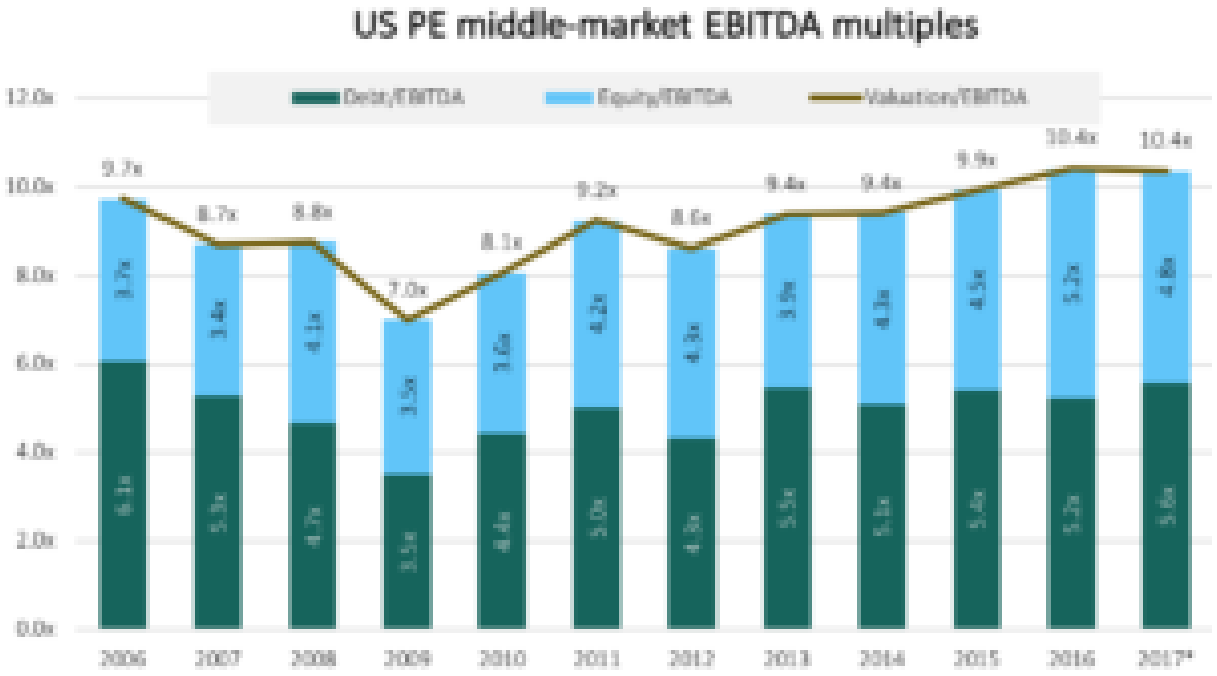
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A closer look at multiples

PitchBook | March 1, 2018



Download PitchBook's 2017 Annual US PE Middle Market Report click here.

The debt markets have been white hot recently, providing a tailwind for private equity and helping prop up valuations across the middle market. While cheap money has been a plus overall, investors have had to cap their debt commitments in today's regulatory environment. Debt multiples of 6x or higher of EBITDA are catching the attention of regulators, and the wide-open lending market is something of a forbidden fruit for investors while they try to put their money to work. PEGs are wary of crossing the 6x barrier, in other words, and the trend is borne out by the numbers. According to PitchBook's 2017 Middle Market Report, last year recorded the closest flirtation to that number since the crisis, hitting a 5.6x median in the US middle market. The last time the median debt contribution crossed 6x was in 2006 (6.1x), which was paired with a much smaller 3.7x equity contribution. The picture is largely reversed today, with equity contributions ranging between 4.5x and 5.2x over the last three years.

Headline valuations (in the low-10s overall) appear to be going nowhere, and fatter equity checks are by and large required to win deals and pass regulatory muster in today's market. That means, most likely, that eventual returns from today's transactions will take a hit once they exit, at least compared to historical returns. That also means that investors have changed their assumptions at the outset. Alan Jones, the coleader of Morgan Stanley Global Private Equity, had this to say at a recent industry conference: "Our presumption is that we'll be exiting at smaller multiples. If we're wrong, it means we planned for a future that was worse than what actually happened."

Are other investors—including those the middle market—presuming the same?

Contact: Alex Lykken
alex.lykken@pitchbook.com