



# CALABASAS CAPITAL

## 2Q 2019 M&A Market Update

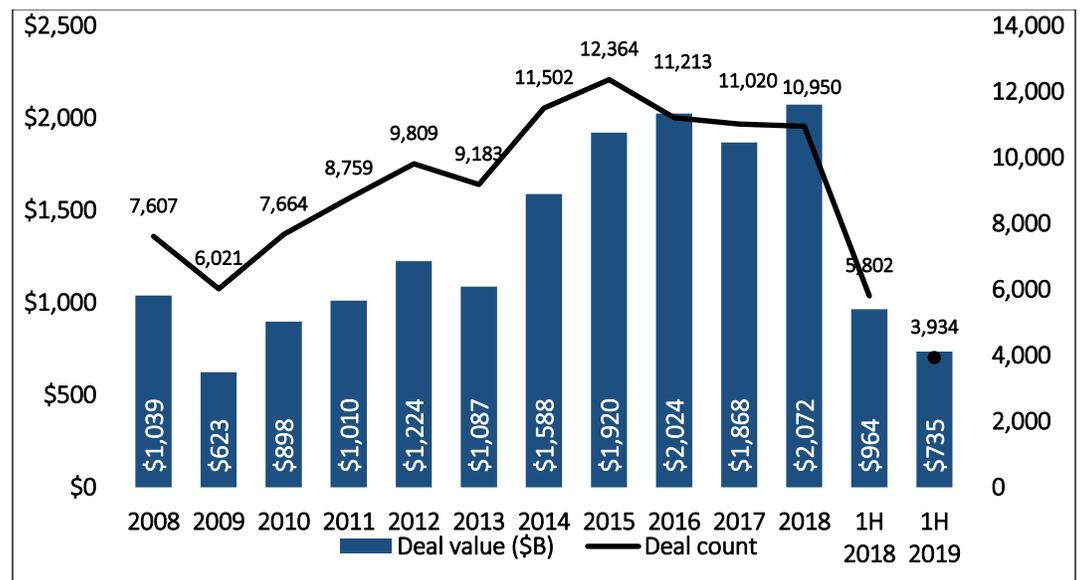
### About Us

Calabasas Capital is a boutique investment banking firm focused on serving lower middle-market privately-held companies and their business owners. We specialize in representing and advising businesses on sell-side and buy-side mergers, sales and acquisitions and we raise private equity and debt capital.

### M&A Activity in 1<sup>st</sup> Half of 2019 Solid but Down

According to PitchBook Data, after a record level of activity in 2018, U.S. M&A activity in the first half of 2019 was down as compared to 1H 2018 by 24% in terms of deal value and by 32% in terms of deal volume (the number of deals). The average deal size however in 1H 2019 of \$187 million was up 12% from the average deal size in 1H 2018 and was the highest since at least 2010, demonstrating a trend towards larger deals in the marketplace.

U.S. M&A Activity (\$Bns)\*



\*Source: PitchBook Data 2nd Quarter 2019 North American M&A Report.

- 1H 2019 deal value of \$734.8 billion was the lowest since 1H 2014 which saw \$727.5 billion in deals. 1H 2019 deal volume of 3,934 was the lowest since 1H 2010 when 3,750 deals closed.
- 1H 2019 average deal size of \$187 million was just above the previous recent high of \$185 million seen in 2016.
  - This trend toward larger deals is likely a function of the vast amount of capital available in the market – it is simply more efficient to put out money in larger chunks than smaller bite sizes. As larger companies grow even larger, they must make bigger acquisitions to move the needle.

