# Porter, White & Company

## What's It Worth

Valuation Review, Summer 2019

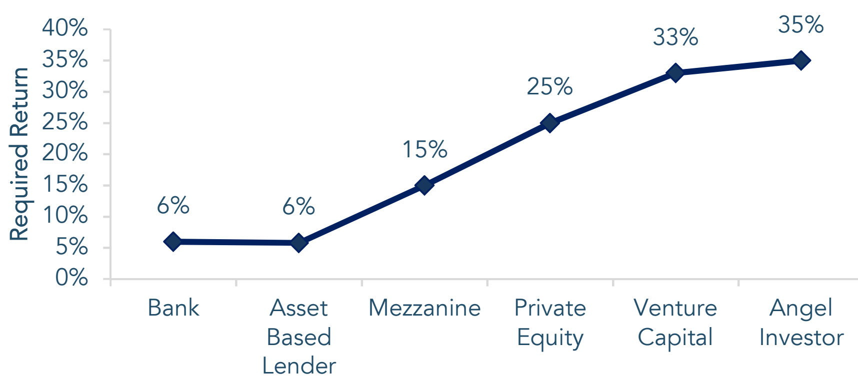
Our valuation review explores recent valuation trends in the public and private markets, directed to small and middle market business owners and the professionals and financial institutions that serve them. The review is designed to provide realistic guidance on the question "What's it Worth?," keeping in mind that proper preparation for real world transactions requires analysis of specific situations based on up-to-date data.

### I. Executive Summary

U.S. private equity deal activity remains robust and continued fundraising and private equity dry powder (funds raised but not yet invested) will drive competition and push deal prices upwards. Private equity firms continue to search aggressively for smaller deals in the lower middle market, which is often less competitive and lacks the strategic acquirer interest.

The chart below shows estimates of required rates of return for different market participants: banks/senior lenders ($5M loan size), asset based lenders ($5M loan size), mezzanine lenders ($5M loan size), private equity groups ($10M EBITDA), venture capital firms (startup investments), and angel investors (startup investments). Returns shown are based on survey data and not actual transactions and should be considered indicative only.

Figure 1: Private Capital Markets Required Rates of Return[1]



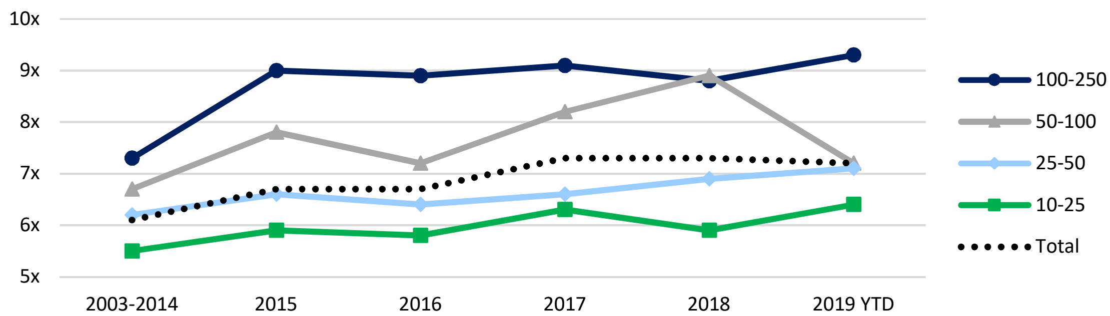

As private equity buyers pay higher prices for businesses, it becomes more difficult for private equity firms to continue to earn higher rates of return without substantial growth.

### II. Valuation Multiples in M&A Deals

Multiples of middle-market companies (defined here as companies with transaction values between $10M and $250M) continued to remain strong in 2019; however, multiples in the $50M-$100M size category dipped in 2019, which is likely more of a temporary aberration than a fundamental change in the market. As shown in Figure 2 below, middle-market companies sold to financial buyers for an average of 7.2x trailing 12-month EBITDA during 2019, consistent with

2018 levels. At the lower end of the middle market with enterprise value less than $25 million, companies sold to financial buyers for an average of 6.4x 12-month EBITDA, up from 5.9x in 2018. For an owner of a $2 million EBITDA business, this valuation increase results in an additional one-half turn (0.5x) of EBITDA or $1 million valuation increase, assuming a sale at the median multiples.

