Spotlight Q&A: GFDR expects purchase price multiples to be higher in 2Q

— by Fran Fornaro

Thomson Reuters LPC sat down to discuss middle market M&A trends with Andrew Greenberg of GF Data Resources. The company provides data on private equity-sponsored M&A transactions with enterprise values of $10 million to $250 million

The average purchase price multiple for middle market companies with enterprise value between $10 million and $250 million averaged 5 times in 1Q10, according to GF Data Resources LLC. Although low relative to the average multiple of 5.7 times paid in 2009, the 1Q10 multiple is in line with quarterly levels of roughly 5.2 times seen in the second half of 2009.

"The first half of 2009 was characterized by a flight to quality; the difficult financing environment resulted in only a few high-quality deals getting done," Greenberg says. "But in 2H09 and 1Q10, sellers of good but not great businesses began to adjust their valuation expectations and reentered the market. These businesses are trading at more significant discounts to pre-downturn highs."

1Q10 M&A deals showed higher levels of senior debt and lower levels of equity in the capital structure relative to 2009. Strong liquidity in the senior loan market and a greater appetite to lend by middle market investors led to an increase in the senior debt component of deal structures to approximately 43% in 1Q10, up from only 28% in 2009.

Meanwhile, equity contributions, while still high from a historical perspective at roughly 54% in 1Q10, are down from peak levels of 62% in 2009. Data also shows that lower levels of mezzanine capital were utilized in 1Q10. Mezzanine capital made up only 4% of the capital structure for deals tracked by GFDR in 1Q10, down from 10% in 2009.

"For deals with EBITDA of $10 million and greater, senior lending is starting to warm up and mezzanine is getting compressed in terms of both multiple and spread," Greenberg says.

While M&A volume was light in 1Q10, anecdotal indicators surrounding deal activity all seem to be pointing up. According to Greenberg, deal activity began to pick up in the first quarter. 2Q10 should be higher from both a purchase price multiple and deal volume perspective, Greenberg says.

"There is a stronger feeling that business owners have left the sidelines, investment banks are pitching more and private equity sponsors are reporting more energetic bidding in some instances," he says. "The most notable improvement will occur first for larger middle market companies with EBITDA of more than $10 million. These firms have greater visibility on performance and better access to capital. Smaller issuers may take a bit longer to perk up and will likely show more of an improvement in the second half of 2010."

(For more information, visit www.gfdataresources.com.)

Fig. 1: Average purchase price multiples and deal volume

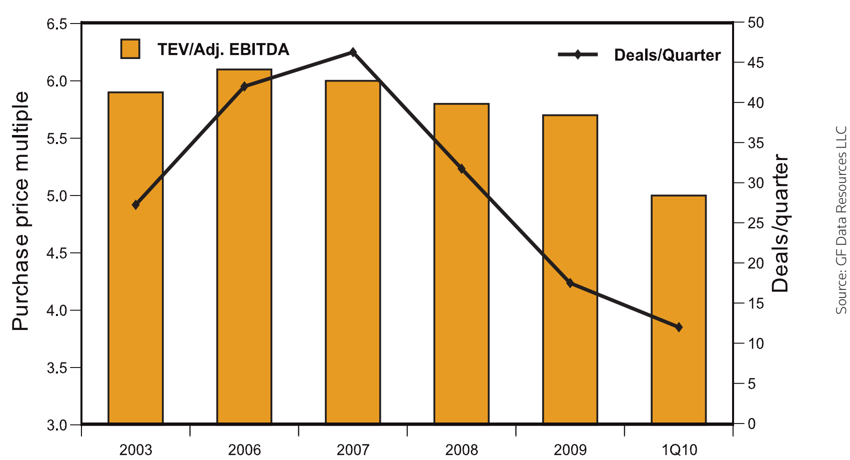

Fig. 2: Equity and debt contributions