PitchBook

Global PE Deal Multiples Report

2017
Part I

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GLOBAL
PE DEAL MULTIPLES
REPORT

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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.

Introduction

Key takeaways

- 69% of respondents believe current multiples still allow for typical private equity returns.
- The use of monitoring fees is becoming more infrequent in the PE industry. Just 17% of transactions included monitoring fees in 2016.
- Leverage on PE deals remains low—just 50% of enterprise value in the first two months of 2017.
- The median EV/EBITDA multiple hit 7.5x through the end of February 2017.

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 4Q 2016, we decided to extend our scope, encompassing deals completed in the first two months of 2017 to make the datasets timelier and ultimately more useful.

Our most recent data shows that investor confidence is extremely high, but debt usage remains low. Meanwhile, pricing pressures are showing signs of softening and closing times have lengthened considerably. In the following pages, we'll also explore trends surrounding monitoring fees, earnout provisions and target company performance.

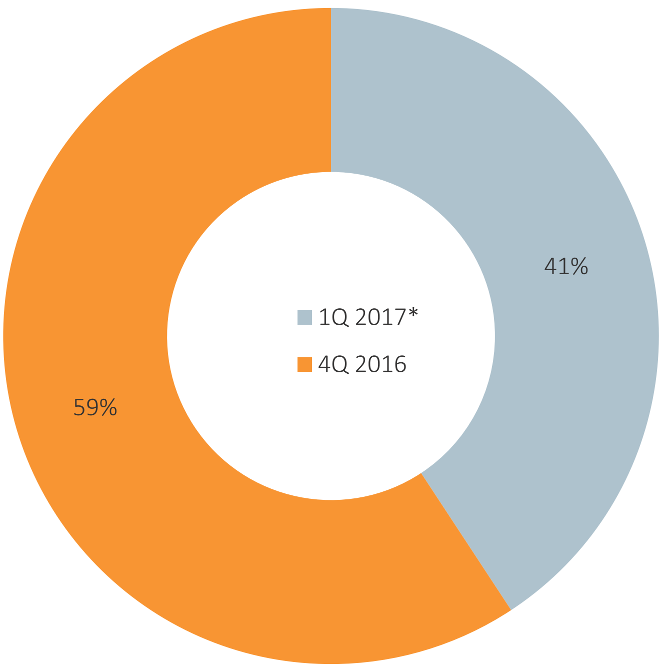
We hope this report is useful in your practice. As always, feel free to send any questions or comments to reports@pitchbook.com.

DYLAN E. COX

Analyst

Survey Population & Market Sentiment

Responses (#) by timeframe

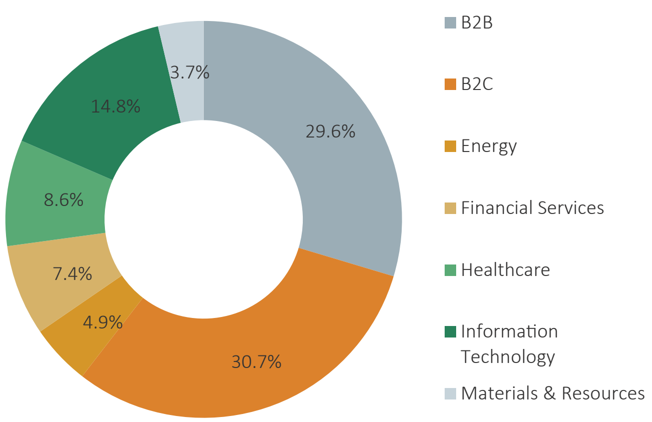


Source: PitchBook. *Note: a handful of respondents failed to indicate the respective quarter in which the transaction took place, but as they then filled in subsequent responses, those answers were assigned to the 1Q 2017 timeframe given when the survey was distributed.

This survey, which includes deals completed between October 2016 and February 2017, includes a broad range of PE investments. Of the 81 deals for which responses were completed, 59% were completed in 4Q 2016, compared with 41% completed in January or February of this year. About a third of the deals (31%) took place in the B2C sector, with slightly fewer (29%) in B2B, followed by a sizable share (15%) in the IT sector. While not all survey respondents indicated the type of deal, at least 48 of the 81 were platform buyouts, whereas at least 22 were considered add-ons.