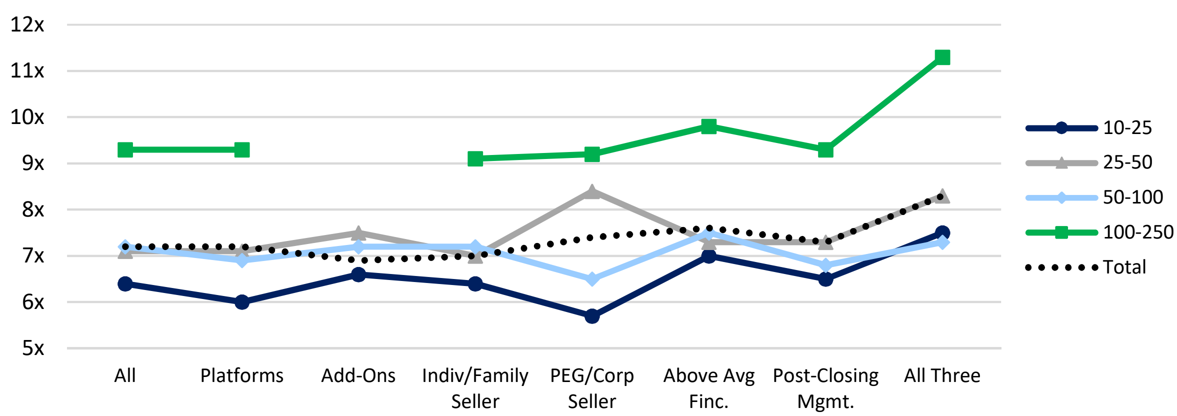
Figure 2: Valuation Multiples in Middle-Market M&A Deals by Size[2]




Source: GF Data®; Size is based on enterprise value of the target (in millions).

As shown in Figure 3 below, value is driven by a variety of factors, including existing ownership (individual/family or institutional), transaction purpose (platform or add-on), financial characteristics, and continuation of management post-closing. In almost all of these categories, private equity buyers have paid a "size premium" for larger businesses over comparable smaller ones. At the lower end of the middle market with enterprise value less than $25 million, sellers don't appear to be getting as much of a premium for all three relative value factors compared to larger deals.

Figure 3: Valuation Drilldown: Private Equity Buyout Multiples in 2019[3]

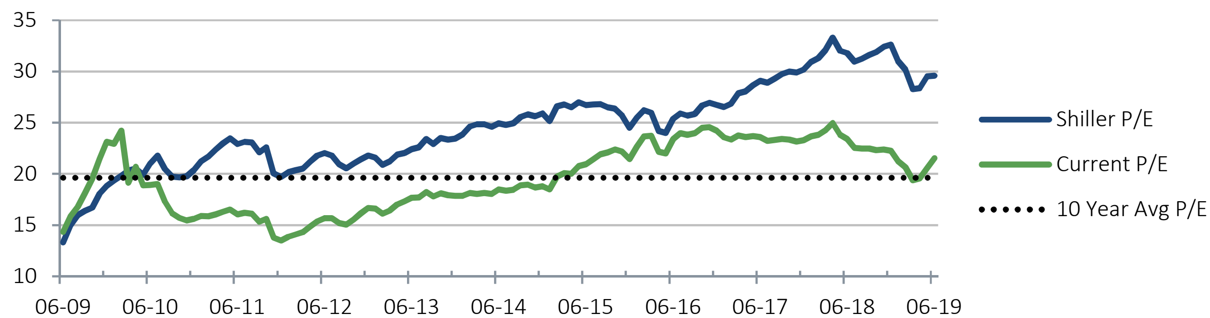



Source: GF Data®; Note: 'All Three' denotes buyouts featuring above-average financial characteristics, a post-closing management solution and private equity/corporate seller. "Add-Ons" buyout multiple for companies with an enterprise value between $100 million and $250 million is not available.

