

# Deal or No Deal – Valuation Considerations for Transactions

*Presented by:*  
**GYF BUSINESS VALUATION SERVICES GROUP**

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# Valuation Considerations for Transactions

## 2023 Thus Far in the U.S.

- Deal valuations fell dramatically, yet hover above typical downturn trough
- Central banks raised interest rates
- Low unemployment rates challenge some sectors, while layoffs accelerated in big tech and financial services
- Inflation slowed, yet persists

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# Valuation Considerations for Transactions

## 2023 Thus Far in the U.S.

- Dealmakers struggle to get deals done
- Private equity exits have dried up and corporate divestitures have slowed
- Conditions vary by industry
- Deals have paused, but the M&A era is not over

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# Valuation Considerations for Transactions

## The Pittsburgh Market in 2023

- YTD July had an increase of 8.3% in comparison to YTD 2022
- July 2023 saw noteworthy transactions:
  - *Continuim Equity Partners*
  - *Gray Matters Systems LLC*
  - *Nortap Technology Inc.*

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# Valuation Considerations for Transactions

## M&A Transactions with EV of \$10 to \$500 million

- Q1 of 2023 saw highs (multiples) and lows (deal volume)
- Q2 provided lows in deal volume and multiples

All Transactions	1Q 21	2Q 21	1Q 22	2Q 22	3Q 22	4Q 22	1Q 23	2Q 23
# of Deals	81	193	99	76	75	78	78	57
TEV/EBITDA	7.6x	7.8x	7.7x	7.4x	8.2x	6.9x	7.7x	6.4x
Total Debt/EBITDA*	3.9x	4.0x	4.0x	4.1x	4.0x	3.9x	3.9x	3.7x
Senior Debt/EBITDA*	3.3x	3.3x	3.2x	3.2x	3.3x	3.2x	3.1x	3.1x

\*Presented as rolling 4-quarter averages.

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# Valuation Considerations for Transactions

## M&A Transactions with EV of \$10 to \$500 million

- **Multiples by Total Enterprise Value (TEV)**

**TOTAL ENTERPRISE VALUE/EBITDA** GF SOURCE: GF DATA® an ACG Company

	2003					1H		
TEV	-2018	2019	2020	2021	2022	2023	Total	N =
10-25	6.0	6.1	5.9	6.1	6.5	5.7	5.9	663
25-50	6.9	7.0	6.7	7.2	7.1	7.1	6.7	580
50-100	8.9	7.5	8.0	8.3	8.5	7.7	7.7	399
100-500	9.0	9.3	8.9	9.7	9.4	9.7	8.7	303
<b>Total</b>	<b>7.3</b>	<b>7.1</b>	<b>7.0</b>	<b>7.6</b>	<b>7.6</b>	<b>7.2</b>	<b>6.8</b>	
<b>N =</b>	<b>307</b>	<b>335</b>	<b>341</b>	<b>499</b>	<b>328</b>	<b>135</b>		<b>1945</b>

Please note that N for 2003-18 encompasses 14 years of activity.

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# Valuation Considerations for Transactions

## M&A Transactions with EV of \$10 to \$500 million

- **Buyers adjusting deal terms in falling markets**
- **Indemnification caps surged in the first 6 months of 2023**
  - *Reflecting deals are taking longer to close and buyer's concern with erosion in target company financials*
- **Values declined on deals without rep and warranty insurance**
- **Challenging debt market lead to more deals requiring a bridge mechanism via seller financing or earnouts**

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# Valuation Considerations for Transactions

## M&A Transactions with EV of \$10 to \$500 million

- Indemnification caps soaring in smaller deals

### INDEMNIFICATION CAP—% OF TOTAL ENTERPRISE VALUE

GF SOURCE: GF DATA® an ACG Company

TEV	2018	2019	2020	2021	2022	1H 2023	Total	N =
10-25	21.3%	13.1%	22.8%	16.9%	18.7%	25.6%	19.1%	444
25-50	14.2%	11.6%	13.4%	15.4%	12.9%	15.7%	13.7%	331
50-100	7.5%	11.2%	8.9%	8.8%	9.6%	21.9%	9.9%	205
100-500	4.8%	3.4%	5.8%	10.0%	7.5%	1.8%	6.7%	105
Total	14.9%	11.4%	16.1%	14.1%	14.2%	21.3%	14.5%	
N =	205	210	195	249	165	61	1085	

