

October 2017

# M&A Valuation: Trends, Challenges and Horror Stories

In the fast-paced world of M&A dealmaking, the issue of valuation can be a huge challenge. The price that one buyer is willing to pay could be tens or even hundreds of millions of dollars different than what someone else is ready to offer. In this report, dealmakers share their experiences and opinions about this crucial phase of the M&A process.

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# Methodology

In Q3 2017, Mergermarket interviewed 25 dealmakers in North America to learn their views on the challenges of M&A valuation. The respondents were senior executives at investment banks (40%), private equity firms (40%), and corporations (20%) that most often do deals in the middle market (below US\$500m in value).

## Introduction

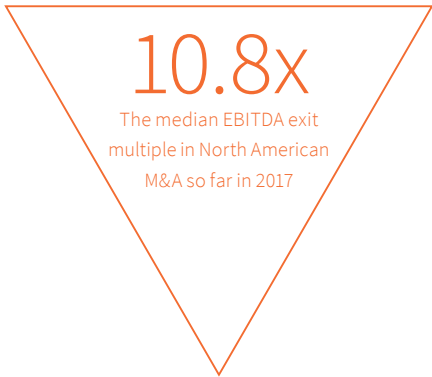
In M&A negotiations, the issue of valuation is typically the most important of all. And the central question facing acquirers is not necessarily, “How much is this asset worth?” Instead, the question they must answer is: “How much are we willing to pay for this?”

The reasons for this distinction are understandable. After all, an accurate valuation can be extremely difficult to calculate. This is especially true for outlier targets – take the recent example of ride-sharing giant Uber. Japanese tech conglomerate SoftBank has expressed its interest in buying as much as 22% of the company, for up to US\$10bn.<sup>1</sup> The catch is that SoftBank’s offer would value the company 30% lower than its last valuation, of around US\$70bn. Uber attained this valuation by impressing investors with non-stop growth – despite also sustaining billions of dollars in net losses.<sup>2</sup>

In fact, Uber has many of the qualities that make valuation challenging: high market share in a growing niche, combined with net losses; a short amount of time in the market, with impressive growth; cutting-edge technology; and a history of management issues. Of course, these are not the only hurdles that dealmakers face when valuing companies, either.

In order to learn about the most vexing issues M&A practitioners face when determining a valuation, Mergermarket, in partnership with Firmex, conducted a survey of senior executives at North American investment banks, private equity firms, and corporations. The executives shared their views on the challenges they face, the most common blunders they see made – and a few of the horror stories they have gone through in assessing company valuations.

In addition, Mergermarket sat down for an extended interview with Scott Hebbeler, managing director at Lincoln International, to learn about his experiences valuing M&A targets. Scott provides a wealth of insight into the difficulties inherent to the task of valuation.



10.8x

The median EBITDA exit  
multiple in North American  
M&A so far in 2017

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1. <https://www.wsj.com/articles/uber-shareholders-divided-over-softbanks-investment-offer-1505409810>

2. <https://www.bloomberg.com/news/articles/2017-04-14/embattled-uber-reports-strong-sales-growth-as-losses-continue>

# Part 1: Precision and bias in M&A valuation

Coming up with a suitable valuation in an M&A deal can involve a significant amount of artistry, in addition to the typical spreadsheet math. If a company is particularly small or in a novel sector, there may not be many comparable deals to rely on. Young start-ups, especially in the tech sector, may have negligible earnings or few customers to speak of.

As a result, few dealmakers believe that valuation can be deemed a science. In our survey, when asked to describe how precise the M&A valuation process is on a scale of 1 to 5, where 5 is “highly precise” and 1 is “highly imprecise,” the average response was 3.28. This

demonstrates that respondents believe the procedure is more science than art – but not by much.

Several respondents noted that new tools and better due diligence have improved the valuation process substantially in recent years. “Had you asked this question seven to eight years back, I would have chosen ‘2’ but now things have changed significantly,” said a senior M&A director at a cloud computing company. “Data analytics and machine learning coupled with AI are changing the way information is retrieved and analyzed. Highly precise and accurate data can be sourced, which helps us arrive at a proper valuation in an M&A deal.”

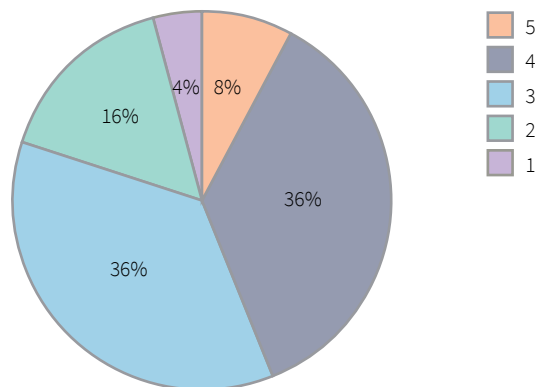
Another survey participant pointed out that the situation varies from sector to sector. “We deal with brands which are mostly B2C-oriented, and we adopt a very careful approach of determining the valuation of the company in an M&A deal,” said a senior vice president for corporate development at a consumer goods company with over US\$10bn in revenue. “But a lot of intricacies are involved when you deal with a consumer-oriented brand, as market reactions are spontaneous and all this has to be taken into consideration during the valuation.”