## III. Publicly Traded Valuation Multiples

Private transaction multiples are the most direct evidence of valuations in the private markets. However, public markets also provide an important view of valuation metrics and show how sophisticated investors currently view and quantify risk in a given company, industry, or geography. The current P/E ratio (current price divided by latest 12-month earnings) of the S&P 500 index has decreased to 21.6 from 22.3 during the last twelve months and the Shiller P/E ratio (current price divided by average earnings over 10 years) decreased to 30.3 from 31.9 over the same time period.

Figure 3: Publicly Traded Valuation Multiples Over Last 10 Years[4]




Note: The average P/E over the last 10 years was 19.6 as of June 30, 2019.

The following table provided by Aswath Damodaran summarizes the publicly traded market EBITDA multiples by industry at the beginning of 2019. It is important to understand and assess the industry drivers when valuing a business, and industry multiples provide a public market view of growth and risk. The table is color coded to reflect the relative valuation metrics. Green rows indicate the highest multiples, yellow rows indicate mid-range multiples, and red rows indicate the lowest EBITDA multiples.

Table 1: Publicly Traded Valuation EBITDA Multiples[5]

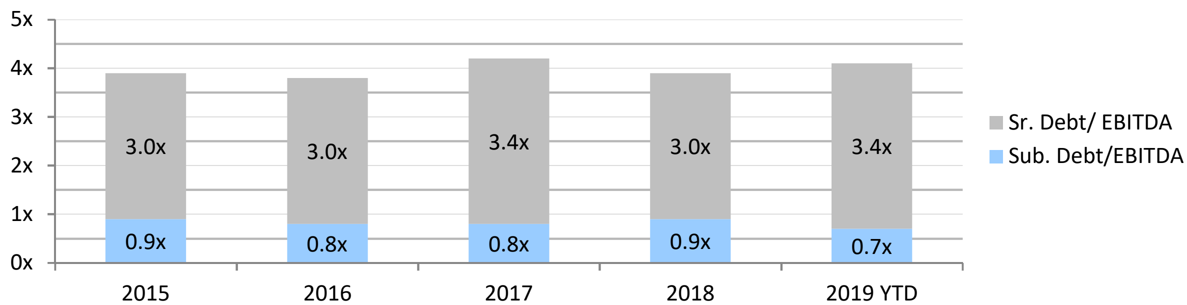
| Industry | # | EV/ EBITDA | Industry | # | EV/ EBITDA | Industry | # | EV/ EBITDA |
|---|---|---|---|---|---|---|---|---|
| Advertising | 48 | 7.9 | Entertainment | 120 | 14.2 | Power | 51 | 10.4 |
| Aerospace/Defense | 85 | 12.1 | Environmental & Waste Svcs | 91 | 11.7 | Precious Metals | 91 | 8.2 |
| Air Transport | 18 | 6.2 | Farming/Agriculture | 33 | 11.4 | Publish & Newspapers | 33 | 6.8 |
| Apparel | 50 | 10.1 | Food Processing | 83 | 11.7 | R.E.I.T. | 238 | 19.2 |
| Auto & Truck | 14 | 10.6 | Food Wholesalers | 18 | 11.3 | Real Estate | 88 | 17.2 |
| Auto Parts | 52 | 5.2 | Furn/Home Furnishings | 30 | 7.5 | Recreation | 72 | 12.3 |
| Beverage | 68 | 15.9 | Green & Renewable Energy | 21 | 15.6 | Reinsurance | 2 | 8.1 |
| Broadcasting | 24 | 8.8 | Healthcare Products | 248 | 19.3 | Restaurant/Dining | 78 | 13.8 |
| Building Materials | 42 | 9.6 | Healthcare Support Services | 111 | 10.7 | Retail | 330 | 11.5 |
| Bus. & Consumer Services | 168 | 11.1 | Healthcare IT | 119 | 19.3 | Rubber & Tires | 4 | 5.0 |
| Cable TV | 14 | 8.4 | Homebuilding | 31 | 8.7 | Semiconductor | 72 | 8.9 |
| Chemical | 134 | 8.3 | Hospitals/Healthcare Fac. | 34 | 8.6 | Semiconductor Equip | 41 | 6.7 |
| Coal & Related Energy | 23 | 3.4 | Hotel/Gaming | 70 | 10.6 | Shipbldg. & Marine | 9 | 9.2 |
| Computer Services | 119 | 8.0 | Household Products | 141 | 13.4 | Shoe | 10 | 17.5 |
| Computers/Peripherals | 57 | 9.4 | Information Services | 71 | 18.8 | Software | 491 | 18.5 |
| Construction Supplies | 48 | 9.1 | Insurance | 93 | 9.9 | Steel | 37 | 5.2 |
| Diversified | 23 | 12.3 | Investments & Asset Mgmt | 172 | 16.8 | Telecom | 186 | 9.0 |
| Drugs (Biotechnology) | 481 | 12.0 | Machinery | 127 | 10.8 | Tobacco | 17 | 10.1 |
| Drugs (Pharmaceutical) | 237 | 13.5 | Metals & Mining | 94 | 4.1 | Transportation | 57 | 8.3 |
| Education | 35 | 11.6 | Office Equipment & Services | 24 | 7.4 | Utility (General) | 18 | 12.4 |
| Electrical Equipment | 116 | 10.9 | Oil/Gas | 460 | 8.2 | Utility (Water) | 19 | 15.9 |
| Electronics | 179 | 16.4 | Packaging & Container | 27 | 8.0 | Total Market | | 14.8 |
| Engineering/Construction | 52 | 8.2 | Paper/Forest Products | 20 | 4.8 | | | |

