchBook
*As of 5/23/2017

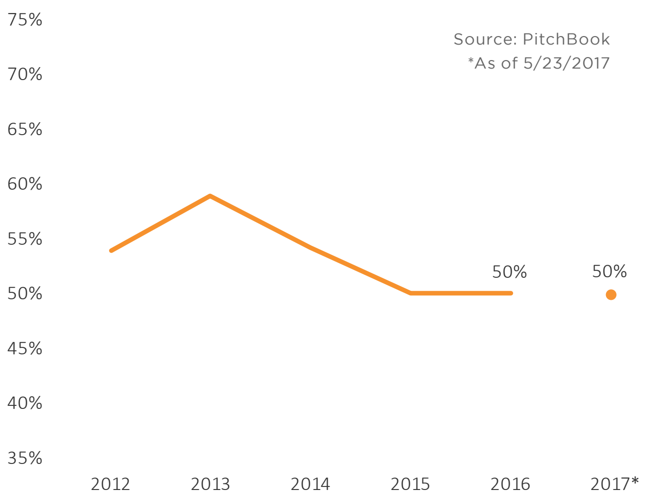
Debt & Equity Levels

Debt usage low, effect on returns uncertain

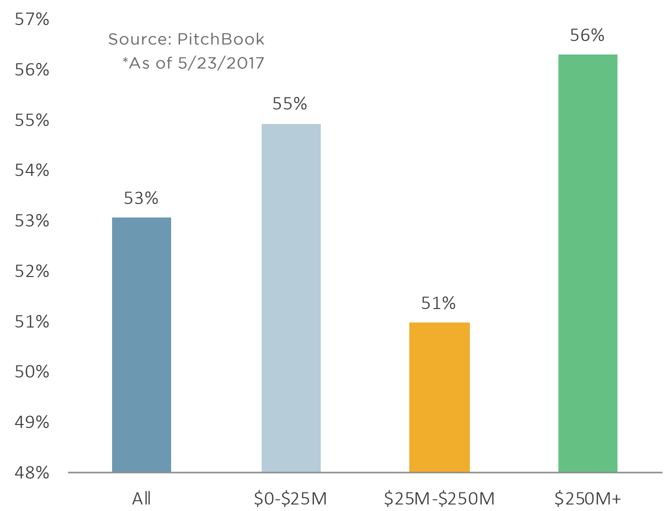
The median debt usage on PE transactions remains at 50% of enterprise value, consistent with the last couple of years, but well below the 54% and 59% we saw in 2014 and 2013, respectively. Beginning in 2015, purchase prices expanded faster than earnings growth, capping the lending capacity of many institutions due to regulatory guidance at 6.0x EBITDA. Thus, debt as a percentage of EV has decreased substantially. If EBITDA increases or acquisition multiples soften, then debt usage should return to the level at which most managers have become accustomed. This, in turn, could amplify future returns to the asset class, but may also make PE holdings more susceptible to an economic slowdown.

Aggregating survey data from 2012 through 2017, the average debt usage for all PE transaction is 53% of enterprise value. Curiously, the largest transactions with EV greater than $250 million exhibit 56% debt usage, while the sub-middle-market with EV less than $25 million uses an almost equivalent 55% on average. We believe this reflects the appetite for broadly syndicated packages at the higher end and the existence of more aggressive, relationship-based lending at the lower end.

