# Porter, White & Company

## What's It Worth

Valuation Review, Q2 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

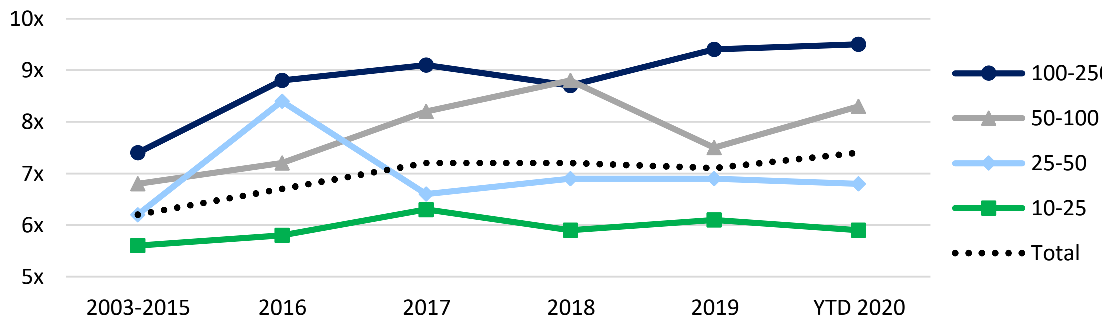
During Q2 2020 (April-June), the public and private capital markets experienced the full effects of COVID-19 throughout the 90-day period. Deal volume halted as the number of completed deals declined by over 50% from recent levels; however, based on the limited number completed deals, there was little to no change in valuations. The amount of debt leverage used in transactions declined, requiring buyers to fund more of the completed transactions with cash. Interest rates remained at record lows during Q2 2020, but credit spreads widened significantly, particularly for small transactions. Sitting here in September, we see an active market of buyers looking for businesses that they can understand and in situations where the buyer can accurately calibrate risk. Many deals that were sidelined during Q2 are beginning to come to market in situations where there is a clear understanding of the impact of COVID-19 on short-term and long-term growth.

This report highlights valuation trends in the public and private markets in Q2 2020. While much has changed since Q2 and the COVID-19 outlook is hazy, 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 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

Valuation multiples of middle-market companies (defined here as companies with transaction values between $10M and $250M) remained strong in Q2 2020 despite COVID-19. Multiples from larger transactions (valuation greater than $50 million) increased from 2019 levels, and multiples from smaller transactions (valuation less than $50 million remained relatively flat). As shown in the figure below, middle-market companies sold to financial buyers for an average of 7.4x trailing 12-month EBITDA during Q2 2020, an increase from 2019 levels.

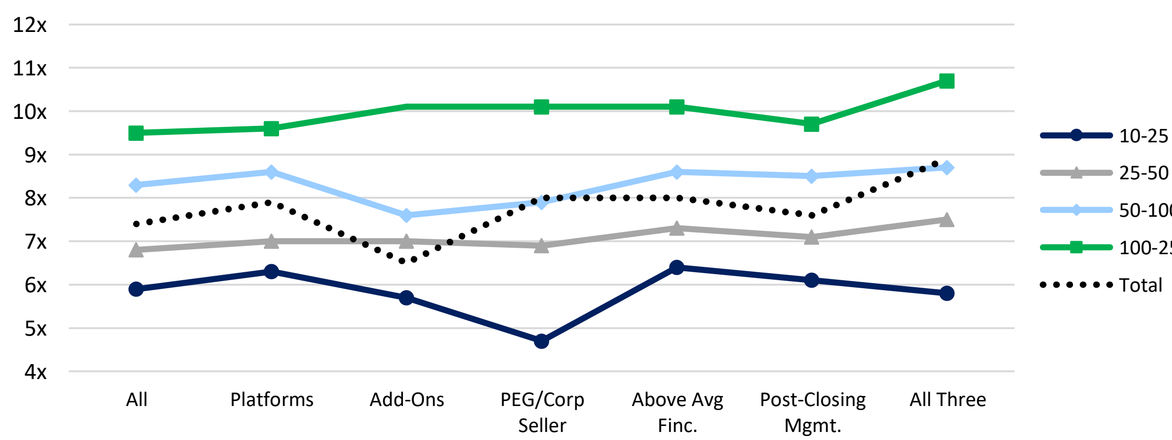
Figure 1: Valuation Multiples in Middle-Market M&A Deals by Size[1]