With M&A multiples as high as they have been in the last year, we've shed doubt on the probability of future PE returns being as high as they have been in the past. Dealmakers, however, remain confident in their own abilities. Nearly seven out of 10 survey respondents believe current prices still allow for typical PE returns. However,

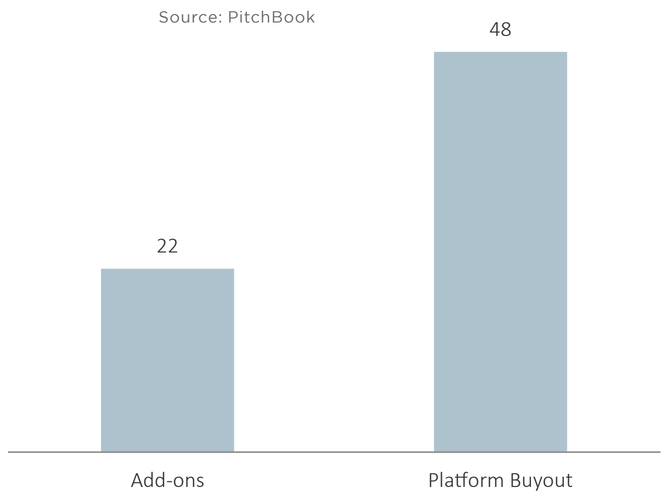
Responses (#) indicating sector of target company



Source: PitchBook

Responses (#) indicating type of transaction

Source: PitchBook

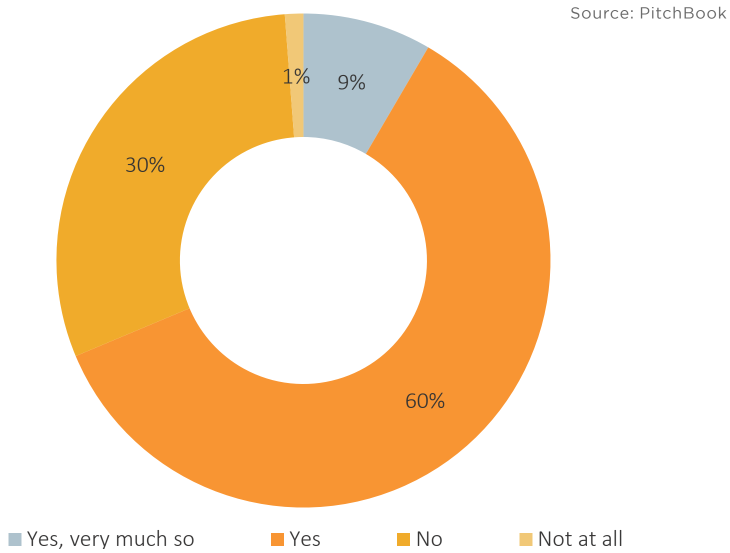


we should point out that our survey population hasn't seen quite the same multiple expansion as that observed in the broader M&A marketplace in the last few years. Even so, the response should be a welcome sign for the industry, especially given that some managers are modeling exits at lower multiples as they underwrite deals.

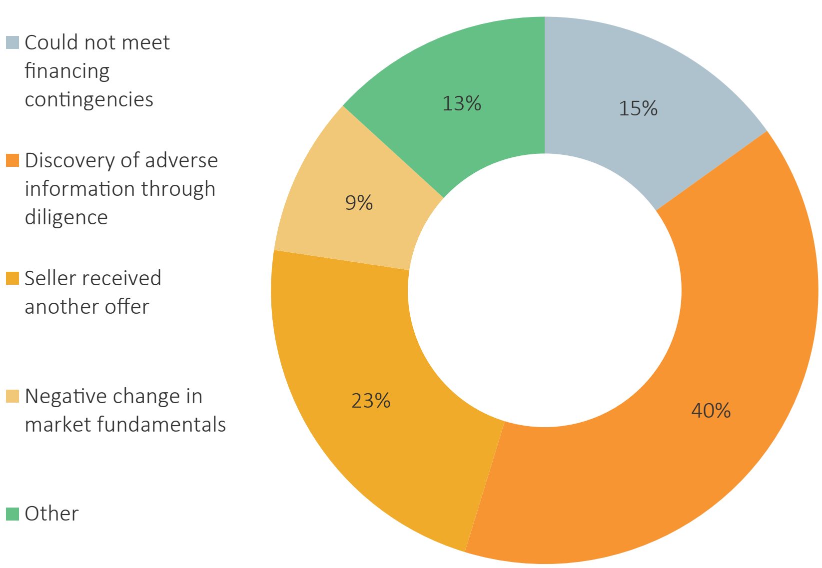
Additionally, and for the first time, we asked managers about the causes of cancelling or renegotiating deals. Of those respondents that did have a cancelled or renegotiated transaction in the last two quarters, 38% cited the discovery of adverse information through diligence as the primary driver. Though we can't make historical comparisons, the figure is significant. Diligence discovery is almost twice as likely as any other factor to be the source of a broken deal.

