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Corporates remain bullish on mid-cap valuations

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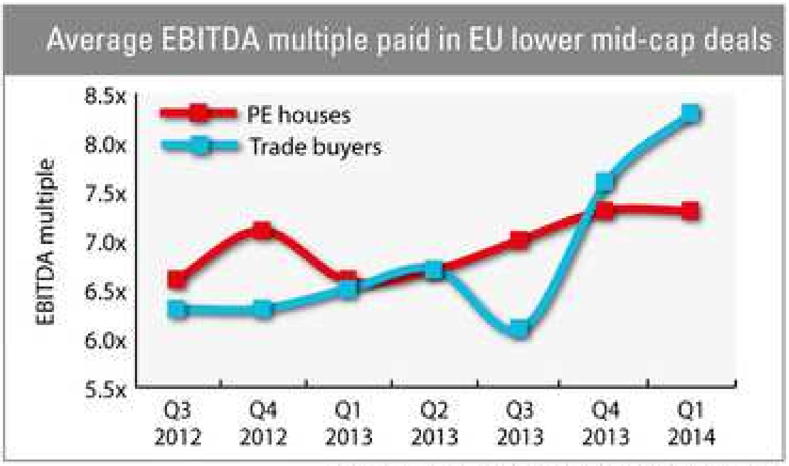

Source: Argos Mid-Market Index / Epsilon Research

It turns out that the bullishness displayed by corporates in the later months of 2013 was not just a flash in the pan: during the first three months of this year, trade buyers paid a median entry multiple of 8.3x EBITDA in lower mid-market buyouts – here defined as deals valued in the €15-150m range – according to the Q1 2014 Argos Mid-Market Index, published by Argos Soditic and Epsilon Research.

This is up by 10% on the Q4 2013 figure, which itself marked a noticeable increase on the 6.1x median recorded in Q3 last year. The Q1 median entry multiple is also the highest recorded in the index since the second half of 2007, when corporates paid a median 8.5x EBITDA.

This uptick was driven to a large extent by listed companies' willingness to acquire targets at multiples in line with their own – which have benefited from the resilience of public markets in recent weeks – as well as the appetite displayed by overseas buyers. US corporates indeed make up half of the non-Euro buyers in the index over the past six months, the highest level ever recorded in the quarterly study.

Private equity buyers, meanwhile, did not follow in the footsteps of their corporate counterparts, with the median entry multiple paid in leveraged buyouts remaining stable at 7.3x EBITDA – a figure similar to that recorded in the final quarter of 2013. This level remains high by historical standards, however: the median multiple witnessed in Q1 is the highest recorded for two years, and not far off the 7.6x average paid by GPs in this segment back in 2006.

"The 'must-have' assets are still commanding very high prices, both in corporate M&A and private equity-backed LBO situations," says Argos Soditic president Gilles Mougenot. "Will pricing remain similar for the latter when less sought-after assets inevitably come to the market? It logically shouldn't, but might not be totally out of the question, based on the significant levels of dry powder still in GPs' coffers and the levels of competition (and thus inflated pricing) we sometimes see for run-of-the-mill assets."

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Although the bullishness displayed by trade buyers could prove hard to match for private equity houses eyeing up the same assets come auction time, the widening disparity between the prices paid by both groups could favour GPs in exit mode, and explain in part why secondary buyouts have become less of a prominent exit route in recent weeks. According to *unquote" data*, trade sales accounted for a third of all divestments in the first quarter volume-wise, against 28% in Q4 last year.

Despite this positive trend, knowing which assets will catch the eye of corporates with very different consolidation and development strategies remains a challenge, says Mougenot: "The appetite displayed by strategic buyers should in all likelihood benefit GPs with the most attractive portfolios. But we are talking about a significant number of assets, and it remains very hard to predict which ones will ultimately appeal to trade players."

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