## Strategic vs. financial

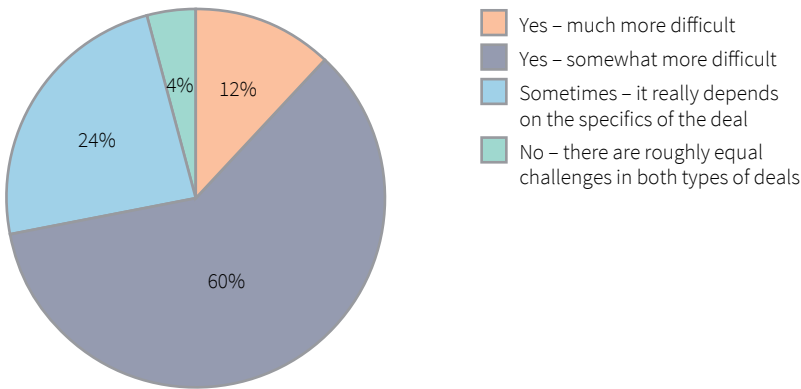
When Microsoft announced its acquisition of social network LinkedIn in June 2016, many observers went agape at the US\$25.5bn purchase price, which represented an incredible 94.7x EBITDA multiple. However, it is impossible to evaluate the deal on a strictly financial basis, given that it was strategic. Microsoft could have far better levers to take advantage of LinkedIn’s assets than buyers which lack the software giant’s infrastructure and reach.

Indeed, 72% of our survey respondents said it was either “much more difficult” (12%) or “somewhat more difficult” (60%) to arrive at a valuation in a strategic deal than in a strictly financial deal. One managing director at a private equity firm in operation for more than 35 years noted: “The seller may not have a strong financial record but sometimes the market or product mix is enough for him to negotiate. The brand value or non-financial factors are difficult to quantify.”

On a scale of 1 to 5, where 5 is “Highly precise” and 1 is “Highly imprecise,” how would you describe the valuation process for a typical M&A deal? (Could be buy-side or sell-side)



In a strategic deal on the buy side, is it more difficult to arrive at a valuation than in a strictly financial deal?



Contrast that situation with strictly financial deals, which are more common for private equity buyers or conglomerates such as Berkshire Hathaway. If special synergies or other advantages cannot be had, then a buyer is left to judge a target almost strictly by its financials and growth profile.

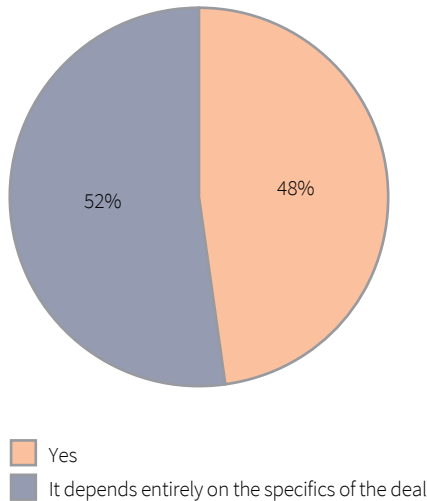
However, interestingly, this situation is becoming increasingly rare. Private equity firms are focusing more heavily on platform companies and bolt-on acquisitions for those platforms, making the bolt-on deals more strategic in nature. This shift can be seen partly in the convergence of EBITDA deal multiples in PE and non-buyout transactions. In fact, the median EBITDA multiple in North American PE buyouts was 11.6x in 2016, which actually exceeded that for corporate deals, 10.7x.

Nonetheless, 48% of our respondents said they believed a seller typically has more leverage when it comes to valuation in a strategic deal as opposed to a strictly financial transaction. No one said sellers do not have more leverage, and the remaining 52% said it depends entirely on the specifics of a given deal. “When a seller is aware of the impact their assets can have on a company, they tend to quote higher sums,” said a managing director at an investment bank focused on the financial services sector.

**The power of bias**

Another crucial factor that can affect a target’s valuation is mental biases. The field of behavioral economics has demonstrated that people are far from rational when making economic decisions – including those in mergers and acquisitions.<sup>3</sup>

In your experience, does a seller typically have more leverage when it comes to valuation if the deal is strategic in nature as opposed to strictly financial?



An array of irrational human habits can have an effect on valuation, and two-thirds or more of our respondents believe that at least three common biases play a role in valuation judgments: the bandwagon effect (68%), anchoring (72%), and ignoring the intangibles of a target in favor of financials (72%). Four in ten survey participants said that ignoring the intangibles in a deal – which will be the focus of Part 2 of this newsletter – is the most dangerous bias in valuation decisions.

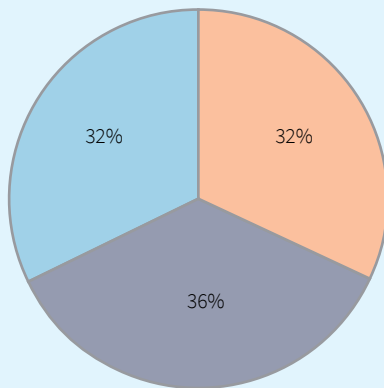
3. <http://scholarship.law.georgetown.edu/cgi/viewcontent.cgi?article=1437&context=facpub>

# Explaining the valuation gap

As any dealmaker knows well, one of the most frequent sticking points in M&A negotiation is valuation. In many cases, there is a gap that proves difficult to bridge.

Our respondents indicated that the main reasons for this gap often vary depending on the particular deal – no single explanation stood out. Instead, around one-third of respondents favored a different reason. Thirty-six percent said the two sides most often have differing opinions regarding the target’s growth potential; 32% said the gap is formed due to each side negotiating to maximize value; and 32% said the two sides most commonly have different opinions about the value of the target’s brand, IP, or other assets.

In your experience, what is the most common reason the buy-side and sell-side in a deal come up with different valuations for a company? (Select one)



- As a negotiation tactic – both sides are trying to maximize value
- Differing opinions regarding the company's growth potential
- Differing opinions regarding the value of specific aspects of the company (e.g., the brand, IP, etc.)

