Porter, White & Company

What's It Worth

Valuation Review, Q1 2020

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

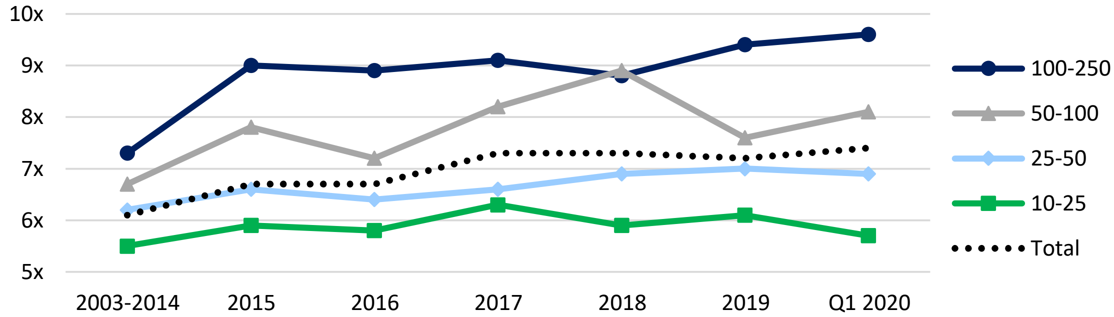
During the first quarter of 2020, buyers and sellers experienced at least two strong months of deal volume before COVID-19 dramatically slowed down M&A activity in March. Investors' views of certain industries and sectors have changed significantly since January, and they will continue to change and develop until we have a better understanding of the impact of COVID-19 on short-term and long-term growth. Sitting here in June, we see an active market of buyers looking for businesses that they can understand and in situations where the buyer can accurately calibrate risk. Virtual management meetings have become the new normal and reduced business travel has sped up some of the deal process. The majority of the completed deals have been sponsor-backed and strategic acquirers where significant leverage is not required. We have not seen a huge shift in valuation multiples since COVID-19; however, many of the deals that would have had large price reductions were likely not completed. At the same time, we have seen a resurgence of distressed situation funds preparing for advantageous opportunities after expected loan defaults and financial distress.

This report highlights valuation trends in the public and private markets in Q1 2020. While much has changed since Q1, it is still helpful to understand where we were only a few months ago. Many of the underlying dynamics that drive high valuation levels remain true today – continued private equity fundraising and excess dry powder (funds raised but not yet invested). A reduction in leverage from cash flow lenders may reduce the ability of some buyers to compete in auction processes for businesses, but there is still significant activity in the private markets and a lot of capital on the sidelines looking for the right acquisition.

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 Q1 2020; however, multiples in the $10M-$25M size category had a slight dip from a strong 2019, as shown in Figure 2 below. As shown in the figure below, middle-market companies sold to financial buyers for an average of 7.4x trailing 12-month EBITDA during Q1 2020, an increase from 2019 levels.

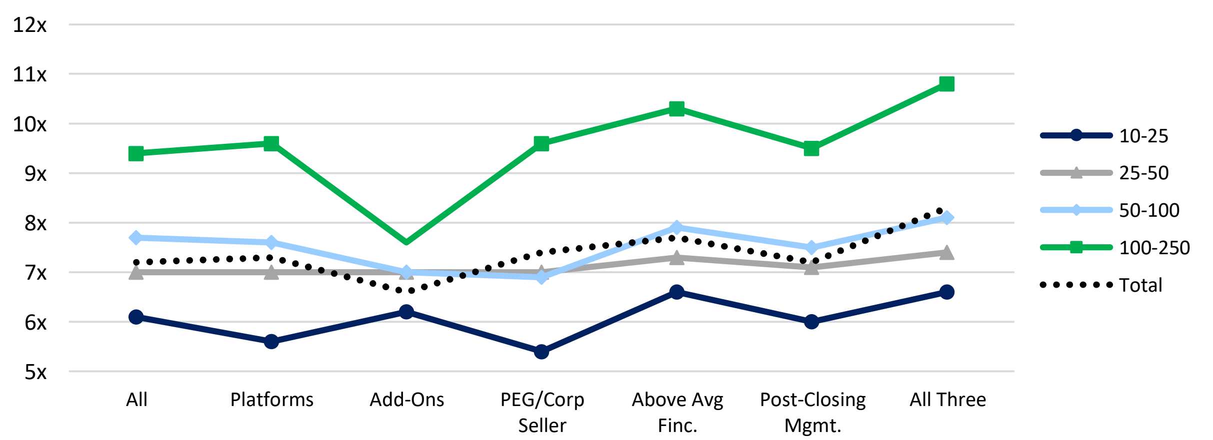
Figure 2: Valuation Multiples in Middle-Market M&A Deals by Size[1]