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# Valuation Considerations for Transactions

## M&A Transactions with EV of \$10 to \$500 million

- Indemnification Periods Increasing in 2023

### INDEMNIFICATION PERIOD—MONTHS

GF SOURCE: GF DATA® an ACG Company

TEV	2018	2019	2020	2021	2022	1H 2023	Total	N =
10-25	19.8	18.3	18.8	20.1	20.2	22.0	19.6	444
25-50	19.4	17.3	22.7	21.3	19.6	27.2	20.3	331
50-100	17.7	18.0	19.2	21.0	20.0	23.5	19.4	205
100-500	21.9	19.7	19.8	19.0	31.7	14.0	21.8	105
Total	19.5	18.0	20.1	20.4	21.3	23.2	20.0	
N =	205	210	195	249	165	61	1085	

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# Valuation Considerations for Transactions

## M&A Transactions with EV of \$10 to \$500 million

- **Escrow/Holdback Periods are Lengthening**

ESCROW/HOLDBACK PERIOD—MONTHS							GF SOURCE: GF DATA® an ACG Company		
TEV	2018	2019	2020	2021	2022	1H 2023	Total	N =	
10-25	16.9	14.0	17.2	16.2	16.1	14.9	16.0	424	
25-50	16.4	16.1	14.8	15.4	14.7	16.4	15.6	337	
50-100	16.4	15.3	14.9	12.9	13.4	14.0	14.5	213	
100-250	15.6	17.1	12.1	14.0	13.3	16.0	14.6	113	
Total	16.5	15.3	15.6	15.0	14.9	15.2	15.4		
N =	208	217	169	254	180	59		1087	

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# Valuation Considerations for Transactions

## Top Industries for Transaction Activity

- **Technology, media, entertainment and communications**
  - *Impacted by recent economic stagnation, causing a decline in advertising revenue*
- **Banking**
  - *Recovering from shock waves associated with collapses of Silicon Valley Bank, Signature Bank and First Republic Bank*
- **Health care**
  - *Strong supply of customers and potential for technology transformation*

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# Valuation Considerations for Transactions

## Industries Forecasted to Have Slowest Rate of M&A Activity

- Non-profit/higher education
- Hospitality and restaurants
- Transportation, logistics, warehousing and distribution

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# Valuation Considerations for Transactions

## Impact on Valuation

- Fundamental Valuation Equation

$$\text{Value} = \text{Economic Benefit of Ownership} \div \text{Required Rate of Return}$$

*Alternatively illustrated as*

$$\text{Value} = \text{Earnings Stream} \times \text{Market Based Multiple}$$

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# Valuation Considerations for Transactions

## Impact on Valuation

- **Expected Benefit Stream**

- *Future expected revenue generated by the business*
- *Associated operating expenses required to generate the future revenue*
- *Necessary investments in the form of capital expenditures and incremental working capital requirements*

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# Valuation Considerations for Transactions

## Impact on Valuation

- **Expected Benefit Stream**

- *Inflation*
  - *Cost of materials*
  - *Cost of labor (wages as well as the cost of recruiting and hiring)*
- *Supply Chain*
  - *Increased cost of goods (direct materials, freight, etc.)*
  - *Delayed lead times (especially internationally)*
  - *Slower revenue generation and recognition*
  - *Scarcity of resources (equipment, inventory, materials)*

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# Valuation Considerations for Transactions

## Impact on Valuation

- **Required Rate of Return**
  - *Buyer specific risk analysis*
  - *Inverse relationship to value*
  - *Influenced by*
    - *Perceived risk inherent within investment opportunity*
    - *Rates of return on investment alternatives*
    - *Resultant risk/reward dynamics and pricing*

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# Valuation Considerations for Transactions