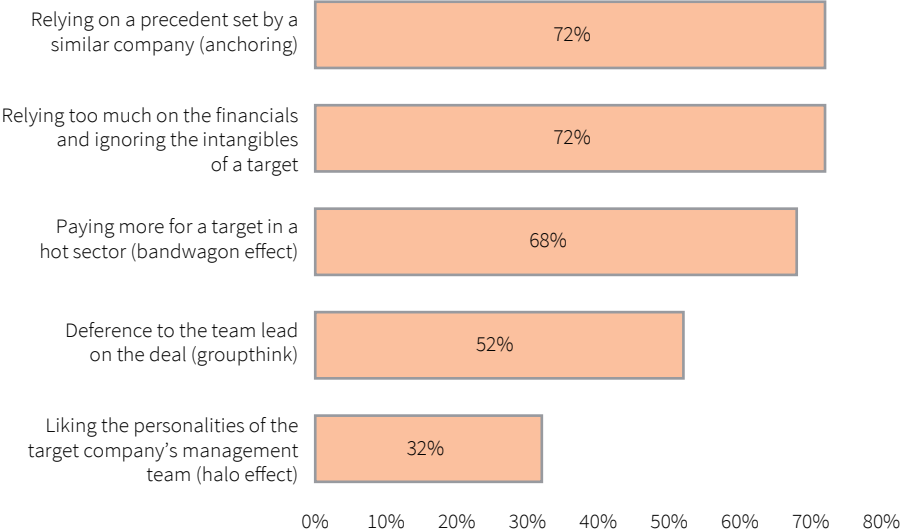
A difference of opinions regarding growth potential can be particularly difficult to resolve due to the inherent challenge of projecting future earnings. Take the recent example of a company for sale reported on by Mergermarket – UK-based telecoms company Arqiva. Two separate private equity consortiums had submitted offers for the company as of early September, but both were far short of Arqiva’s expectation – due to a disagreement over prospective changes to the company’s future TV revenues in the switch to digital.

A managing director at a US-based PE firm that does several deals every month argued that divergent valuations even of tangible assets can often cause a gap in negotiations. “This phenomenon is most common in healthcare, manufacturing, and energy sector deals, as the valuing of the company’s assets is a tedious task,” the PE executive said. “More than the brand value, the valuation of the physical and intellectual assets of a company affects the valuations greatly.”

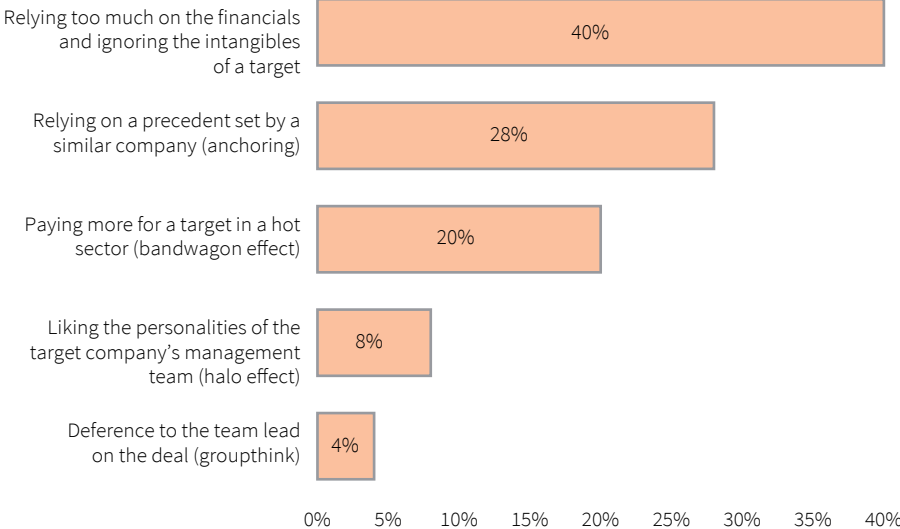
“More than the brand value, the valuation of the physical and intellectual assets of a company affects the valuations greatly.”

Managing director at a US-based PE firm that does several deals every month

Which of the following biases do you think affect judgments regarding valuation? (Select all that apply)



Which of the following biases do you think affect judgments regarding valuation? (Select the most dangerous one)



“Almost all the reasons given are factors that influence valuations,” said a managing director at a mid-market PE firm. “Out of those mentioned, I feel the most dangerous is that most analysts spend a lot of time studying and breaking down the financials of the target company. Financials are important, but other important factors such as product or service mix, competition, and operational details get ignored, and they often make a bigger impact on the actual numbers.”

The anchoring effect can especially impact valuations in emerging or niche sectors, where there may not be many comparable deals. (See the interview on page 9 with Scott Hebbeler, managing director at Lincoln International, for a concrete example of this effect at work in a slightly different situation.) Meanwhile, the bandwagon effect is often seen in the technology and consumer sectors.

“For consumer brands, this is the most frequent problem faced in any M&A deal,” said a VP for corporate development at a consumer company with more than 50,000 employees worldwide. “Hot sector syndrome affects most of the valuations. We usually assess the cycle, trajectory, duration and the spread of this hotness in the sector and the level of impact it is showing. Many times, brands ride short-term demand in the market, after which the valuation subsides.”

## Part 2: The importance of intangibles

How can you determine the value of a management team or other employees? This is one of the thorniest issues that M&A practitioners must answer in arriving at a company valuation: the real worth of intangibles.

A majority of our survey participants (52%) said the quality and fit of a target's management team was among the top two intangible aspects, making it the number-one response. Indeed, the importance of sound managers has been well-established by dealmakers.