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

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

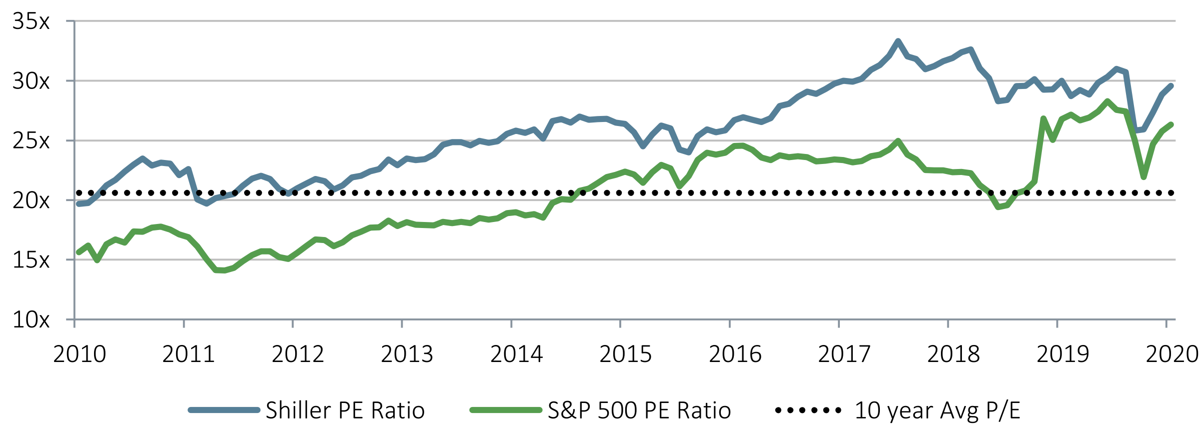



Source: GF Data®; Note: 'All Three' denotes buyouts featuring above-average financial characteristics, a post-closing management solution and private equity/corporate seller.

## 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 had a slight decrease to 26.3 from 26.8 during the last twelve months and the Shiller P/E ratio (current price divided by average earnings over 10 years) decreased to 29.6 from 30.0 over the same time period. The public markets have been extremely volatile since COVID-19, and the market recovered significantly during Q2 2020. As shown in the figure below, the P/E ratio of the S&P 500 increased from 21.9 to 26.3 during Q2 2020.

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




Note: The average P/E over the last 10 years was 20.6 as of June 30, 2020.

The following table summarizes the change in publicly traded market EBITDA multiples by industry from December 31, 2019 to June 30, 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. The table is color coded to reflect the change in relative valuation metrics. Green rows indicate the highest increase in multiples, yellow rows indicate mid-range change in multiples, and red rows indicate the greatest reduction in EBITDA multiples.

Table 1: Publicly Traded Valuation EBITDA Multiples[4]