### What's Causing this Drop in Activity So Far in 2019?

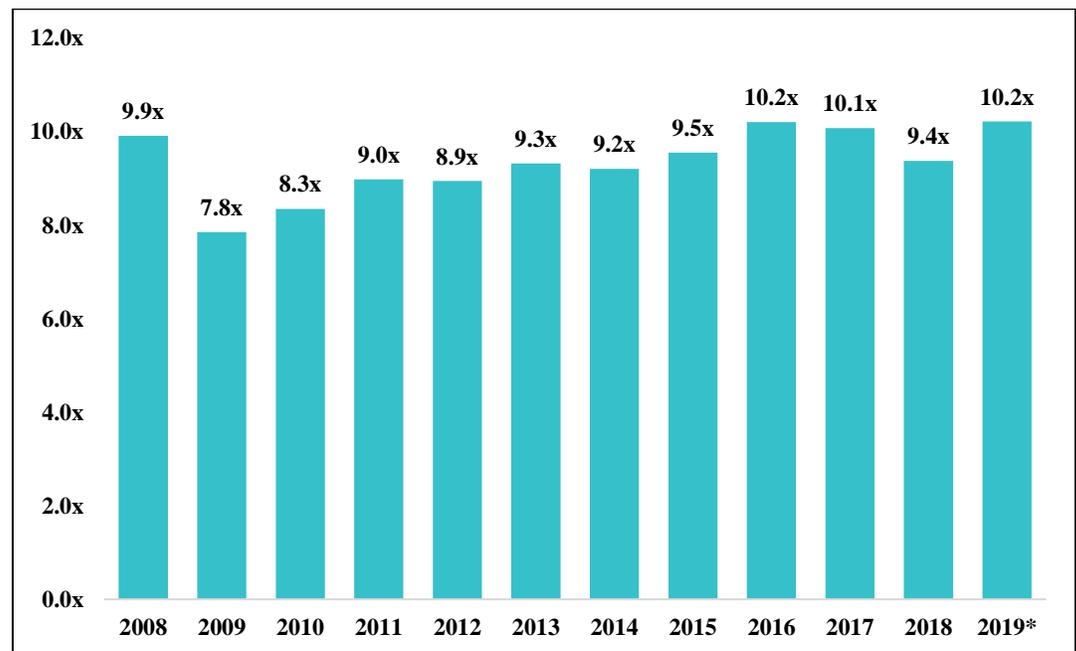
This slowdown in activity may be a result of a combination of factors, including:

- An escalation in geopolitical tensions and a global economic slowdown outside the U.S.,
- With valuations so high for so long more buyers are deciding to wait until prices come back down to normal levels before making additional acquisitions,
- Growth in U.S. corporate profits has slowed so far this year as compared to last year when profits were boosted by the corporate tax cuts so would-be acquirers are being more cautious, and
- Uncertainty regarding tariffs and the impact on future profits is making it increasingly difficult for buyers to properly assess the prospects of acquisition targets.
- The data includes only closed deals and once the announced deals are closed in the second half of the year, the gap in activity between 2019 and 2018 will be narrowed. Our own observations support this notion.

## Valuation Multiples Rebound

According to PitchBook Data, after two years of slight declines, North American M&A valuation multiples ticked back up to 10.2x in 1H 2019 to match the previous record high.