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. Within each segments of the middle market, sellers paid a premium for businesses that contained "all three" relative value factors (private equity seller, strong financial performance, and post-closing management).

Figure 3: Valuation Drilldown: Private Equity Buyout Multiples in 2019 and 2020[2]

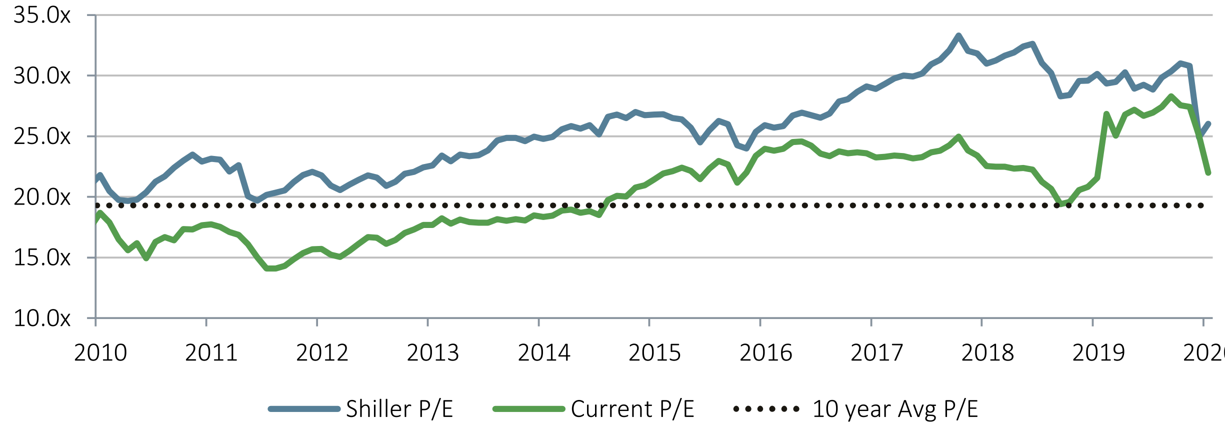


Source: GF Data®; Note: 'All Three' denotes buyouts featuring above-average financial characteristics, a post-closing management solution and private equity/corporate seller.

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 slight increased to 22.0 from 21.6 during the last twelve months and the Shiller P/E ratio (current price divided by average earnings over 10 years) decreased to 26.0 from 30.1 over the same time period.

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



Note: The average P/E over the last 10 years was 19.3 as of March 31, 2020.

The following table provided by Aswath Damodaran summarizes the publicly traded market EBITDA multiples by industry at the beginning of 2020. It is important to know what the industry looks like when valuing a business, and industry multiples provide a public market view of growth and risk. Public markets react more quickly more quickly to recent events than private markets, and we expect significant changes in some industries multiples as a result of COVID-19 in our next quarterly report. 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[4]