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

Source: PitchBook



Causes of cancelling or renegotiating deals



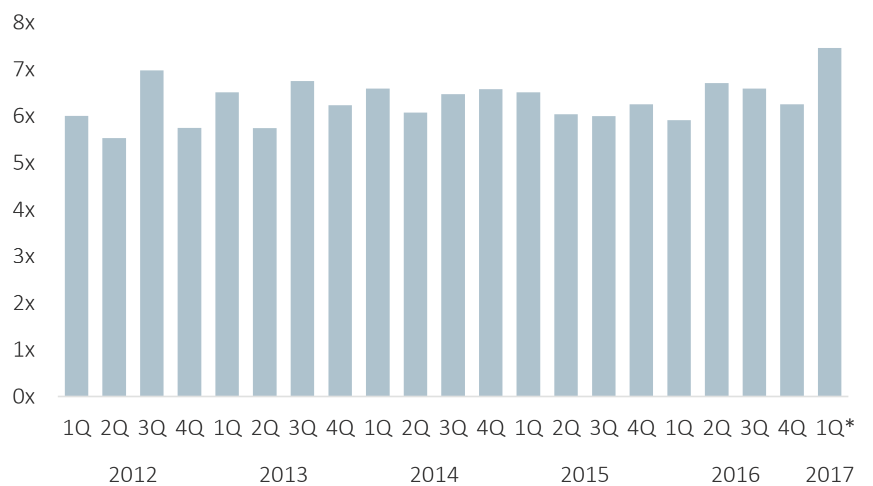
Source: PitchBook

Investment Multiples

Combining data from both our survey and the PitchBook Platform, we observed a softening in prices in the final quarter of 2016. Median EV/EBITDA multiples dropped to 6.3x and median revenue multiples fell to just 1.1x. The ebb in pricing toward the end of last year is inconsistent with what we saw in our larger M&A datasets, where the median EV/EBITDA jumped slightly from 9.5x to 9.8x in 4Q 2016. The disparity in the sheer level of pricing is mostly due to the higher proportion of middle-market deals in our survey population, but the reversal in trends suggests that survey participants have had better success than most in terms of sourcing and closing deals at better valuations. Perhaps these middle-market deals are not seeing the same pricing pressures as larger counterparts, which see more interest from institutional capital and corporate acquirers alike. Moreover, our survey population is likelier to invest in lower-middle-market deals that trade at smaller multiples.

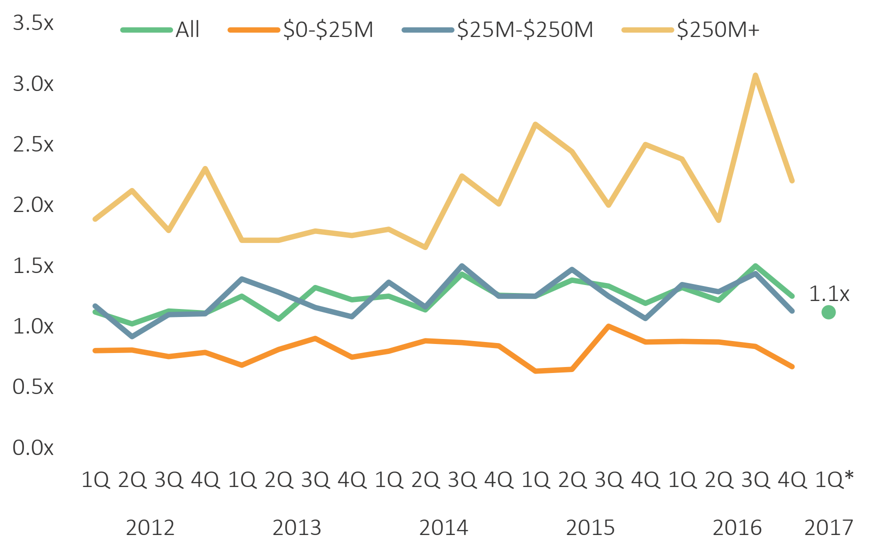
When looking at price levels in the first quarter of this year, the story is quite different. The median revenue multiple softened for the second quarter in a row to 1.1x, while the median EV/EBITDA multiple skyrocketed to 7.5x—a rare divergence for the industry. This widened disparity, then, could be due to PE firms buying more low-margin companies in the last quarter. Examples include increased purchases of struggling oil & gas producers now that crude prices have begun to stabilize, or increased interest in low-margin raw materials providers and construction firms in anticipation of new federal infrastructure spending in the US.

