

CFA Trending Topics

August 15, 2018

1. Market primed for LBOs

Key takeaways:

- Market dynamics are primed for a pick-up in LBO activity as valuation multiples (EV/EBITDA) begin to plateau, continued economic strength drives strong cash flow generation, and tax reform offers greater access to global cash piles.
- Global LBO dollar volumes are up 35% year-over-year and are on pace to be the highest since 2007¹.

Tax reform limitations on deductibility of interest expense might have initially been expected to have a chilling effect on the Leveraged Buyout (LBO) market. Subsequent analysis has shown the impact on returns to be marginal thanks to increased cash flows from lower headline tax rates.

At the same time, continued strength in the U.S. economy has bolstered free cash flow (FCF) generation: Q2 '18 S&P 500 FCF was 35% higher than three years prior while EBITDA multiples increased by only ~1x (or about 10%) over the same time period. Couple this with a high yield debt market that remains issuer friendly and underpinned by low interest rates and all signs point to continued strength in LBO activity.

¹ Based on first half 2018 vs. first half of 2017 data.

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