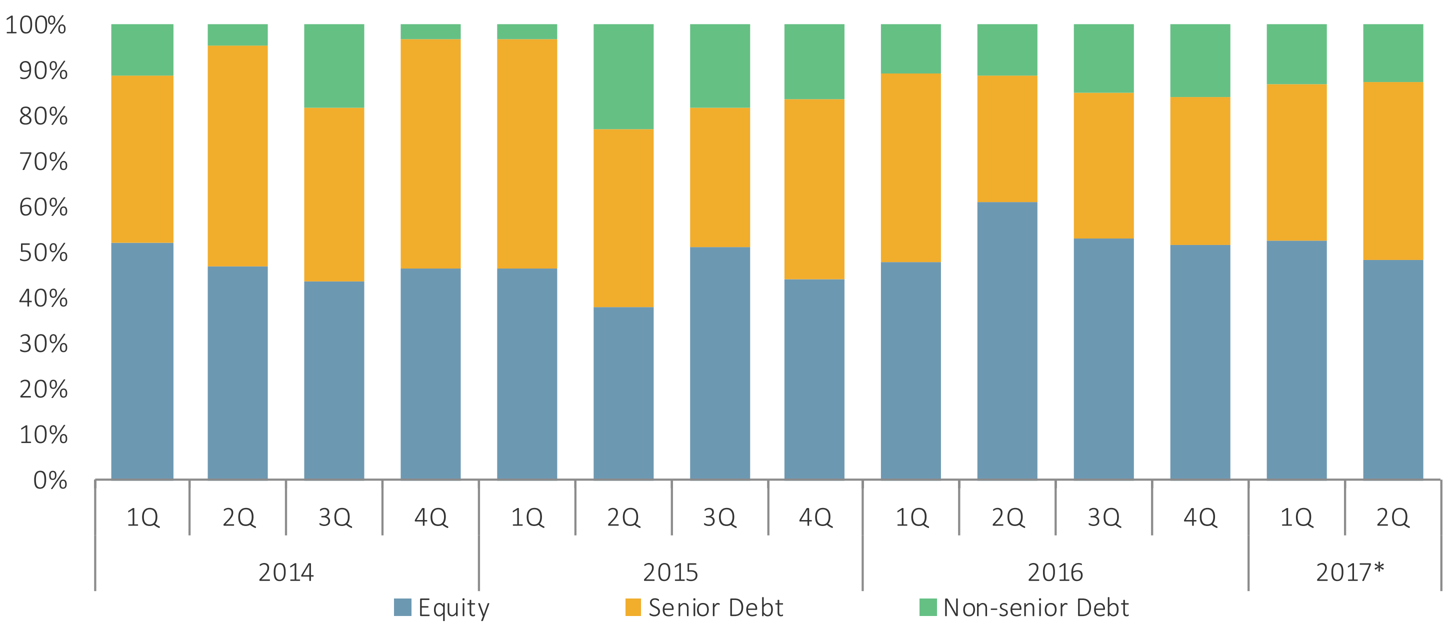
Median debt levels



Average debt levels by deal size (4Q 2016-2Q 2017*)



Average debt-to-equity breakdown



Source: PitchBook
*As of 5/23/2017

Fees

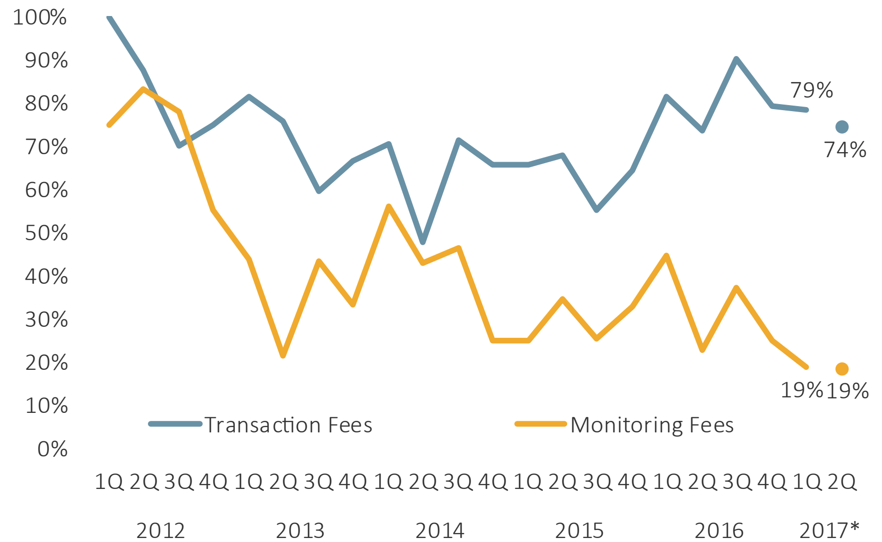
Limited partners continue applying pressure

Monitoring fees—defined here as fees charged to the portfolio company by the general partner for its advisory and management services—continue to be used in a smaller percentage of PE deals. Just 19% of transactions included monitoring fees in both the first and second quarters of the year, lower than any other in the dataset. The increasing sophistication of LP teams, prevalence of co-investments and recent SEC rulings against PE firms regarding monitoring fees all contribute to the abatement of such fee structures. Though the recent rulings against KKR and Blackstone are controversial—mostly because the firms disclosed the fee practice to LPs but were penalized anyways—they bring to mind the ongoing conflicts of interest posed by monitoring fees. In essence, GPs are incentivized to not only charge but accelerate monitoring fees, to the detriment of the portfolio company and ultimately the LPs.