Median EV/EBITDA buyout multiples



Source: PitchBook
*As of 2/28/2017

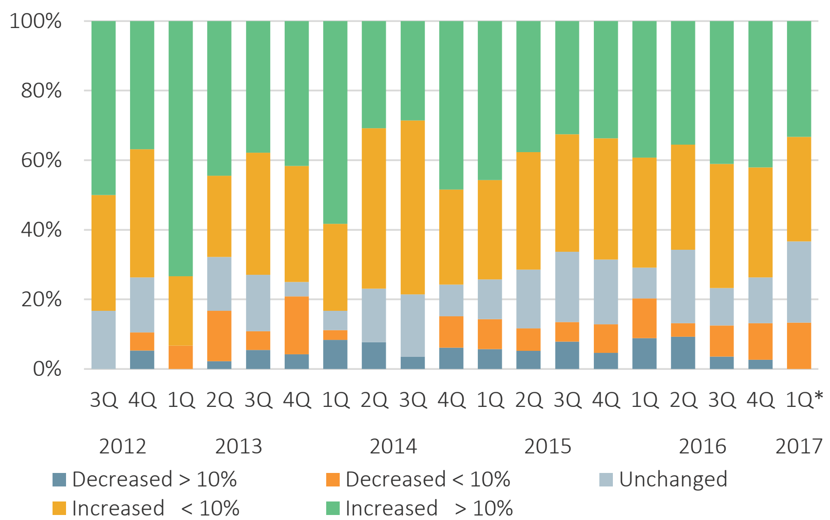
Median revenue multiples by transaction size bucket



Source: PitchBook
*As of 2/28/2017. Note: we excluded revenue multiples broken out by size buckets in 1Q 2017 as sample sizes were insufficiently robust.

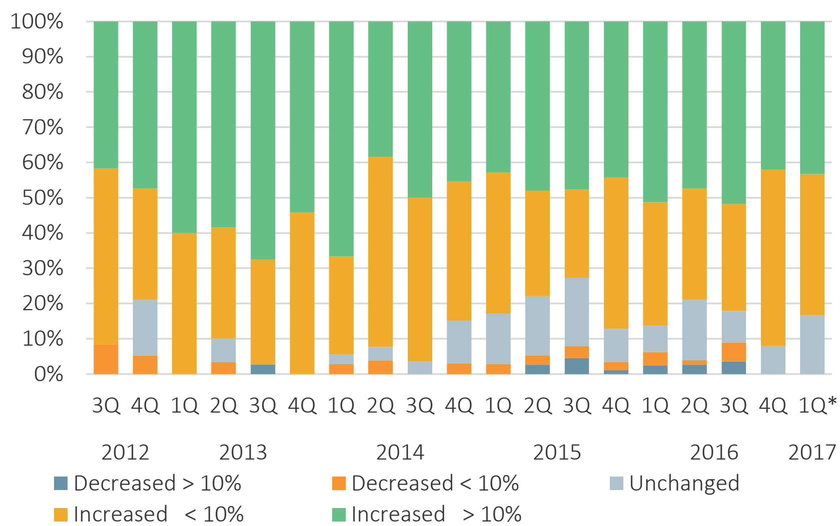
Revenue Change

Revenue change 12 months prior to deal



Source: PitchBook
*As of 2/28/2017

Anticipated revenue change 12 months following deal



Source: PitchBook
*As of 2/28/2017

On top of information about deal multiples, we ask investors about the trailing 12-month (TTM) revenue change at the acquired company, as well as the respondents' anticipated revenue changes in the 12 months immediately following a deal. Overall, the percentage of acquired companies which show revenue growth in the year prior to acquisition continues to dwindle from a high of 83% in 1Q 2014 to just 63% three years later. This trend reflects the greater availability of healthy leveraged buyout targets in the years prior to the most recent buyout boom.

Compared to the last year, however, newly acquired portfolio companies remained relatively healthy in the last two quarters. 42% of companies acquired in 4Q 2016 reported TTM revenue increases greater than 10%, the highest since 1Q 2015. Further, fewer firms acquired in the last two quarters had severe TTM revenue decreases. Just 3% of companies bought in 4Q 2016 and 0% of acquisitions in 1Q 2017 had TTM revenue decreases of greater than 10%, the lowest figure in the last three and a half years.