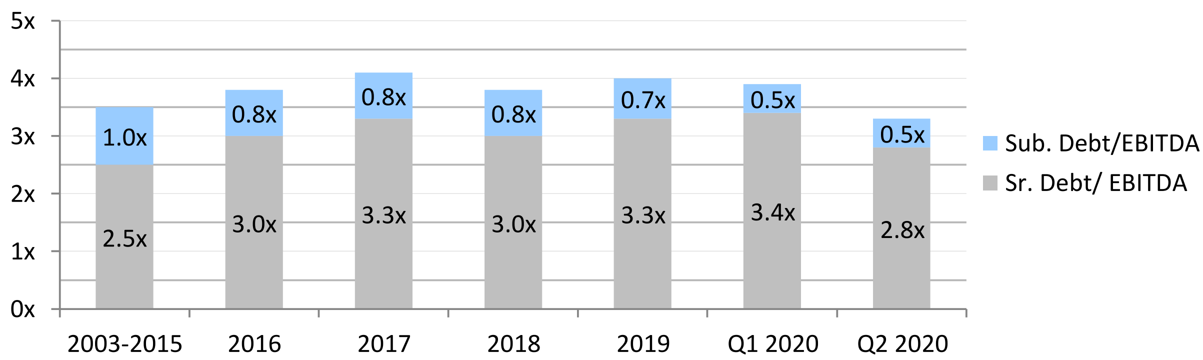
| | EV/EBITDA | | | EV/EBITDA | | | EV/EBITDA | |
|---|---|---|---|---|---|---|---|---|
| Industry | 30-Jun | Δ | Industry | 30-Jun | Δ | Industry | 30-Jun | Δ |
| Aerospace & Defense | 8.4x | -2.7x | Forestry & Paper | 6.7x | -0.8x | Nonequity Investment Instruments | 15.8x | 3.3x |
| Alternative Energy | 12.5x | 0.6x | Gas, Water & Multiutilities | 8.8x | 0.1x | Nonlife Insurance | 9.5x | -0.3x |
| Automobiles & Parts | 6.8x | -0.2x | General Industrials | 7.6x | -0.5x | Oil & Gas Producers | 4.9x | -0.8x |
| Banks | 5.4x | 0.0x | General Retailers | 8.6x | -1.1x | Oil Equip, Services & Distribution | 6.3x | -1.7x |
| Beverages | 9.4x | -1.2x | Health Care Equipment & Services | 13.0x | -1.2x | Personal Goods | 8.6x | -0.9x |
| Chemicals | 7.7x | -0.4x | Household Goods & Home Construction | 8.1x | -1.0x | Pharmaceuticals & Biotechnology | 13.7x | 0.7x |
| Construction & Materials | 7.3x | -1.0x | Industrial Engineering | 8.2x | -0.5x | Real Estate Investment & Services | 14.2x | -1.1x |
| Electricity | 8.6x | -0.4x | Industrial Metals & Mining | 7.9x | -0.1x | Real Estate Investment Trusts | 21.0x | 3.1x |
| Electronic & Electrical Equip | 9.0x | -1.1x | Industrial Transportation | 7.3x | -1.2x | Software & Computer Services | 11.8x | -1.0x |
| Equity Investment Instruments | 12.4x | 0.1x | Leisure Goods | 10.5x | 0.2x | Support Services | 8.4x | -1.4x |
| Financial Services | 11.0x | -0.8x | Life Insurance | 8.3x | -6.1x | Technology Hardware & Equip | 10.7x | -0.2x |
| Fixed Line Telecommunications | 6.6x | -0.6x | Media | 7.3x | -1.2x | Tobacco | 9.3x | -0.8x |
| Food & Drug Retailers | 9.1x | -0.3x | Mining | 6.6x | 0.2x | Travel & Leisure | 9.4x | -1.1x |
| Food Producers | 9.6x | -1.0x | Mobile Telecommunications | 7.0x | -0.5x | **Total Market** | **8.9x** | **-0.8x** |

## IV. Debt Markets

Following the onset of COVID-19, debt utilization decreased significantly in Q2 2020, requiring buyers to fund transactions at high deal prices with additional cash. Total debt leverage averaged 3.3x EBITDA in Q2 2020, a reduction from 3.9x in Q1 2020. Since January 2020, total leverage for add-on transactions has averaged 4.3x EBITDA (compared to 3.5x EBITDA for platform acquisitions), as acquirers used their existing company's financials to obtain increased levels of debt. Senior debt pricing averaged 6.0% in Q2 2020, as credit spreads widened by over 150 basis points to 5.7% over 90-day LIBOR. In transactions with valuations between $10 million and $25 million, credit spreads have increased from 4.3% to 8.0% over 90-day LIBOR. Subordinated debt interest rates averaged 10.9% (13.9% all-in, including PIK and warrants) in during 2020. [5]

Figure 4 summarizes the historical change in leverage ratios from private equity transactions.

Figure 4: Debt Multiples[6]




Source: GF Data®; Notes: Total debt multiples are additive. For example: a company with $10M in EBITDA in Q2 2020 could borrow $28M from a senior lender and $5M from a subordinate loan ($33M 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] GF Data®, M&A Report, August 2020.
[2] GF Data®, M&A Report, August 2020.
[3] Bloomberg, accessed 9/3/20.
[4] Bloomberg, accessed 9/11/20
[5] GF Data®, Leverage Report, August 2020.
[6] GF Data®, Leverage Report, August 2020.