Diligence drives transaction costs

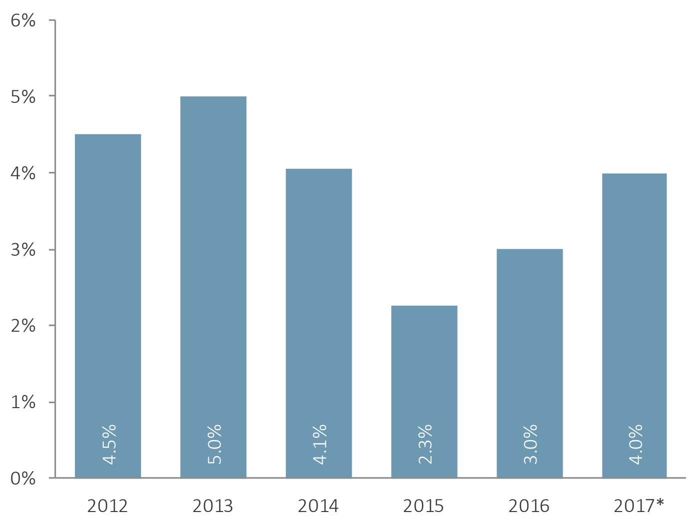
Transaction fees were present in 79% and 74% of PE transactions in the first and second quarters, respectively. This is below the 90% we saw in the back half of last year, but also well above the 64% we saw on average during 2014 and 2015. The higher prevalence of transaction fees in the last year reflects the intensified diligence processes, which are a result of heightened fears regarding an economic slowdown.