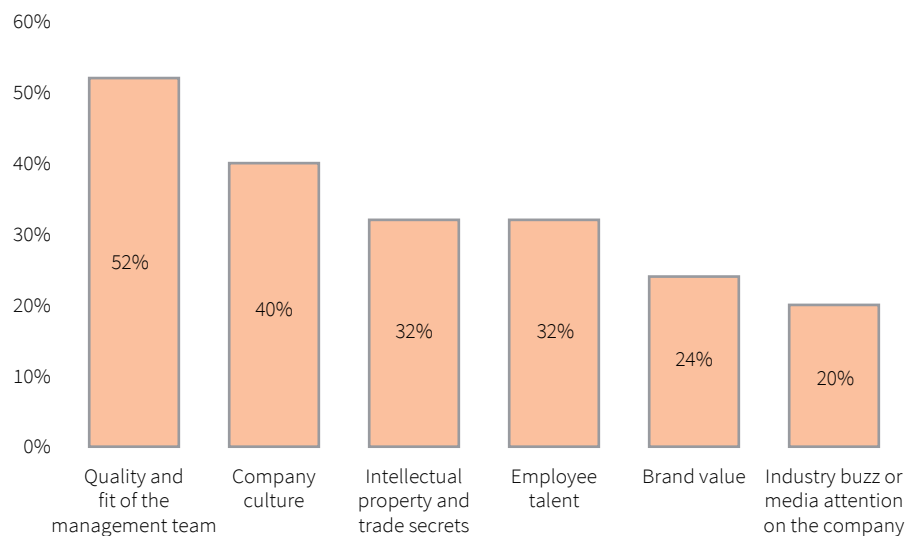
One recent study conducted by Mergermarket and Kilberry found that the quality of management contributes approximately one-third of the success of a deal – making it equal in standing to a company's operating model and product, respectively.<sup>1</sup>

One managing director at a PE firm that specializes in fintech and healthcare argued that company culture was one of the most vital intangibles of a company, since it intertwines with a firm's brand. "Company culture builds brand value and

is the most important [intangible] aspect in deciding a valuation," the PE executive said. "It is even more important than the financials, since the financials can be improved when the brand value is strong."

In Mergermarket intelligence articles about companies looking for acquisitions, executives often note the significance of "cultural alignment" with potential targets. This could encompass features such as a firm's approach to innovation or the ways in which employees are held accountable for their performance.

### What are the most important intangible aspects of a company when deciding on a valuation? (Select top two)



The director of M&A at a technology company that makes two or more acquisitions a year said that employee talent is of vital importance in their sector. "The talent pool is crucial, as most of the tech business is intellect-oriented rather than based on processes," the M&A director said. "We attach a lot of value to the human intellect in the organization, since if that aspect is present, the deal will pay great dividends."

#### Scoring a valuation

M&A deals can hypothetically be focused on long-term strategy, meaning bets that are meant to pay off in five to ten years or more. However, all of our survey respondents said they typically judge whether the valuation of an acquisition was justified after four years or less. Eight percent said

Continued on page 8

1. <https://www.acuris.com/view-both-sides-how-pe-firms-and-sellers-can-form-wise-partnerships>

2. <http://www.mckinsey.com/business-functions/organization/our-insights/a-mckinsey-perspective-on-getting-practical-about-culture-in-m-and-a>

# Common mistakes

Determining a proper valuation for a target is challenging enough when everything goes right; the downside potential increases even more when various errors occur. After all, something as simple as a spreadsheet blunder can cause hundreds of millions of dollars in fines and other costs.<sup>3</sup>

Our survey responses indicated that no single mistake seems to take place most often in M&A deals. Instead, roughly one-fourth of our respondents named four different types of errors they see most commonly, from not properly evaluating the quality of a management team (24%) to missing key pieces of information during due diligence (20%).

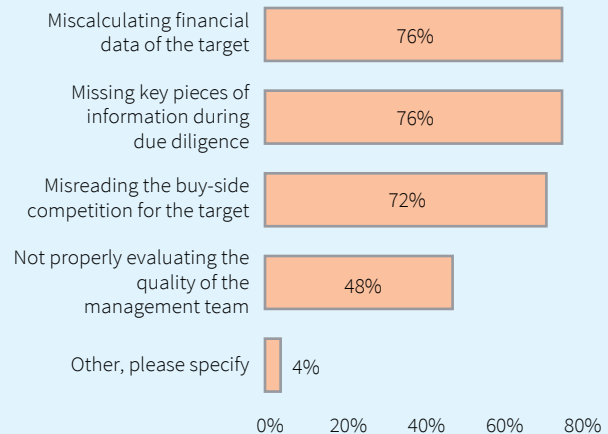
One respondent, a managing director at a PE firm with more than US\$40bn in assets under management, said in his experience that misreading the buy-side competition occurs most often, in part due to the makeup of certain industries.

“For deals in some sectors that have consolidated players or we have an oligopolistic market structure, it is difficult to get the data on the actual size of the market in terms of the competition that exists,” the PE managing director said. “There are many small players that collectively make a significant impact, and this in turn affects the financial aspects of the valuation.”

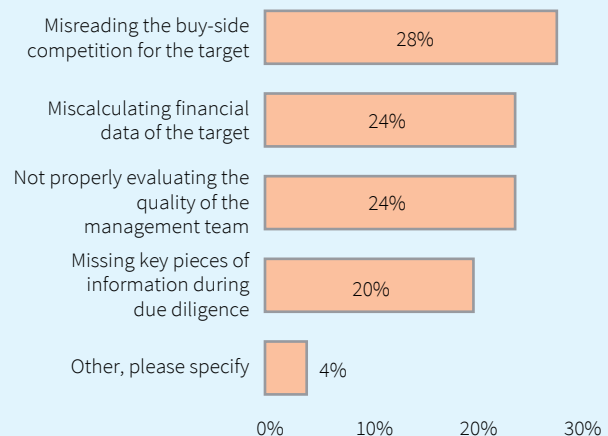
Another PE managing director said that obtaining information in due diligence is especially important in sectors such as technology, where many young companies rely heavily on media buzz and may lack hard evidence of success.

“The most important question we ask ourselves about a company is the purpose for its existence, and whether it is serving that purpose,” he said. “Many tech entrepreneurs are forming companies, floating them in the market, hyping up their valuations and putting them up for sale. We have to be careful about all these aspects in dealmaking.”