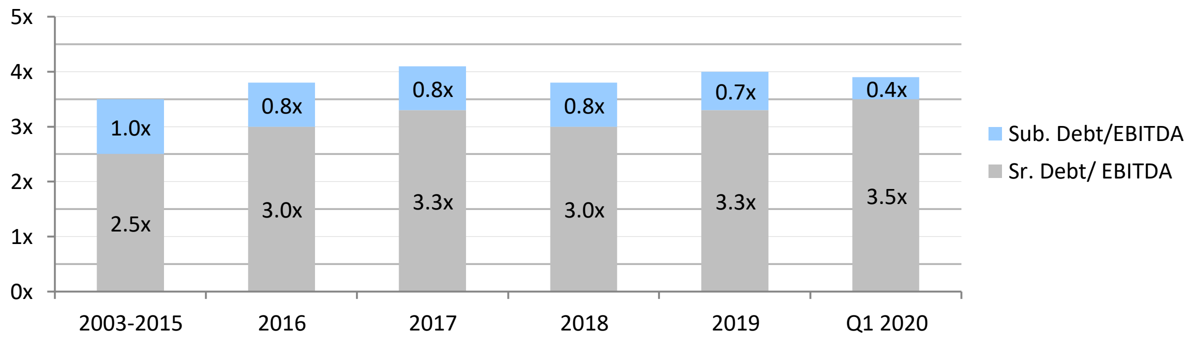
Industry	#	EV/ EBITDA	Industry	#	EV/ EBITDA	Industry	#	EV/ EBITDA
Advertising	47	9.2	Entertainment	107	21.9	Power	52	12.0
Aerospace/Defense	77	14.9	Environmental & Waste Services	82	13.9	Precious Metals	83	13.7
Air Transport	18	6.5	Farming/Agriculture	31	13.9	Publshing & Newspapers	31	9.2
Apparel	51	10.9	Food Processing	88	14.3	R.E.I.T.	234	22.6
Auto & Truck	13	14.4	Food Wholesalers	17	14.0	Real Estate	89	15.5
Auto Parts	46	6.4	Furn/Home Furnishings	35	9.3	Recreation	63	13.3
Beverage	55	18.1	Green & Renewable Energy	22	17.2	Reinsurance	2	14.9
Broadcasting	27	9.1	Healthcare Products	242	22.7	Restaurant/Dining	77	16.9
Building Materials	42	12.3	Healthcare Support Services	128	11.7	Retail	313	13.4
Business & Consumer Services	165	14.0	Heathcare IT	129	23.5	Rubber & Tires	4	5.9
Cable TV	14	10.1	Homebuilding	32	11.0	Semiconductor	72	13.7
Chemical	143	8.9	Hospitals/Healthcare Facilities	36	9.4	Semiconductor Equip	39	15.7
Coal & Related Energy	22	2.3	Hotel/Gaming	65	12.7	Shipbuilding & Marine	10	11.3
Computer Services	106	10.4	Household Products	127	16.6	Shoe	11	22.1
Computers/Peripherals	48	15.1	Information Services	69	26.4	Software	479	21.6
Construction Supplies	44	10.5	Insurance	94	10.4	Steel	32	6.2
Diversified	23	12.9	Investments & Asset Mgmt	192	22.0	Telecom	176	9.3
Drugs (Biotechnology)	503	13.3	Machinery	120	13.9	Tobacco	17	12.3
Drugs (Pharmaceutical)	267	14.6	Metals & Mining	92	9.6	Transportation	59	11.3
Education	35	14.5	Office Equipment & Services	22	8.8	Utility (General)	16	14.1
Electrical Equipment	113	12.8	Oil/Gas	433	8.9	Utility (Water)	17	19.0
Electronics	173	14.4	Packaging & Container	24	9.5	Total Market		17.5
Engineering/Construction	54	9.8	Paper/Forest Products	15	7.5			

IV. Debt Markets

Debt utilization remained in the first quarter of 2020, helping private equity firms fund transactions at high deal prices. During 2019 and 2020, total leverage for add-on transactions has averaged 4.9x 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% (4.2% spread over 90-day LIBOR) in Q1 2020, and subordinated debt interest rates averaged 11.1% (13.9% all-in, including PIK and warrants) in Q1 2020. [5]

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

Figure 1: Debt Multiples[6]



Source: GF Data®; Notes: Total debt multiples are additive. For example: a company with $10M in EBITDA in 2020 could borrow $35M from a senior lender and $4M from a subordinate loan ($39M 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, AM

[1] GF Data®, M&A Report, May 2020.
[2] GF Data®, M&A Report, May 2020.
[3] Bloomberg, accessed 5/29/20.
[4] *Table A*. Source: Damodaran, Aswath. http://www.damodaran.com, accessed May 29, 2020.
[5] GF Data®, Leverage Report, May 2020.
[6] GF Data®, Leverage Report, May 2020.