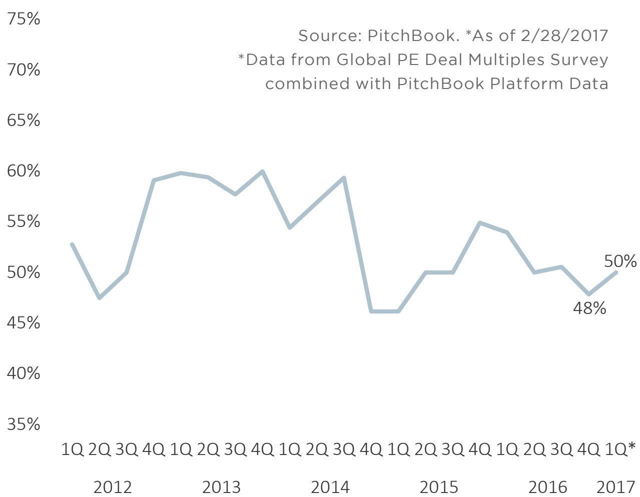
When it comes to predicting revenue changes at these recently acquired companies, PE managers remain as optimistic as ever. Exactly zero respondents predicted revenue decreases for portfolio companies acquired in either 4Q 2016 or 1Q 2017—it's worth noting this obviously won't be the eventual case, and speaks more to current investor mindsets more than anything else. To be able to close a deal at this point in the cycle, firms are counting on underlying performance improvement rather than solely multiple expansion or paying down portfolio company debt.

Debt & Equity Levels

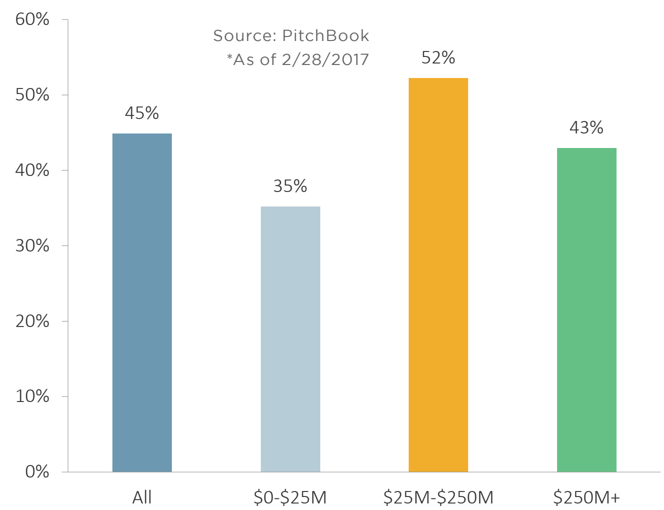
Debt usage in PE deals remains historically low. Median debt usage was just 48% of EV for deals completed in 4Q 2016 and 50% for deals completed in 1Q 2017, down from 51% in 3Q and 60% just a few years prior. Financing is readily available and rates are still low, but debt packages expressed as a percentage of purchase price will remain small in an environment of high valuations and stagnant earnings.

The same trend is supported by data on average equity contributions in our survey population, which relatively flatlined in 4Q at 51% of EV, then ticked up in 1Q 2017 to 53% of EV. This marks four consecutive quarters with average equity contributions above 50%. As discussed in previous reports, continually high equity contributions and low debt usage will put downward pressure on future PE returns. However, it should be noted that managers have increasingly relied on smaller-than-ideal debt packages at close, while planning on subsequent refinancings, which could be artificially inflating the equity contribution statistic. Even so, firms must put extra emphasis on operational improvements and organic value creation—in addition to sourcing relatively cheaper deals—to maintain the returns that many of their limited partners have come to expect.

