M&A trends and private equity deal activity
"We're starting to see some tension in terms of seller expectations and how much buyers are willing to pay for assets."

Harshad Khurjekar, Principal, Transaction Advisory Services
Seller expectations have seldom been higher than they are today. Asking prices are somewhat inflated, with high synergistic expectations already baked in. Those optimistic assumptions are creating issues when synergies don’t pan out as hoped. Because of the disconnect between buyer and seller expectations, the market is seeing more broken deals in recent quarters. High valuations create significant uncertainty when even small earnings adjustments are discovered prior to closing. Private equity (PE) investors are cautious of overpaying in this market, which saw a decade-high $331 billion invested last year. Valuations aren’t expected to come down until investor interest subsides dramatically, which doesn’t appear to be the case this year.
While the initial public offering (IPO) market has slowed generally, 2017 saw a rebound in offerings specific to global automotive suppliers. Among other auto suppliers that went public last year were Gates Industrial, a Blackstone-backed manufacturer of power transmission belts and fluid power products, and CarGuru, an online network with more than 40,000 dealers. The industry is facing a number of challenges, including changing demands and sustaining profitability. Among other priorities, suppliers may need to secure sufficient financing to succeed in this market. The IPO market was a popular way to do so last year, and the $2.3 billion raised through IPOs was more than twice the amount raised in Q4 2017.
Some RSM clients are starting to plan for a “soft slowdown” in the economy, even if a downturn doesn’t fall to recessionary levels. Recent investments may be affected by any macroeconomic hiccups over the next three to five years. Recent changes to the federal tax code shouldn’t significantly affect PE, though the changes are worth understanding. From a structuring perspective, RSM is helping clients understand the changes from a post-close, cash flow perspective, which is the most relevant to PE firms.
GLOBAL M&A VOLUME CONTINUES ITS DOWNWARD TREND

Deal volume dropped: North American activity fell 7 percent while European activity declined 24 percent.

- Slow start to private equity capital spend: $55 billion in Q1.
- With $26.6 billion invested, the commercial services subsector is already ahead of last year’s pace.
- Big buyouts continue: Q1 median spend of $94.4 billion.

PRIVATE EQUITY COMING OFF A HISTORIC 2017

- Q1 IPO value – $2.3 billion – exceeded 50 percent of 2017 totals.
- Private equity sponsors were behind two first-quarter IPOs worth a combined $2.2 billion raised.

IPOs TO REBOUND THIS YEAR?

- Uptick of 7 percentage points since 2013 for deals completed by financial sponsors. Private equity plays an increasing role in the overall M&A numbers.
- With $26.6 billion invested, the commercial services subsector is already ahead of last year’s pace.
- Big buyouts continue: Q1 median spend of $94.4 billion.

$77.2B
spent in Q1 on B2B acquisitions.

$26.6B

$94.4B

$55B
FEWER BUT BIGGER DEALS—THE TREND CONTINUES

After peaking in Q4 2017, M&A deal sizes fell back to earth in the first quarter. The Q1 median of $25.0 million compares well to recent quarters, though the heightened average ($347.7 million) reflects more large deals being done today.

With the exception of transportation, M&A values by subsector were in line with recent quarters. The $33.5 billion spent on commercial products were a bit higher than Q4 levels ($31.6 billion), while the $39.7 billion spent on commercial services deals wasn't far off the $46.7 billion spent in Q4 2017.
COMING OFF A RECORD YEAR

Over $331 billion of PE capital was invested in B2B last year, a 15 percent increase over 2016. 2018 got off to a slower start, but activity should pick up as the year progresses. The Q1 median B2B deal size ($94.4 million) was just under the 2017, which marked a record. As is the case with other sectors, B2B deal sizes are being skewed by consistently high yearly values and declining investment counts.
Q1 saw only 151 PE-backed exits, a visible decline from the first and fourth quarters of 2017 (215 exits each). Strategic acquisitions and secondary buyouts (SBOs) both fell significantly from Q4 levels, down 33 percent and 46 percent, respectively. SBOs made up a majority of PE exits in 2017, which hasn’t been seen since the run-up to the financial crisis. Q1 2018 continued that trend, with 87 SBOs outpacing 61 strategic acquisitions and only three IPOs.
THE VALUE OF RSM’S MIDDLE-MARKET LEADERSHIP

Focusing on the middle market, RSM US provides integrated transaction advisory, tax, assurance and consulting services. Our work with 4,300 middle-market businesses and professional services companies gives us a deep understanding of the key trends impacting the industry. In addition, we have performed due diligence on more than 2,000 deals in the past five years, over 300 of which were business and professional services transactions. This in-depth knowledge provides our private equity and strategic buyer clients with industry-specific due diligence considerations.