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Multiples Shrink Year over Year

GF Data's second quarter report shows higher deal volume, highlighting that valuations, year over year, are still down significantly.

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Dealflow is up, while the credit markets – versus 2009 – have certainly improved, yet purchase price multiples for middle-market companies have retracted year over year, according to **GF Data Resources**' second-quarter report. The news, however, doesn't necessarily reflect of a softening of the M&A market.

GF Data Resources' database is compiled using activity from 154 private equity firms. In the second quarter, the number of deals, versus both the year-ago period and the preceding quarter, grew by over 70% and 60% respectively. The average enterprise value multiple, though, seemed to move in the opposite direction. It rested at 5.6x Ebitda for the quarter. The multiple marks an incremental improvement over the preceding quarter but is still down significantly from the 6.7x earnings multiple posted in 2009.

To be sure, a number of factors are at work that help explain the diverging trend lines. The early part of 2009 saw dealflow characterized by a bifurcation in the market in which only the companies that could sell were brave enough to initiate a process. The result is that purchase price multiples weren't indicative of the low M&A volume.

"There was a real flight to quality at the end of 2008 and early 2009; the only companies selling were the strongest companies with really attractive fundamentals," according to **Andrew Greenberg**, CEO and co-founder of GF Data. The result, he added, is that average purchase price multiples skewed higher.

Meanwhile, two years removed from the credit crisis, sellers of companies who may have put off processes are now re-entering the market. This influx of dealflow is being driven by the 'second tier' properties, now comfortable with lower valuations and further emboldened by improving performance.

"No doubt, there has been some pent-up inventory that has been returning to the market," Greenberg adds.

A takeaway from the second-quarter data is that a notable gap in valuations exist between mid-sized properties and smaller companies. Companies with Ebitda of between $10 million and $25 million, for example, yielded an average multiple for the quarter of 4.8x. Businesses with Ebitda of at least $25 million were able to fetch, on average, 6.3x, while companies with earnings ranging from $100 million to $250 million were a fraction under 7x Ebitda.

Looking ahead, Greenberg believes multiples for the most part will continue to trend higher. Based on GF Data's research, average multiples hit a trough in the third quarter of 2009, at 5.1x Ebitda, and since then have shown slow gains. Greenberg, however, is unsure if the momentum will extend to companies below $7 million to $8 million in Ebitda.