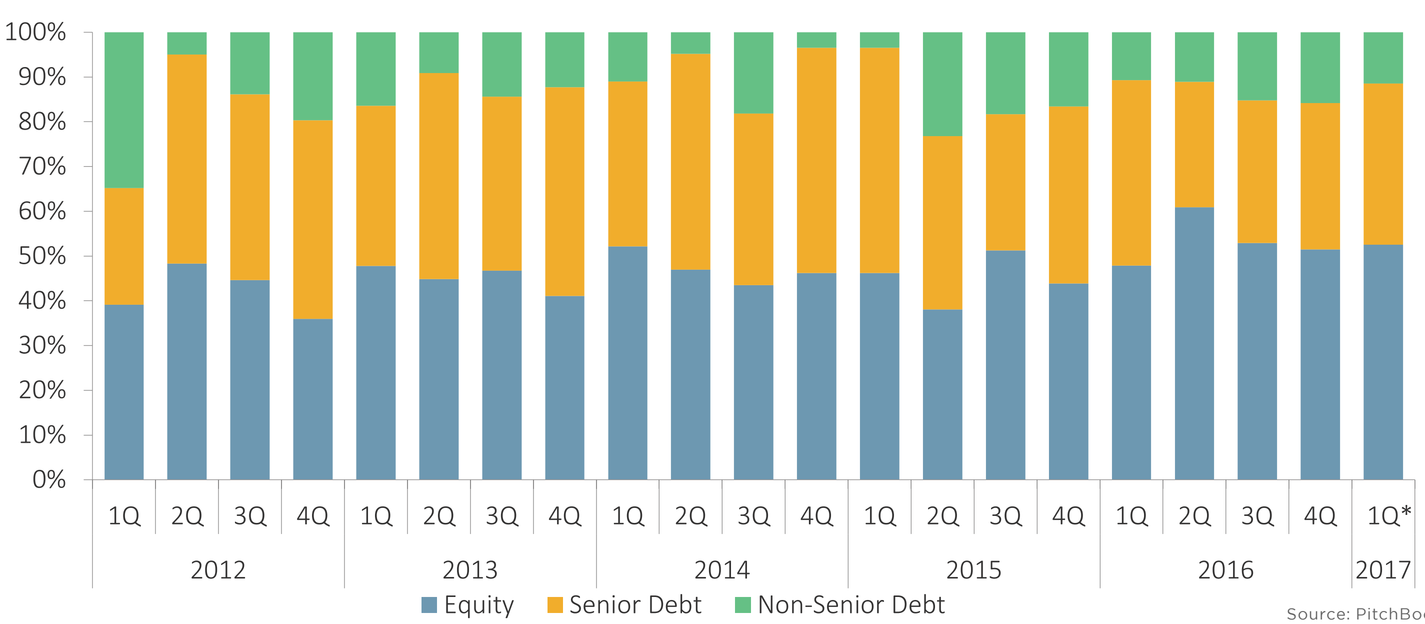
Median debt levels



Average debt levels by EV (4Q 2016-1Q* 2017)



Average debt-to-equity breakdown



Source: PitchBook
*As of 2/28/2017

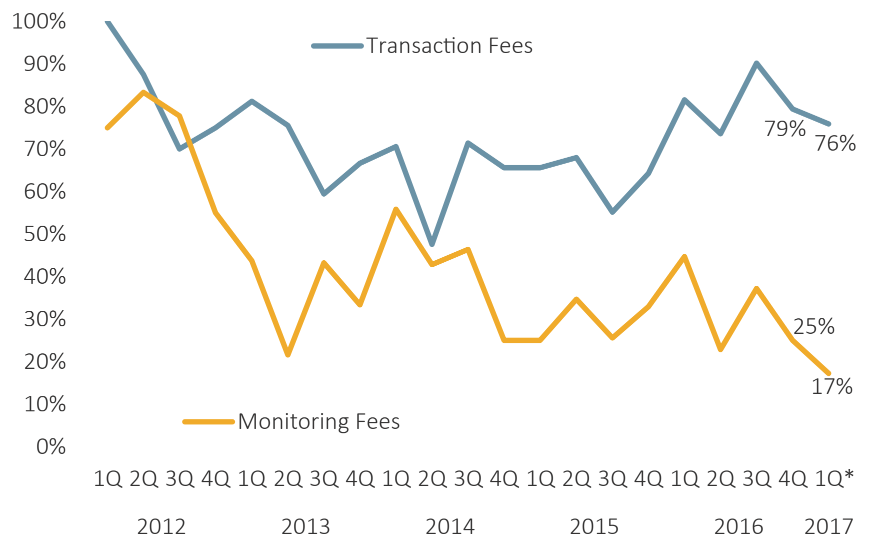
Fees

Generally, the industry is moving toward more transparency in regards to fees and manager compensation. Last year, however, we saw an increase in the size of fees associated with PE deals. Monitoring fees—defined here as fees charged to the portfolio company by the general partner for its advisory and management services—increased slightly in 2016, to 3.0% of EBITDA. We attribute this increase to the dwindling quality of acquisition targets, as lower EBITDAs will incentivize higher fees as a percentage of earnings.