### M&A EV/EBITDA Multiples\*



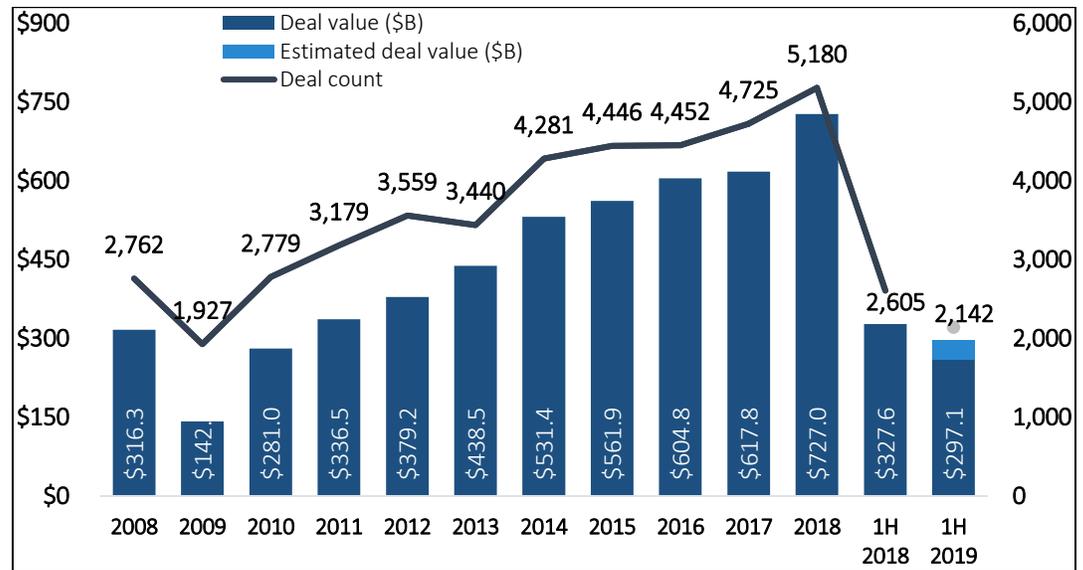
\*Source: PitchBook Data 2nd Quarter 2019 North American M&A Report. Through June 2019.

These multiples however reflect the overall market including public company deals and multibillion-dollar transactions. According to GF Data, the average multiples paid by private equity buyers in the lower middle market (deals between \$10mm and \$250mm in value) have remained in the **7.0x to 7.5x range**.

## Private Equity Activity Also Down but not Out

Private equity deal activity followed the overall M&A market down in 1H 2019 but not quite as severely (probably because the PE community continues to feel pressure to put money to work). According to Pitchbook Data, private equity M&A activity in 1H 2019 was down by 9% as compared to 1H 2018 in terms of deal value (\$297 Bn versus \$328 Bn) and down by 18% in terms of deal volume (2,142 deals in 1H 2019 as compared to 2,605 deals in 1H 2018).

### U.S. Private Equity Deal Activity (\$Bns)\*



\*Source: PitchBook Data 2nd Quarter 2019 Private Equity Report.

Technology has been a key area of increasing focus for the PE community over the past few years. In 2Q 2019, three of the nine deals completed above \$1 billion were buyouts of tech companies.

According to several reports, the PE community in the U.S. now sits on \$1 trillion of dry powder (committed but uninvested capital). As a result, the PE market should remain the more active part of the overall M&A market for the foreseeable future. As the U.S. economy rebounded in 1H 2019 from weakness in 4Q 2018, so did private equity deal activity. Healthy financial markets, including public equities and leveraged lending bode well for expectations for stronger deal flow in 2H 2019 although it appears unlikely that 2019 will match 2018 full year amounts especially if trade talks do not improve quickly.

## Interest Rates and Market Outlook

We believe the Fed started lowering rates again at the end of July to compensate for the negative impact to corporate profits from high tariffs increasing supply costs for U.S. companies and the stronger dollar making exports costlier for foreign consumers of U.S. goods. At the same time, low unemployment in the U.S. is making it increasingly difficult for U.S. companies, even those in the lower middle market, to add needed capacity to capitalize on growth opportunities. A continuation of Fed easing may be expected to extend the economic expansion and M&A cycle, but this could also lead to a bigger bubble (and ultimately a more significant downturn eventually) and could ultimately lead to negative interest rates in the U.S. during the next recession if the Fed empties its tank prematurely. For now though the market got its fix and the blue skies are clear for the most part so we might as well take advantage of it.

## Calabasas Capital

Our comprehensive services include:

- Sell-Side and Buy-Side Mergers & Acquisitions Advisory
- Private Equity & Debt Capital Raising
- Acquisition Financing
- Financial Restructuring

Our industries of expertise include:

- Consumer Products & Services
- Business Services
- Industrial Manufacturing & Distribution
- IT & Software

## Contact Us

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