Proportion of transactions with fees



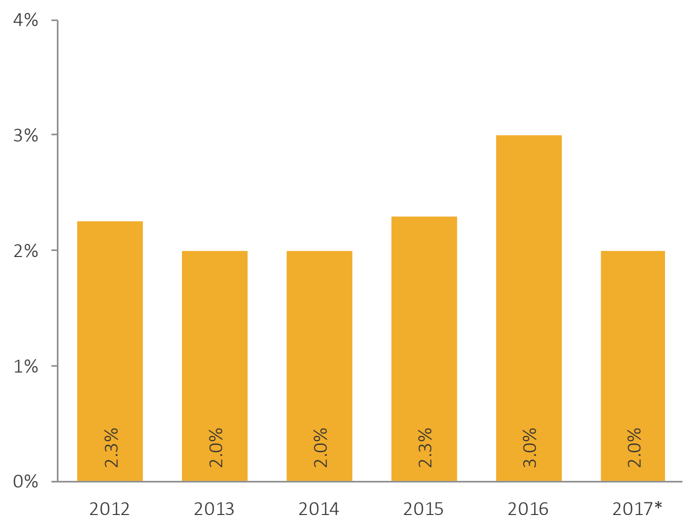
Source: PitchBook
*As of 5/23/2017

Median monitoring fee as % of EBITDA



Source: PitchBook
*As of 5/23/2017

Median transaction fee as % of deal value



Source: PitchBook
*As of 5/23/2017

Closing Times & Earnouts

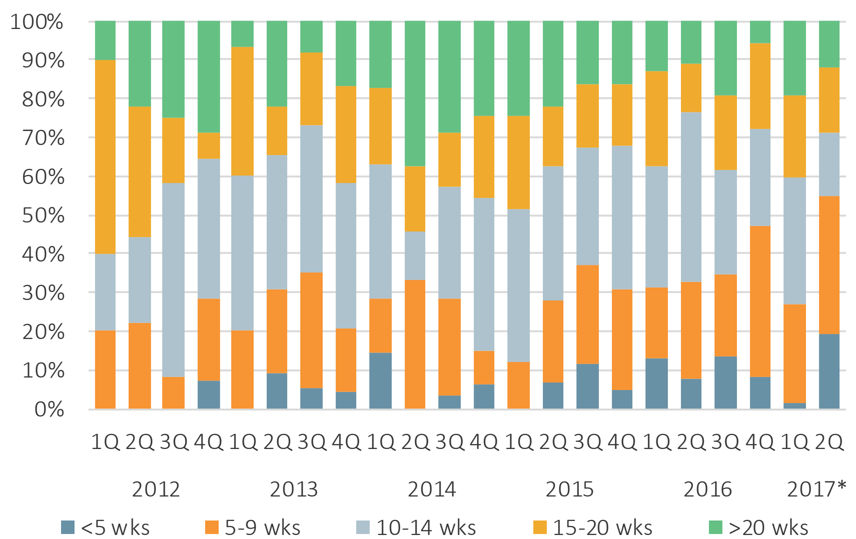
Seller's market continues

The percentage of deals in our survey population that include earnout provisions continues to hover between 30% and 45%, most recently 41% in 1Q 2017 and 36% for the partial second quarter. As a higher percentage of the companies in our survey population exhibit strong top-line growth, we expected to see a larger proportion of deals with earnout provisions. This would protect acquirers from overly exuberant growth expectations, while also allowing sellers to participate in the upside they believe is deserved. But this hasn't happened. PE deals are still done with relatively seller-friendly terms despite the uncertainty of growth expectations, reflecting the extent to which we are in a seller's market.

Closing times relatively stagnant

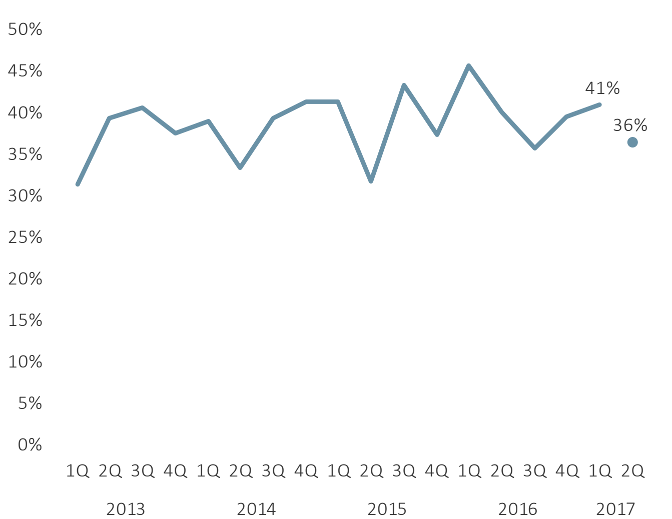
The time it takes, on average, to close PE deals has also remained relatively unchanged. After collecting preliminary 1Q 2017 data, we saw a spike in median time to close, which we attributed to extended diligence periods during the US presidential transition period. Data for the full quarter, however, shows this not to be the case. Median time to close was 13 weeks in 1Q 2017, consistent with the last few years. In that same quarter, just 26.9% of deals closed in nine weeks or fewer, the lowest since 1Q 2015. The longer-term trend, however, is that fewer PE deals have been delayed in closing processes of greater than 20 weeks, while a higher proportion of deals tend to close in less than nine weeks. The latter reflects PE firms having to close quickly to compete with strategic acquirers who can often pay cash and arrange for financing later.

Transactions (#) by weeks to close



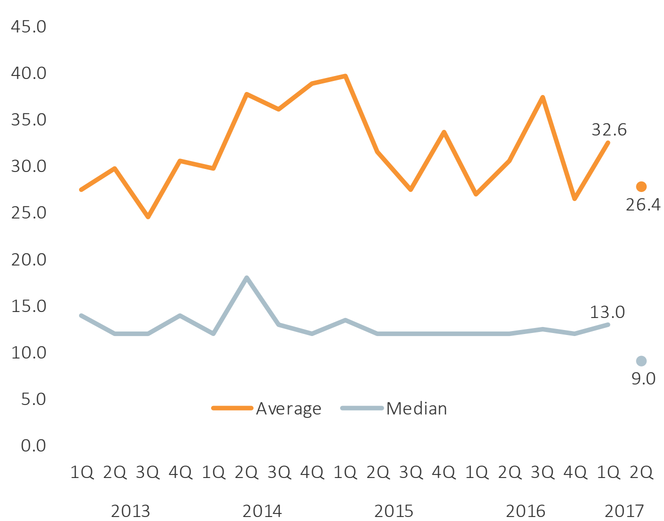
Source: PitchBook
*As of 5/23/2017

Deals with earnout provisions or seller financing (#)



