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Middle Market Deal Activity Slows, Full Impact of Credit Squeeze to be seen in Fourth Quarter

November 20, 2008 - Middle market deal activity slowed slightly in the third quarter, but the full impact of the economic meltdown and credit squeeze has yet to be seen in the aggregate numbers, according to GF Data Resources, a proprietary database that collects detailed data on private-equity transactions valued between $10 million and $250 million.

"The data from the third quarter reflects a combination of two different market dynamics," said Andrew T. Greenberg, CEO of GF Data Resources LLC. "The selective but still active M&A market prevailed through the summer months, while tougher conditions took hold following the capital market tailspin in mid-September."

The 104 firms that contribute to the report completed 20 deals in the third quarter of 2008. By comparison, 42 deals were completed in the first half of 2008. These firms completed 133 transactions in all of 2007.

"The number of third quarter deals is approximately in line with activity levels for the first half of the year," said Greenberg. "However, the most severe economic and market events of the quarter did not strike until mid-September. We expect the fourth quarter data to show the full effects of the downturn."

The primary valuation metric – Total Enterprise Value as a multiple of adjusted Earnings Before Interest, Taxes, Depreciation and Amortization (TEV/EBITDA) – averaged 6.1x for the third quarter, up from 5.7x for the first half of 2008 and 5.8x in the second half of 2007.

"The uptick in valuation indicates that good businesses with secure market niches and the ability to withstand larger economic uncertainty continued to be bought and sold throughout the late summer months while less strong companies were more likely to pull back from the market," said Greenberg.

GFDR identified a number of emerging signs of a more difficult borrowing environment for business acquirers in the middle market:

-- Senior debt declined as a multiple of cash flow from 3.1x adjusted EBITDA in the first six months of 2007 to 2.5x in 3Q '08. Total debt – which also includes subordinated debt and other forms of junior capital – declined from 3.9x to 3.3x.

-- With less available debt, buyers needed to increase their equity contributions - equity accounted for 49.2% of the average capital structure, a rise of nearly 10 percent from 39.5% in the first half of last year.

-- As is often the case when bank lenders retreat and business sellers have not yet revised their expectations about value, subordinated debt providers began to play a more pivotal role in the market place. The percentage of deals utilizing sub debt increased over the past year from 45.2% in the first half of '07 to 50.0% in 3Q '08.

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