## Impact on Valuation

- **Required Rate of Return**
  - *Changes in interest rates will impact the potential return on investment alternatives*
    - *As rates rise, investment alternatives become more attractive*
    - *The threshold for required return on an equity investment increases as rates of return for alternatives increases*
  - *Lending environment*
    - *Financing acquisitions has become more costly*
    - *Shift in deal structure in recognition of impact on valuation*

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# Valuation Considerations for Transactions

## Impact on Valuation

- **Required Rate of Return**

- *Sensitivity of the Discount Rate/Required Rate of Return*

	Discount Rate						
	26.0%	25.0%	24.0%	<b>23.0%</b>	22.0%	21.0%	20.0%
Indicated Value	\$4,348	\$4,545	\$4,762	<b>\$5,000</b>	\$5,263	\$5,556	\$5,882
Implied Multiple	4.3x	4.5x	4.8x	<b>5.0x</b>	5.3x	5.6x	5.9x
% From Base	-13.0%	-9.1%	-4.8%	<b>0.0%</b>	5.3%	11.1%	17.6%

*Assumptions: Cash Flow = \$1,000; Growth Rate = 3.0%*

# Valuation Considerations for Transactions

## Impact on Valuation

- **Market Multiples**

- *Provide a market-based indication of how risks are priced by investors on the open market*

- *Interrelated with the required rate of return*

- *Measured as a resultant calculation in a disclosed transaction*

# Valuation Considerations for Transactions

## Impact on Valuation

- **Market Multiples**

- *In volatile times, focus should be on most recent transactions*
- *Longer period of analysis can lead to indicated multiples that do not adequately incorporate current market conditions*
- *Changes in market multiples are likely to follow impacts on interest rates and the required rate of return (inverse relationship)*

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# Valuation Considerations for Transactions

## Impact on Valuation

- **Expectations**

- *Interest Rates*
  - *Fed shows no sign of decreasing rates*
  - *Still low considering historical levels*
  - *Elevated compared to most recent history*
  - *What will be the 'new normal'*
- *Inflation*
  - *Easing but damage has been done*
  - *Historical results may not be representative of future results*
  - *Ability of business to pass cost increases through to customers*

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# Valuation Considerations for Transactions

## Impact on Valuation

- **Expectations**

- *Labor Market*

- *If labor market remains tight and expensive, employers may look to automation*
- *Automation may be higher upfront cost with longer-term benefits*

- *Other Factors*

- *Worldwide geopolitical landscape*
- *2024 Presidential election*

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# Valuation Considerations for Transactions

## On the Horizon

- **M&A Activity**

- *Level of activity is difficult to predict*
- *Conflicting macroeconomic drivers and opinions*
- *Worldwide geopolitical uncertainty*
- *Varying levels of risk tolerance*

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# Valuation Considerations for Transactions

## On the Horizon

- **M&A Activity**
  - *Abundance of dry powder*
  - *Strong balance sheets*
  - *Buyers able to be more selective*

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# Valuation Considerations for Transactions

## On the Horizon

- **M&A Activity**
  - *Creative deal structures will continue*
  - *Alternative ways to match buyer and seller desires*
  - *Earnouts, equity incentives, etc. incentivize sellers to contribute to continuity and performance*

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# Valuation Considerations for Transactions

## On the Horizon

- **M&A Activity**

- *Technological incorporation and acquisition will continue*
- *Incorporation of AI and investment in AI focused entities*
- *ESG focused investments*

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# Valuation Considerations for Transactions

## On the Horizon

- **Valuation**

- *Slight stabilization of major factors impacting valuation*
- *Inflation has begun to ease*
- *Lending environment will continue to impact financing costs*
- *Supply chain issues remain*
- *Labor markets remain tight*

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# Valuation Considerations for Transactions

## On the Horizon

- **Valuation**

- *As lending rate environment calms, multiples should stabilize*
- *Companies have adjusted prices to offset inflation*
- *Customer tolerance to price adjustments is better understood*
- *As earnings steady, perceived risk of volatility eases*

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# Thank you for your attention!

Please contact the presenters directly with questions:

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