2017 Deal Volume Increases from Q4 2016 Lows

The first quarter of 2017 experienced a slight improvement in middle-market deal flow, with volumes up 2.2% over Q4 2016. With the presidential election uncertainty behind us, the M&A market has improved and appears to be accelerating into Q2 2017, despite volumes 2.9% below the first quarter of 2016. Additionally, the last two quarters represent the lowest level of deal volume for back to back quarters since the first half of 2013. These lower levels are likely tied to the uncertainty resulting from the election, with anticipated changes in taxes, regulation, government spending and healthcare. As this uncertainty subsides, deal volume will likely continue to increase.

Strategic and Foreign Acquirers Gain Market Share

The first quarter of 2017 experienced notable changes in the composition of acquirers. Strategic acquirers comprised 69% of the buyer base for middle-market deal volume. This is the highest level witnessed for any quarter over the past five years and represents an increase from 67% in the fourth quarter of 2016. Conversely, the continued decrease in private equity-backed transactions hit a recent low of 31% of total transaction volume. However, given the underlying dynamics of the economy and the credit markets, we anticipate that the remainder of 2017 will show a significant upswing in private equity activity.

In addition to strategic buyers gaining share, Q1 2017 experienced continued strength in foreign buyers’ portion of overall transaction volume. Foreign buyers comprised 13.0% of the buyer base during the first quarter of 2017. Despite the slight decrease from the prior quarter, in which foreign buyers made up 13.4% of the buyer base, these two quarters represent the highest level of cross border deal flow in the U.S. for any period since 2009. Continued strength in cross border deal activity and strategic acquirer interest, coupled with an anticipated upswing in private equity activity, should continue to provide momentum for deal volumes and multiples.

Observed Valuation Multiples Improve

Valuation multiples (as measured by enterprise value / EBITDA) for reported deals increased from 9.4x EBITDA during the fourth quarter of 2016 to 10.3x in the first quarter of 2017. The aforementioned uncertainty around the presidential election is believed to have driven deal multiples downward during the fourth quarter. Observed EBITDA multiples were similar, but slightly higher than those observed in Q1 2016. It is anticipated that Q2 2017 will show a continued improvement in valuation multiples as the election uncertainty subsides, with the potential to eclipse the five year highs set in 2014. The data presented herein is indicative of the middle-market M&A environment, despite the limited number of deals with disclosed enterprise values and EBITDA multiples.

Source: Capital IQ
Private Equity Continues to be a Significant Component of Food and Beverage M&A

Both strategic and financial buyers have remained active in the Food and Beverage ("F&B") industry, accounting for 76% and 24% of acquisitions, respectively, in Q1 2017. Strategic buyers continue to dominate overall deal flow and have sought acquisitions to offset slowing organic growth and to diversify their offerings. However, for the last five quarters, financial buyers have continued to play a meaningful role, accounting for an average of 27% of total transaction volume, demonstrating a steady interest in the industry. Q1 2017 saw a modest dip in this trend which appears to be an anomaly likely driven by available supply vs. private equity demand. 2016 and continuing through Q1 2017 saw private equity investments outpacing exits, driven primarily by the attractiveness of the industry’s stability and relatively constant market demand.

As the overall consumer demand for fresh, healthy and organic packaged foods has increased, large companies have adopted a buy vs. build mentality to keep up with demand. A great example of this can be seen with the recent acquisition in March 2017 of Ready Pac Foods Inc., a portfolio company of H.I.G. Capital, by Bonduelle Group. This deal gave Bonduelle increased access to the "better for you" single-serve and ready-to-eat salad and meals market.

F&B M&A Activity Continues to be Driven by Packaged Foods

Consolidation within the Packaged Foods and Meats sector will continue to drive strategic acquisitions, especially as favorable market conditions (i.e., low interest rates, proposed tax reform) and idle cash stockpiles promote deal flow. Q1 2017 was a key indicator of this trend, with 32% of all F&B transactions involving packaged food companies. While many sectors experience growth via product or technology innovation, growth in the Packaged Foods segment comes almost exclusively from adding new offerings. With significant shifts in what consumers are demanding, the quickest and often most efficient way for industry participants to grow revenue, and thus market share, is through mergers and acquisitions.

Deal Flow Driven by Lower Middle-Market

Q1 2017 saw a continued trend towards deals below $250 million. Nearly 95% of transactions were valued below $250 million for the quarter, demonstrating the sustained propensity of large strategic companies to make a greater number of investments in smaller companies rather than making large acquisitions, such as Maple Leaf Foods acquiring Lightlife foods for $140 Million in February 2017. A key driver in this continued trend is the increase in lower middle-market private equity interest, which has led to smaller add-on investments for their respective platform portfolio companies.
Q1 2017 Healthcare M&A Transactions Experience a Rebound

Q1 2017 middle-market Healthcare M&A activity experienced a slight rebound from the recent trough observed in Q4 2016. Both deal volume and value increased, with 1,020 transactions valued at over $6.3 billion in total enterprise value, representing an increase of 7% and 20%, respectively, from Q4 2016. Total observed deal value over the last twelve months reached $25.6 billion on 4,128 transactions, with an average transaction value of approximately $64.4 million.

