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Oscar David Discusses Valuation Gap in Mid-Market M&A

MARCH 1, 2016

Oscar David, a partner in Winston & Strawn's Chicago office whose practice focuses on mergers and acquisitions, securities, and private equity, was quoted extensively in the third edition of Mergermarket Group's North American Mid-Market newsletter. The report focuses on how buyers and sellers can close valuation gaps in 2016.

According to Mergermarket data, mid-market deals in North America fell in 2015. Mr. David explains that the valuation gap between sellers and buyers in mid-market deal negotiations has widened due to enhanced competition for high quality middle market companies. With more attention focused on the mid-market segment, corporate buyers are more invested in the space. Among other factors is the performance improvement among mid-market companies; greater performance has led to higher valuations.

Mr. David has found the telecommunications and life sciences sectors to have a pronounced valuation gap. As he explains, this is due to what a buyer thinks a business is worth versus what a seller believes it is worth.

"On the life sciences side, buyers are showing much more scrutiny in terms of where a company is regarding product development and the regulatory approval process. A lot of companies are trying to price themselves as if they already have approval, or as if the product development is going to hit certain milestones. Buyers are simply scrutinizing those factors much more closely," Mr. David explains.

Despite economic uncertainty, Mr. David has found that corporate executives and private equity professionals remain confident regarding valuations. Though he is not convinced that there will be a significant downturn, if one does occur, he states that he does not expect to see a direct correlation with company valuations on either the private or public side.

"Ultimately, it's not just about the downturn itself, but about how the downturn affects the prospects of a particular business," Mr. David said.

In regard to private equity, Mr. David has found the impact of the valuation gap to be relatively the same when compared to corporate buyers. Having experience with both private equity firm buyers and corporate buyers, he explains that "both take their responsibility with extreme care and both groups have an incentive to pursue transactions."

Both parties are sophisticated and are playing to their competitive advantages. Regarding the corporate side, he states that they “can often justify a higher valuation, but not because they’re willing to overpay—it’s that they may have synergistic opportunities that a PE fund won’t see.”

As far as the private equity side, “they have the unique feature of providing rollover equity and other financial packages to the management team.”

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