PE HUB

Lower Middle-Market Deals Return (Slowly)

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Smaller, middle-market deals don't get much respect.

Andy Greenberg, a managing director at investment bank Fairmount Partners, says he couldn't find any good data for lower middle market firms in 2006. So Greenberg, along with Graeme Frazier of Private Capital Research, started GF Data. The Philadelphia-based GF information provider compiles its data from 146 private equity firms that submit the information blindly — with a focus on PE deals between $10 million and $250 million.

"If you were representing a $50 million revenue consumer products company, the comps would be a $500 million revenue business," he explains.

The lower end of the middle market saw an uptick in second quarter volume. There were 26 transactions for the quarter ended June 30, up from 15 deals in 2009, according to GF Data. However, the 26 deals are still below peak volume of 2006 and the first half of 2007, when 40 such deals were announced per quarter.

Q2 multiples are gaining but still off last year's comps. Companies this year sold at 5.6x 12-month trailing EBITDA, down from the 6.7x they traded at in 2009. Greenberg blames last year's higher multiples on the mix of firms included in the data. "In the first half of 2009, the aftershocks of the recession were still so strong that the only deals getting done involved very strong businesses," he says.

Lower grade companies are now getting sold which is pulling down the averages, he says.

Small companies are still recovering from the recession, he says. "The recovery has crystallized more quickly for firms with more than $8-$10 million EBITDA than for firms with less than $5 million EBITDA," Greenberg says.

As more debt becomes available, valuations also will increase. But this trend will likely benefit larger middle market companies with $10 million EBITDA or more. "We expect that total debt and senior debt multiples will be stronger in third and fourth quarters and are the primary reason that valuations in that size range will continue to strengthen," he says.

PE firms that are looking to buy in the middle market are faced with an interesting choice. They could seek out larger deals, which may have more favorable dynamics but more competition. Or they could vye for smaller properties, which are still recovering but the competition isn't as intense. "Do you go larger or do you go smaller?" he says.