Providers and Services Lead M&A Activity, Anchored by Physician Practice Transactions

The Healthcare Providers & Facilities and Services sectors led the activity in Q1, representing nearly 30% of the transaction volume for the quarter and resulting in approximately $1.9 billion in enterprise value. The strength in these sectors is largely attributable to the surge in M&A activity among physician medical groups, which has been driven by anticipated payment model changes and regulatory requirements that are causing physicians to either affiliate with larger health systems, sell to larger practices or partner with private equity. Overall, this trend is expected to continue as the Affordable Care Act ("ACA") remains in effect, despite efforts to appeal this legislation by the new administration.

Aside from the effect of regulatory uncertainty and the ACA, affiliating with larger health systems or practice groups is an attractive option as they provide physician medical groups with incremental resources, favorable reimbursement environments and reduced capital costs and administrative burden. These transactions are also advantageous for larger practice groups, hospitals and health systems, as these entities are interested in stronger medical networks and affiliated service groups, which position them to drive incremental patient volume and build brand awareness in the marketplace.

Favorable Market Dynamics Drive Increased Valuation Multiples in Q1 2017

Q1 2017 valuation multiples in the industry averaged 9.6x EBITDA, up from 8.3x EBITDA in the prior quarter. This reflects an increase of approximately 16%, despite limited valuation multiples observed for middle-market healthcare transactions (Less than $500 million in enterprise value).

In the last twelve months, the weighted average observed EBITDA multiple was 10.9x for U.S. middle-market healthcare transactions. Favorable macroeconomic conditions, combined with evolving competitive and regulatory dynamics in the Healthcare industry, will likely support M&A transaction volumes and valuations for the next several quarters.
Q1 2017
Industry Highlight | Industrials

Industrials M&A Nearing its Peak

Q1 was a strong quarter for Industrials M&A activity. However, the threat of interest rate hikes, uncertainty around the administration’s ability to enact change and slower economic growth on the horizon serve as reminders that the market is likely nearing its peak in terms of volume and value of transactions. These factors are likely to compel those owners of companies who are still on the sidelines to make a move to enter the market as sellers in the near-term.

Strategic Buyers Continue to Dominate Industrials M&A

Strategic buyers outpaced financial buyers in the first quarter, accounting for 82% of transaction activity. Armed with strong balance sheets and record high levels of cash available for investments, corporations continue to have an edge over financial buyers, particularly those that do not have complementary portfolio companies to leverage. That said, financial buyers continue to enjoy strong capital markets and an abundance of capital funds have yet to deployed. Much of the financial buyer activity this quarter was focused on smaller, add-on acquisitions where this group was able to more effectively compete with strategic buyers.

The trend towards strategic buyers was further highlighted by the increase in foreign buyer activity in the Industrials segment, representing approximately 20% of deal flow in the first quarter. Notably, foreign buyer activity in Industrials transactions was significantly higher than it was in the broader M&A market (13%), demonstrating a strong global interest in the U.S. Industrials sector. European corporations were an active buyer group in Q1 as European markets have been gaining strength in recent quarters, enabling buyers to fulfill significant pent-up demand for acquisitions.

Valuation Multiples Reach a Historical High, Despite a Dip in Deal Value

Industrials M&A activity was up 3% in Q1 2017 from the same quarter a year ago, however, total enterprise value fell by 21% in the same period. Deal flow was largely driven by smaller transactions, with average deal values of $53.0 million, down from $62.1 million in Q1 2016. At the same time, valuation multiples for Industrials M&A activity averaged 9.7x EBITDA in the first quarter. Despite the slight decrease from the first quarter of 2016, multiples were well above the FY 2016 average of 8.3x and the five-year average of 8.5x. M&A markets continue to be buoyed by significant capital (equity and debt) available for transactions, strong public market activity in the first quarter and the potential for tax reform under the new administration. These dynamics should continue to drive activity for the remainder of 2017.
About the Report

Research Methodology

For the purpose of this report, GCG defines middle-market M&A as an announced and/or completed transaction in which one company purchases a minority or majority equity stake in another company that is based in the United States and has an undisclosed or disclosed enterprise value less than or equal to $500 million. The information provided in this market overview was obtained from sources believed to be reliable, but its accuracy cannot be guaranteed. Statements provided herein reflect GCG’s objective opinions and are not to be construed as legal, accounting, financial or investment advice.

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