## IV. Debt Markets

Debt utilization is at near-record highs in 2019, helping private equity firms fund expensive transactions at current deal prices. Total leverage for add-on transactions averaged 5.2x EBITDA (compared to 3.7x EBITDA for platform acquisitions), as acquirers used their existing company's financials to obtain increased levels of debt. Senior debt pricing averaged 5.7% (3.4% spread over 90-day LIBOR) in Q2 2019, and subordinated debt interest rates averaged 11.1% (13.8% all-in, including PIK and warrants) in Q2 2019. [6]

The figure below summarizes the change in leverage ratios over the past five years.

Figure 2: Debt Multiples[7]




Source: GF Data®; Notes: Total debt multiples are additive. For example: a company with $10M in EBITDA in 2019 could borrow $34M from a senior lender and $7M from a subordinate loan ($41M debt total).

## V. Conclusion

Business owners often have a significant amount of their net worth tied to their own businesses. When evaluating business options (expansion opportunity, company sale, ESOP feasibility, succession plan, etc.) a business valuation is often a good place to start. At PW&Co, our expertise in valuation allows us to advise clients on valuation issues in connection with the sale of companies and informs our advice on the process by which they are sold. When selling an entire company, we advise clients to look for synergistic and industry buyers who can realize the greatest benefits from the acquisition, and thus pay the highest price for the company. Regardless of market conditions, successful liquidity events take preparation and time. We encourage our clients who are considering the sale of their business, raising debt or equity capital for growth, evaluating succession plan options, or contemplating how to put their capital to work most effectively to contact us to discuss how to prepare in advance to achieve the best possible outcome.

Michael C. Stone, CFA

[1] Derived from the Pepperdine Private Capital Markets Project | Capital Markets Report – 2019.
[2] GF Data®, M&A Report, Aug 2019.
[3] GF Data®, M&A Report, Aug 2019.
[4] Bloomberg, accessed 9/26/19.
[5] *Table A*. Source: Damodaran, Aswath. http://www.damodaran.com, accessed September 26, 2019.
[6] GF Data®, Leverage Report, Aug 2019.
[7] GF Data®, Leverage Report, Aug 2019.