Middle Market Pulse

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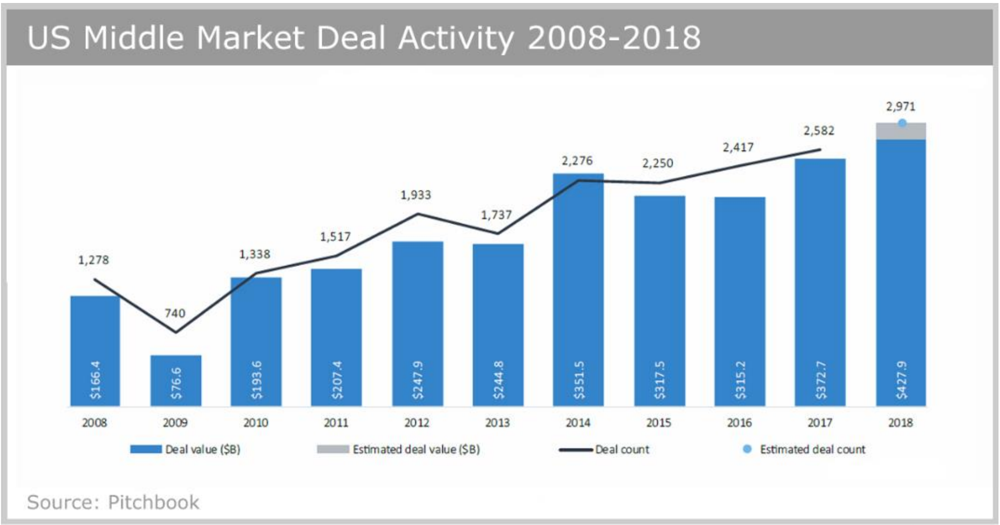

Figure 1

Pitchbook, a database of private company transactions, recently published their 2018 Annual Report on private equity investing in the middle market. Therein, they described how 2018 was a record-breaking year for aggregate middle market deal value with each quarter exceeding the $1 billion threshold and the total transaction value for the year exceeding the $4 billion mark.

Will this upward trend in deal value continue in 2019? The answer may lie in the fact that 2018 was another healthy year for U.S. middle market private equity funds, which raised close to $110 billion. 2018 also saw valuation multiples remain at lofty levels because private equity firms were flush with investment capital from their ongoing fundraising efforts; and also because the competition was fierce for best in class companies among both financial and strategic buyers. Another factor was the ready availability of relatively low-cost leverage capital and creative alternative funding solutions.

The data also suggests, however, that in certain industry sectors, like IT and healthcare, middle market deal activity actually dipped in 2018. A closer look helps to explain this counter-intuitive finding. With increased venture capital funding and higher multiples, many IT and healthcare companies grew in value to over $1 billion, which pushed them up and out of middle market territory. It is likely that this trend will continue.

Noted also in the report was that add-on investing was prolific in 2018 and the surge should continue in the coming years.

In 2018, U.S. private equity firms exited 876 investments with a combined deal value of nearly $188 billion. However, the overall exit value was down 10.5% compared with 2017 and has been trending downward since 2014. As with the IT and healthcare sectors, the explanation may again lie in the valuations of the companies upon exit. A company can enter into a portfolio as solidly middle market sized. Then, after the company executes a “buy and build” business model by integrating some add-on acquisitions, it can grow to be solidly outside the definition of a middle market company (i.e. $10 million to $1 billion in revenues). This is a trend that also will likely continue.

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