Despite the uptick in fees as a percentage of earnings, the percentage of deals that have monitoring fees built into them dropped in both 4Q 2016 and 1Q 2017, to 25% and 17%, respectively. Due to the growth in co-investment popularity and subsequent direct involvement of LPs in portfolio companies, there has been heightened pressure to do away with, or at least lessen, monitoring fees. In addition, the SEC has cracked down on accelerated monitoring fees recently, as showcased by Blackstone's $39 million settlement over the matter in 2015.

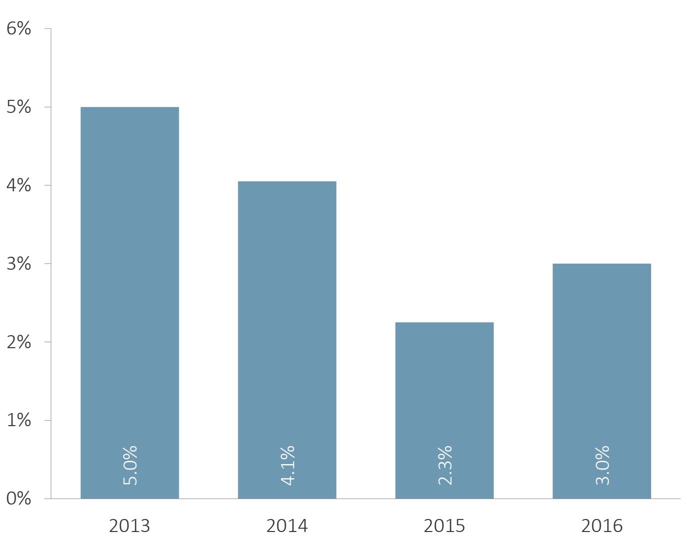
Conversely, transaction fees—defined here as legal, advisory, accounting or due diligence fees specifically related to the transaction and paid to a third party by the company being acquired—increased last year to a median of 3.0% of deal size, up from 2.3% the year prior. Due to the intensified and well-documented trends of economic uncertainty, lofty M&A pricing and stagnant portfolio company earnings, PE firms examined each deal with extra scrutiny, more often employing specialty diligence firms and advisors to ensure quality before deploying capital.