What are the most common mistakes you’ve seen made on the buy-side in determining a valuation for a target? (Select all that apply)



What is the most common mistake you’ve seen made on the buy-side in determining a valuation for a target? (Select most common)



3. <http://blogs.mazars.com/the-model-auditor/files/2014/01/12-Modelling-Horror-Stories-and-Spreadsheet-Disasters-Mazars-UK.pdf>

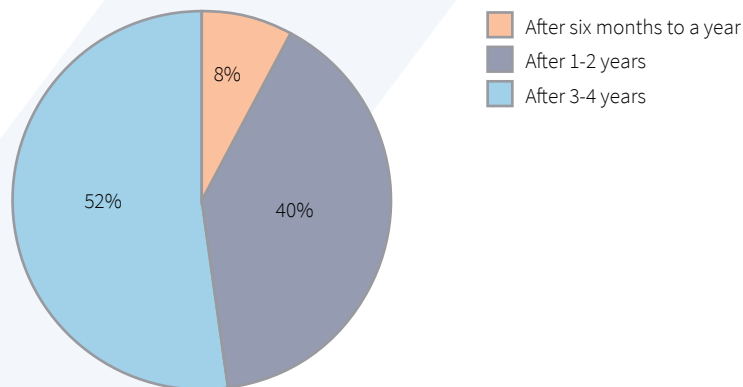
they make the determination after just six months to a year, 40% said after 1-2 years, and 52% said after 3-4 years.

A managing director at a PE firm that made nine acquisitions in Q1-Q3 2017 said that a range of company-specific factors affect the timeline for gauging the success of the deal. “Three years is the average time needed to determine the success of an acquisition, but it depends on the sector and size of the company,” he said. “The time will certainly vary for a manufacturing unit compared to a tech acquisition. For any acquisition, there will always be a certain degree of change in the organization, and measuring this change also helps evaluate and justify the deal.”

Of course, PE buyouts inevitably need to be evaluated more quickly than strategic deals, given the need to exit the company. But the value of corporate acquisitions can sometimes become rapidly clear as well – for good reasons and bad.

On the favorable side is a deal such as Facebook’s US\$1bn purchase of photo-sharing app Instagram in 2012. Just three years later, two Bank of America analysts judged that the company would be worth US\$37bn on its own.<sup>4</sup> A much less positive outcome was seen in Google’s US\$12.5bn acquisition of Motorola in 2012. The internet conglomerate ended up divesting the troubled mobile phone maker for US\$2.9bn after only two years.<sup>5</sup>

On the buy-side, how long after making an acquisition do you typically judge whether the valuation was justified?



“Three years is the average time needed to determine the success of an acquisition, but it depends on the sector and size of the company. The time will certainly vary for a manufacturing unit compared to a tech acquisition.”

Managing director at a PE firm that made nine acquisitions in Q1-Q3 2017

4. <http://www.businessinsider.com/instagram-valuation-2015-3>

5. <https://qz.com/172207/why-google-just-sold-motorola-to-lenovo-for-3-billion/>



**Scott Hebbeler**  
Managing Director,  
Lincoln International

“Factors such as scale, customer concentration, growth profile, and true or normalized profitability of a business can have a dramatic impact on value.”

## Part 3: Dealmaker Q&A - Scott Hebbeler, Lincoln International

### Mergermarket: Why do buyers and sellers sometimes come to radically different valuation numbers?

**S. Hebbeler, Lincoln International:** More often than not, this stems from sellers comparing apples to oranges – that is, assuming two businesses or deals

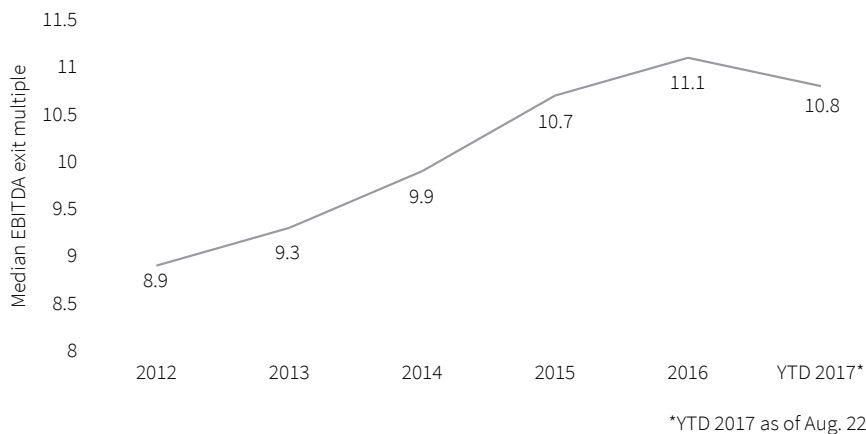
are comparable when they are not. I see this phenomenon most often with founder- or family-owned sellers who might learn about another transaction in their space but not fully understand the deal specifics. In today’s environment, high valuations and attractive exits are reported on a near daily basis, but it’s

important to keep in mind that sellers don’t normally advertise less attractive deals.

So, you might see a founder- or family-owned seller who will think a billion dollar transaction in the same space is a logical comparable, even though their business is one-tenth the size. Yet factors such as scale, customer concentration, growth profile, and true or normalized profitability of a business can have a dramatic impact on value. Smaller businesses might also have systems and controls that aren’t as robust, and less leverage over their customer or supply base. These factors all affect your profitability.

For more experienced sellers – such as private equity firms or strategics performing carve-outs – it’s amazing how often emotion or the human element can impact views on valuation. One way in which this manifests itself is through anchoring bias. Let’s say you’re a PE seller and you’ve had some

### Median EBITDA exit multiple in North America M&A, 2012 - YTD 2017\*



preliminary discussions with a strategic buyer, and the potential buyer throws out the price of US\$150m – but they haven’t done any due diligence yet. Then, once the buyer starts to dig into the numbers, maybe they realize the company isn’t as attractive and they drop the valuation to US\$125m. The PE buyer may be frustrated by this and shoot back, “Wait – you told me US\$150m and now you’re dropping it by US\$25m?”

