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Analysis

Trade buyer appetite boosts mid-cap valuations

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Improved confidence from both corporates and private equity investors has resulted in lower mid-cap valuations creeping up in the last quarter of 2013, according to the latest Argos Mid-Market Index.

Corporate buyers paid a median entry multiple of 7.6x EBITDA in lower mid-market buyouts – here defined as deals valued in the €15-150m range – according to the Q4 Argos Mid-Market Index, published by Argos Soditic and Epsilon Research. This is a healthy 25% rebound on the median figure of 6.1x recorded in the previous quarter, when trade players were apparently less aggressive than their private equity counterparts by some margin.

This increase comes on the back of a general uptick in European mid-cap M&A towards the end of last year, albeit from a low base and still below the levels of dealflow recorded in recent years. Argos investment manager Jérémie Falzone points to the signs of renewed interest in European assets as a notable factor behind this positive trend: "We can see a noticeable uptick in US corporates targeting Europe. The general feeling is that the risks surrounding the eurozone have dissipated to some extent, which has boosted these buyers' appetites – although France still remains something of a question mark."

Overseas investors indeed featured prominently in the index's sample, accounting for more than half (51%) of corporate buyers for the first time since 2008, while their historical average contribution stands at 32%.

This renewed confidence and willingness to pay higher multiples also extended to private equity buyers in Q4. The median entry multiple recorded in lower mid-cap LBOs rose to 7.3x, confirming the gradual improvement initiated at the beginning of 2013 – when the median multiple stood at 6.6x. The Q4 figure is the highest witnessed since March 2012, when private equity buyers paid a median 7.4x multiple for lower mid-cap assets.

This uptick in LBO valuations also came on the back of increased activity in the segment during the second half of 2013: dealflow in the €15-150m range went up by more than a quarter in both volume and value over the last six months of the year, according to *unquote" data*. Argos partner Gilles Mougenot highlights the positive impact of more favourable leverage opportunities on both dealflow and pricing: "Financing being more readily available has certainly had an impact. Senior lenders are now back in the game and alternative products such as unitranche keep gaining in popularity, notably in France."

More to come

Furthermore, the current level of competition among investment-hungry GPs and the comparatively low number of attractive assets on the market are likely to result in average multiples creeping up further. "Dealflow remains pretty sedate for the time being," notes Mougenot. "A significant number of processes are said to be underway, but many are unlikely to progress before full-year results for 2013 are produced. Vendors will be wary of avoiding the fate of several processes that collapsed in recent months on the back of trading issues coming to light and seriously dampening buyers' appetites."

This is compounded by the recent fundraising successes enjoyed by several European mid-cap players, with Mougenot warning of the widening mismatch between the level of dry powder and the number of opportunities to invest. "Fundraising has benefited from the increased appetite for Europe (notably on the back of more cautious attitudes towards emerging markets), and yet M&A activity remains quiet – in this context, prices should logically creep up even if current private equity portfolios remain a strong source of potential dealflow," he says.

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