Proportion of transactions with fees



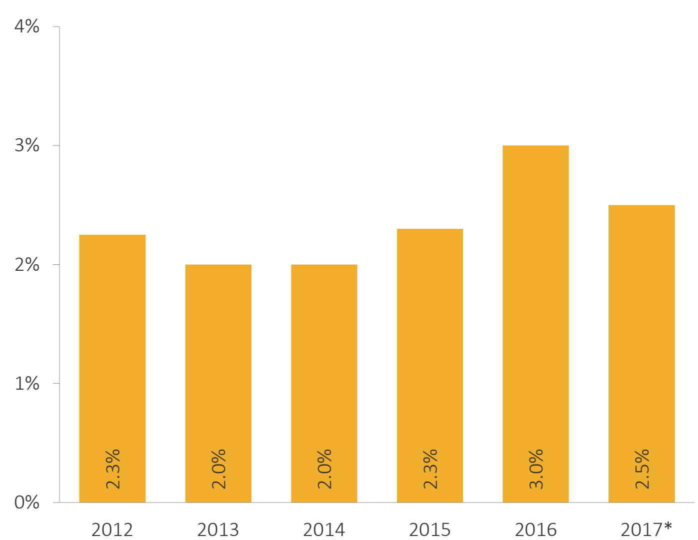
Source: PitchBook
*As of 2/28/2017

Median monitoring fee as % of EBITDA



Source: PitchBook

Median transaction fee as % of deal value



Source: PitchBook
*As of 2/28/2017

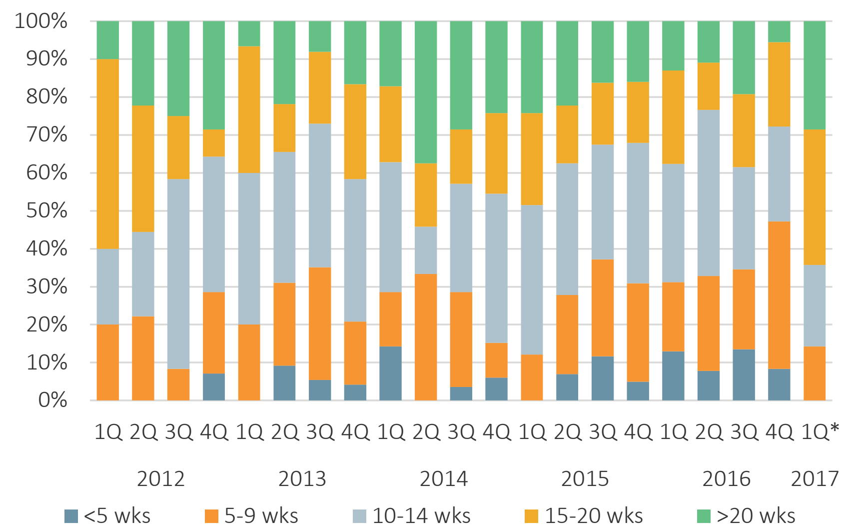
Closing Times & Earnouts

Though median time to close for PE transactions in our survey has always hovered around 12 weeks, the percentage of deals that closed in nine or fewer weeks had crept up from 12% in 1Q 2015 to a high of 47% in 4Q 2016. We attributed this rise to increased competition from strategic and financial sponsors alike. For certain assets, corporate competitors could complete all-cash deals in just a few days, while buyout shops became willing to waive financing contingencies and rely on refinancing after close.

It's puzzling, then, that median time to close shot up to 18.5 weeks in 1Q 2017, while 64% of deals took longer than 15 weeks to close—both the highest in the survey's history. The most likely culprit here is the US presidential election, the outcome of which was certainly a surprise to many investors. With so much in limbo during the transition period, many deals that were in play in 4Q could have had diligence periods extended into the first part of the new year.

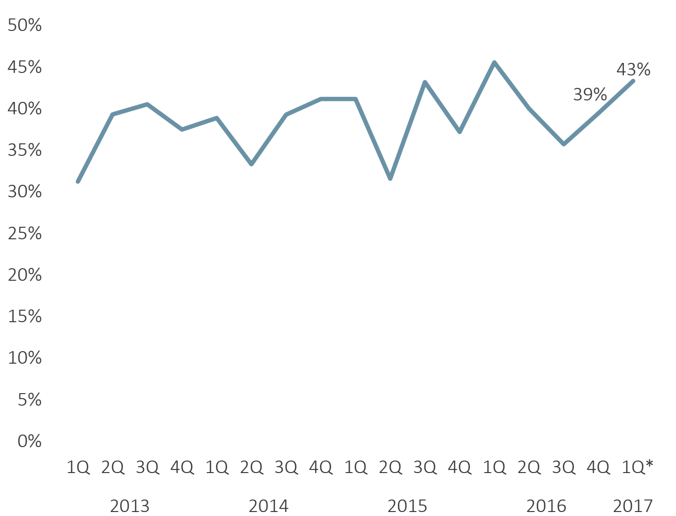
The percentage of deals to include earnout provisions or seller financing increased in both 4Q 2016 and 1Q 2017, to 39% and 43% respectively. Though it's still around the historical mean, we'll watch to see if this figure rises in the next few quarters, which could reflect increasing unpredictability in acquired company performance.

Transactions (#) by weeks to close



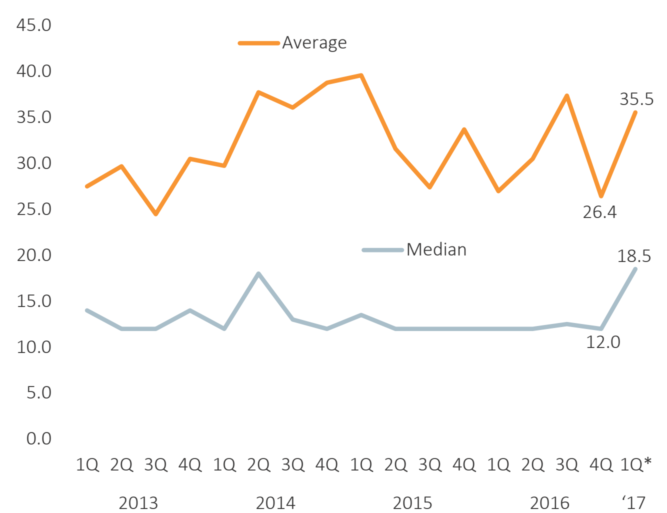
Source: PitchBook
*As of 2/28/2017

Deals with earnout provisions or seller financing (#)



Source: PitchBook
*As of 2/28/2017

Weeks to close



Source: PitchBook
*As of 2/28/2017