There can also be disagreement over who gets to capture the synergy benefits that a strategic deal will gain down the road. A PE seller may argue that a buyer should pay a higher valuation because of those synergies, but a strategic buyer will often counter that they will be doing the work and therefore they should realize the value.

The last point I would make is that there are genuine disagreements sometimes on valuation that are valid on both sides. One person might have one view on the growth profile of a business and the other disagrees, for instance, and I think growth and size more than anything else can really drive value within a business. You can also have legitimate and valid disagreements about what a diligence finding might mean. Perhaps you’re selling a manufacturing plant and there is an environmental risk. Of course, the seller will say it’s highly unlikely that anything adverse will happen, but the buyer may have just gone through a process where they got burned by finding something after they made the transaction. So they might view and quantify that risk very differently. And it’s not to say

that one side is wrong or the other is right – rather they assign a different probability to an identified risk or set of financial projections.

Mergermarket: How does the process of determining a target’s valuation change when the motivations for a deal are strategic as opposed to being strictly financial?

**S. Hebbeler, Lincoln International:**

There certainly is a difference in how you think about value when there’s a strategic versus a financial buyer in mind. Generally speaking, if a strategic buyer really wants a target, they can take it off the table by out-paying a private equity acquirer or a family office buyer. In today’s market, that difference may not be as wide as it has been in the past, because private equity has access to significant debt financing at good terms, and a lot of them are being very aggressive. So that’s closing the gap between strategic and financial buyers.

Nonetheless, a PE buyer may have a return hurdle in the mid-to-high-teens, and a strategic buyer might have a lower threshold. A strategic buyer might just need to realize a return over a very long period of time, whereas PE firms are generally trying to generate that return over the course of four to five years if it’s not a family office. If a PE firm is buying a business that they’re not pairing with another portfolio company, they’re also not going to be able to capture the top line synergies or hard-cost takeouts – some of the things that a strategic buyer or a private equity firm that owns another portfolio company in the same space would be able to take advantage of.

EBITDA multiples in select  
2017 North American  
PE deals

29.3x

Sycamore Partners’ US\$6.6bn  
acquisition of Staples, Inc.

18.7x

JAB Holdings’ US\$7.4bn  
acquisition of  
Panera Bread Company

8.5x

Olympus Partners’ US\$425m  
acquisition of Petmate

More often than not, PE firms are also going to need the management team to stick around and work enthusiastically, since financial buyers don’t often have a deep bench of management talent they can plug into the business. All of those factors play into value.

On the strategic side, they usually give sellers more value for the hard-cost takeout than they would for the top line – that is, revenue growth. The hard-cost takeout could be things like closing a redundant factory or consolidating back office functions. They’re going to have improved purchasing power with suppliers as well, and then you can save on indirect expenses, such as insurance

policies. On the top line side of the equation, strategies might be able to immediately drive product through their distribution channels.

One last thing is that strategies are often all-cash buyers, and that can be another factor in their favor. In today's financing environment, it's not as big of a deal, but it often adds time to the process.

**Mergermarket: Can you recall a deal in which it was particularly challenging to arrive at a valuation? What made the process challenging?**

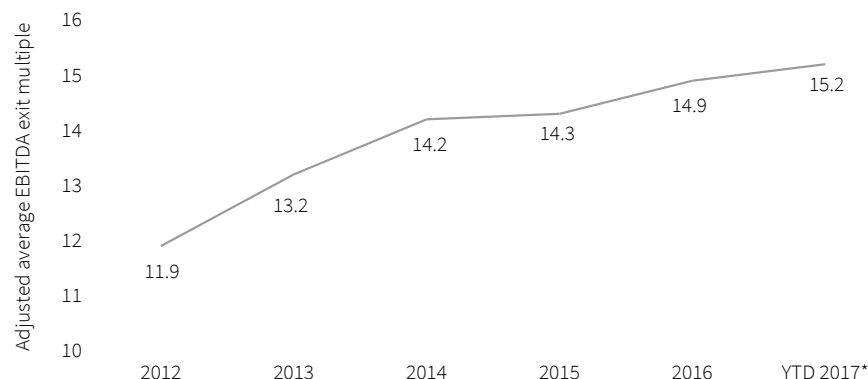
**S. Hebbeler, Lincoln International:**

I can give you a few examples, and I'll start with one that reflects the human element of valuation. One PE firm we worked with had a building products portfolio company, and they had conversations with a potential strategic buyer a couple of years before we were involved in the process. This was clearly the most suitable buyer for this business. In their earlier discussions about buying the business, they threw out one possible sale price.

Flash forward two years later to when the PE firm was actually ready to sell, and lo and behold they are indeed the best buyer. They came out of the process with a valuation at least 20% higher than everybody else. So they were clearly the best buyer – but the business wasn't quite as good as it had been a few years earlier. It had lost a little steam and the growth profile was slowing down.

The valuation the buyer offered wasn't quite as high as the one first discussed two years prior, when they had informal

## Adjusted average EBITDA exit multiple in North America M&A, 2012 - YTD 2017\*



\*Adjusted average multiple based on removing the top and bottom 2.5% of the original data results

\*YTD 2017 as of Aug. 22

conversations about the business. And on the private equity side, they were pretty angry about this because the seller knew the business really well and he knew the buyer really well. He knew the buyer could drive all their products through their distribution network, and gain strength in new regions. He knew what all the synergies were and how valuable this asset was going to be to the buyer, and he felt like he was being treated unfairly by not being able to share in almost any of that, in his view.

These disagreements got to the point where the PE seller became so irritated that he pulled the deal. Ultimately, we were talking about a US\$5m gap, so clearly emotion had entered into the situation. The sad part of all of this is that we pulled the deal several months before the financial crisis happened – and you can imagine what happened to this building products company after that.