Source: PitchBook
*As of 5/23/2017

Weeks to close



Source: PitchBook
*As of 5/23/2017

Methodology

Survey Process

In certain cases, responses collected across multiple iterations of our Global PE Deal Multiples Survey have been aggregated and augmented with PitchBook Platform data to generate the underlying datasets cited in this report. The survey is typically sent out to a worldwide audience via the PitchBook newsletter or email to a customized audience of relevant industry professionals across the globe.

Notes Regarding Survey Phrasing

In the survey, transaction fees were defined as legal, advisory, accounting or due diligence fees specifically related to that transaction and paid to a third party.

Monitoring fees were defined as fees charged to the portfolio company by the general partner for its advisory and management services.

Notes Regarding Transactional Data

Not every survey participant provides answers to every question, yet to improve overall sample size, we include all data points recorded via the survey process. In combination with the fact that not every transaction pulled from the PitchBook Platform has every relevant financial statistic, the datasets underlying different charts of transaction multiples are not static. There will be overlap among datasets, and each chart should be interpreted more as a snapshot of the industry rather than a given population of transactions.

Deals

PitchBook only tracks closed transactions, not completed, rumored or announced deals. The eligible PitchBook transaction types utilized in this report are all buyout types, as opposed to overall PE activity covered in other reports, which also include growth investments and investor buyouts by management.

Additional note: *Due to the opaque nature of private markets, we are constantly backfilling our database to include the most up-to-date information. Consequently, some data points may change from time to time, particularly for more recent quarters.*

We do

EBITDA multiples, private comps, valuations, market trends, growth metrics.

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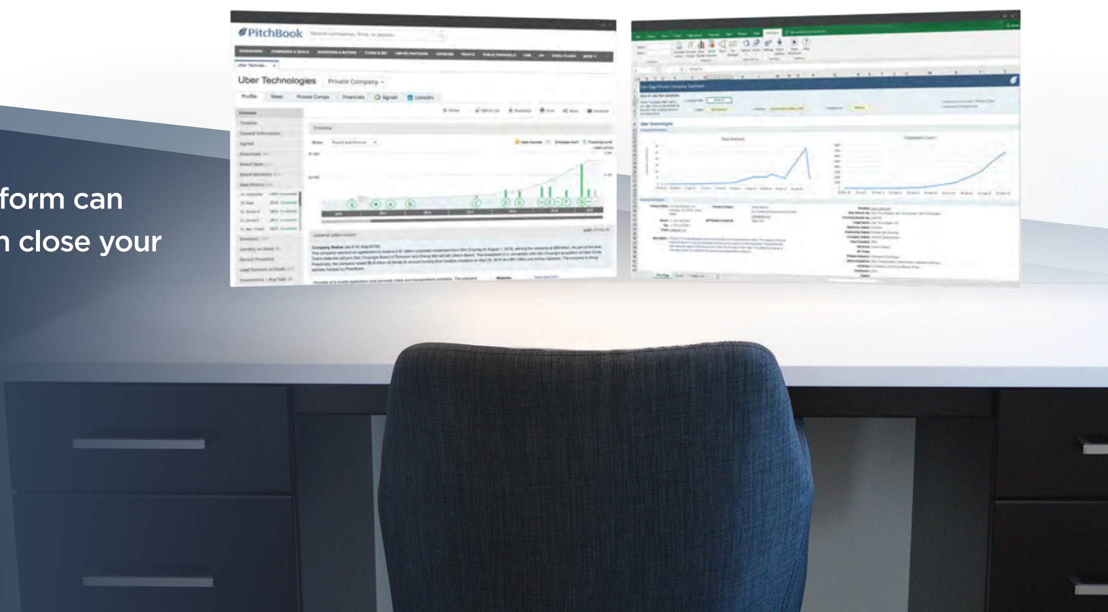

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