Then there can also be challenges in valuing certain companies just by the nature of what they do. One example is a business services company focused on supporting and servicing home foreclosures, and in a typical year they might do US\$10-15m in EBITDA. But back during the financial crisis, they did US\$60m in EBITDA. You can imagine the difficulties in trying to value that. You have to ask yourself what a “normal” year is for the company, and to decide whether to add more value to the asset because it's truly countercyclical and would be a nice diversification point to have within a private equity portfolio, for example.

The last example I can give is another business we've worked with, which is a consumer products company that went from doing US\$5m in EBITDA to well over US\$50m in the same year. They have a product with design and fashion risk,

and so as a buyer, you have to decide how to value that. It's hard to know if a competitor will come in and start to knock off the product or if it will lose steam quickly. The growth profile clearly can't continue on the path it's been on or it would have Apple's market cap in a few years. So many investors struggle with how to reflect those aspects in a valuation.

Mergermarket: For sellers, the deal valuation is not necessarily the only consideration. What other considerations most commonly come into play in your experience? (e.g. looking out for employees, retaining some control of the company)

**S. Hebbeler, Lincoln International:** Nearly all sellers will trade some value for factors such as speed and certainty to close, reduced post-transaction liabilities, and cash at closing. Deal terms such as earn outs or significant escrow amounts can make the seller nervous given the possibility of never seeing that money post-closing. Sellers are also wary of having significant post-transaction liabilities

and will often take a lower valuation to reduce that exposure. The emergence of transaction insurance products highlights this desire among sellers.

Some other considerations also surface with many family- or founder-owned sellers. Often these types of sellers do indeed consider the impact of the deal on the employees but also on the surrounding community. If you have a manufacturing plant in a small town with US\$200m in revenue and that goes away, it has a real impact on your community.

So these sellers are sometimes looking for the next owner to preserve the culture while still being able to accelerate growth. These types of owners will really look at a deal as a partnership – particularly if they're going to stick around on the management team or if they have a really good relationship with the next generation of management. It's almost like a marriage – they want to know if the buyers are going to make their life easier and be a pleasure to work with going forward as well as help speed up the growth of their company.

Then, in conjunction with that, if an owner really believes in the outlook of the business going forward and wants to stick around in it, they consider the upside. Can they roll equity into the business? Will there be options or incentives for their management team to really motivate them to help accelerate the growth of the company under new ownership? If they feel like they're partnering with a firm that can take their company from US\$10m to US\$20m in EBITDA, they might trade on value a little bit versus a firm that might be paying a slightly higher price now but might not have the relationships, the skill, or the experience to help ramp up the company's growth.

Another family/founder-owned seller issue I see with regularity is with Baby-Boom-generation owners who are sailing off into the sunset. These sellers may be concerned about duplicating income post-transaction if they are pulling a lot of money every year out of their company. That doesn't necessarily have a direct impact on valuation, but it could have an impact on how you structure a deal. If there is some type of guaranteed payout, or if you could keep this individual on as chairman with a salary, that can incentivize them to go through with the deal.

The last factor I would mention is that for a lot of these business owners, their self-identity is tied to the company. So it matters to them what the buyer is willing to do for them going forward. If there is a firm that is going to allow them to stay on as chairman or have a significant role in the business, that can help sway the seller. If they're fearing what retirement brings, they might sacrifice value for that role and that kind of sustainment of their self-identity.

“For a lot of business owners, their self-identity is tied to the company. If there is a firm that is going to allow them to stay on as chairman or have a significant role in the business, that can help sway the seller.”

Mergermarket: Do you know of any examples of companies that appeared to be significantly undervalued or overvalued at the time of acquisition? Why do you think the valuation was inaccurate?

**S. Hebbeler, Lincoln International:** Yes, there's an example I can give of a big deal I worked on several years ago. This was a carve-out situation, an asset owned by a multinational corporation.

The business unit had US\$1bn in revenue and something like 20,000 employees around the world. The business was no longer core to the larger corporation and we were heading into the financial downturn at the time; the unit as a whole wasn't performing very well. Parts of it were actually losing money, and the owner thought it would take a lot of time and human capital to turn around. They figured that when you factor in all the intangibles, it might be more trouble than it's worth to keep it.

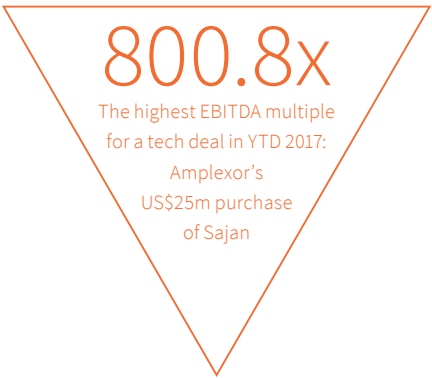
What they didn't fully appreciate was the strong market position the business had. It was number one or number two in a lot of areas in the world. From that perspective, it still had considerable value. This was a situation where we were engaged and we shopped the business. We had a private equity firm that was willing to dig in operationally. They provided the seller with the certainty that they could get something done and avoid some of the intangible issues that the seller didn't want to have to deal with, such as closing a large factory in Europe and handling the public relations and regulatory issues that would come along with that.

Because this PE firm was willing to come in and take the unit off the seller's hands quickly, the seller basically gave it to the PE firm for nothing. In addition to that, they provided them with a transaction services agreement that would provide a lot of the back office functionality for a period post-transaction.

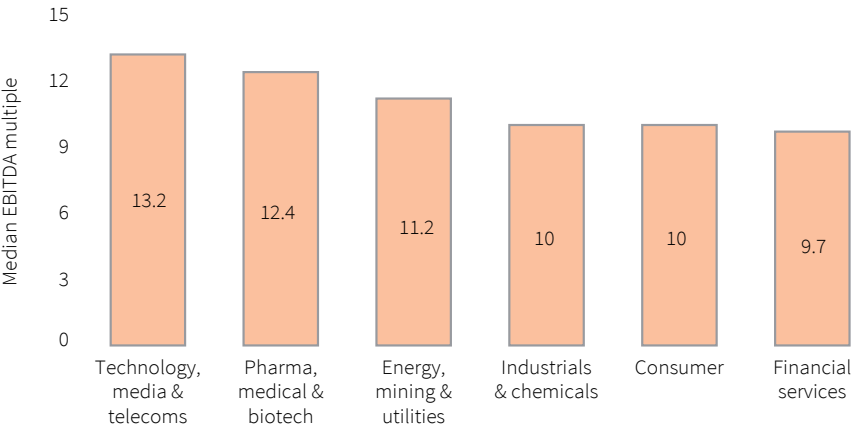
The PE firm then identified the market leaders within this business unit and really put resources into them. They closed a few operations, but for the most part, they paid attention to this business and provided dedicated resources and focus. Within around three years, they ended up selling it for several hundred million dollars.

Not only did the PE firm make an enormous return on the deal, they saved thousands of jobs, as the corporate owner was heading down the path of just shutting the whole

thing down. So in this case I think the corporation really undervalued the business. But in a sense, it wasn't so much a disaster for the seller as much as a great opportunity for the PE firm. And there weren't many PE firms that wanted to take this unit, either. It took one that had the guts and the know-how to come in and get their hands dirty, as they say.



**Median EBITDA exit multiples in North American M&A by sector, 2015 - YTD 2017\***



\*YTD 2017 as of Aug. 22

## About Mergermarket



Mergermarket is an unparalleled, independent mergers & acquisitions (M&A) proprietary intelligence tool. Unlike any other service of its kind, Mergermarket provides a complete overview of the M&A market by offering both a forward-looking intelligence database and a historical deals database, achieving real revenues for Mergermarket clients.

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**Note on Mergermarket data:**  
Mid-market deals are defined by Mergermarket as those valued at US\$5m to US\$250m. Mergermarket does not include deals with undisclosed value in its mid-market figures.

## About Firmex



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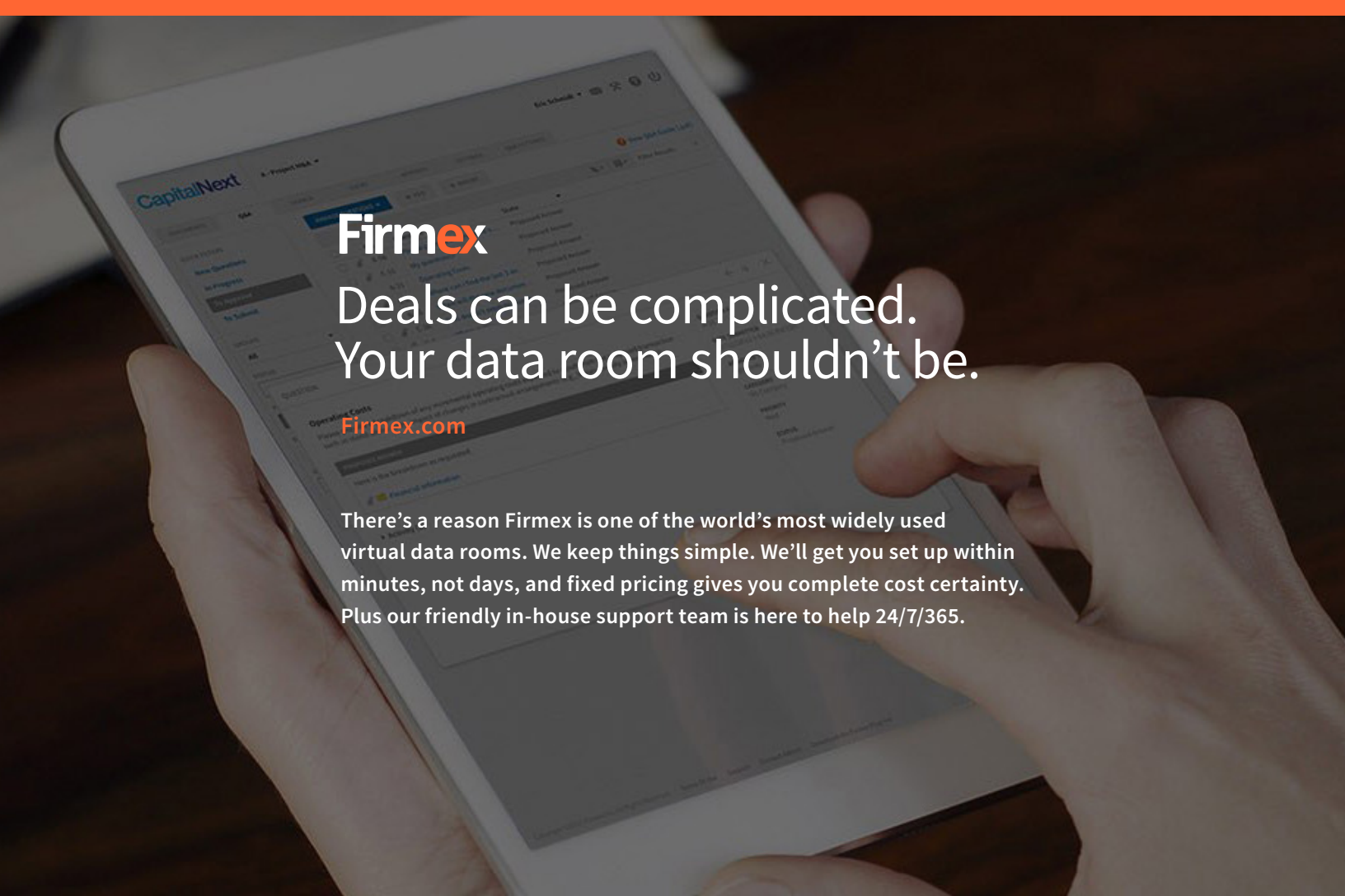
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