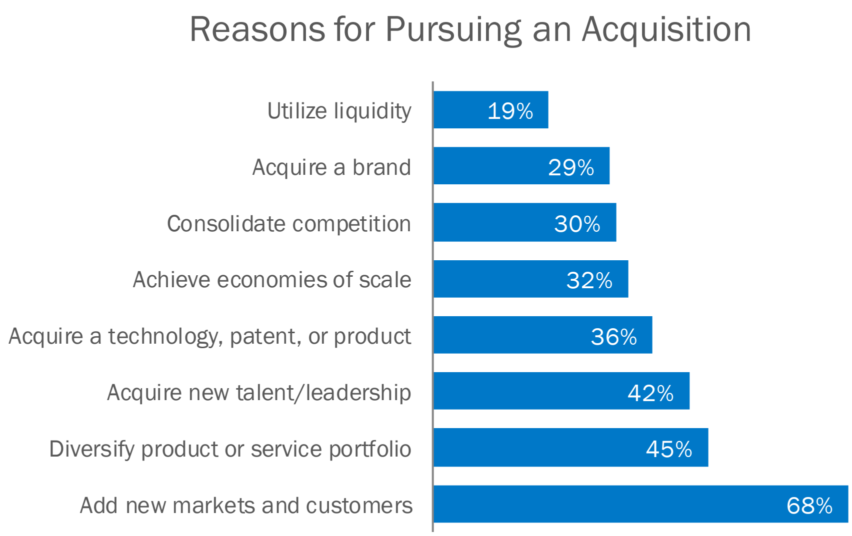
Valitas Insights: U.S. Middle Market, Q2/2017: Slower Growth, Sustained Appetite for M&A

Why, with our focus on Canadian mid-market M&A, are we writing about the U.S. Middle Market?

U.S. middle market companies[1] generate 33% of U.S. private sector GDP, and as such, represent a significant economic force. According to a recent survey conducted by the [National Center for the Middle Market](), 38% of middle market firms expect to engage in an M&A transaction over the next twelve months, motivated in large part by a desire to add new markets and customers. Additionally, there is an expectation that increased revenues will be generated outside the U.S., with Canada identified as one of the top three contributing markets[2].



A healthy U.S. middle market with an appetite for growth through outbound M&A is likely to impact our Canadian deal activity, particularly when we layer on the discount attributed to Canadian company valuations relative to their U.S. counterparts.

So now that we've established why we care, let's discuss U.S. Middle Market Q2 performance, which comes on the heels of a record setting first quarter.

In our Q1 review, we reported euphoric levels of revenue growth and expectations, but those are proving to be anomalous. While recently released Q2 2017 survey results reveal that U.S. middle market companies continue to outpace their S&P 500 counterparts, growth indices have declined from Q1 levels.

Trailing twelve-month (TTM) revenue growth declined from 9.2% in Q1/2017 to 6.7% in Q2, still slightly above the five-year average, while TTM employment growth declined from 7.5% to 5.7%.

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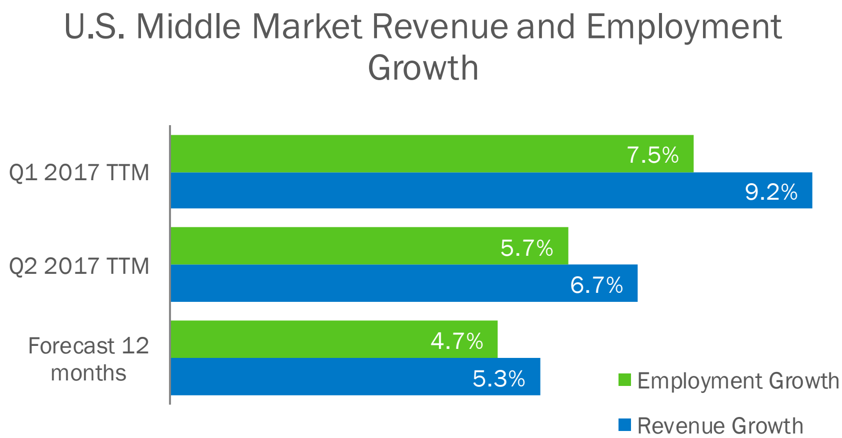
[1] As defined by the National Center for the Middle Market

[2] In a recent (post-election) Deloitte's survey of U.S. middle market companies, more than half of respondents reported this expectation.

Private equity (PE) owned middle market firms continued to lead the pack, with revenue and employment growth of, respectively, 9.5% and 6.7[3]. Over the same period, revenue and employment growth for S&P 500 companies was 4.75% and a mere 1.5%.



Looking ahead, U.S. middle market expectations are more tempered than Q1's, with its post-election (dare we say it) "Trump Bump". There is a still a high degree of confidence in local, national, and global economies, but the twelve-month revenue growth forecast has declined from 8.8% in Q1 to 5.3%, Deal activity contributed approximately 20% to employment and revenue growth in the past twelve months, and this level is likely to at least be sustained, given robust middle market expectations for M&A over the next twelve months.

Despite uncertainty surrounding U.S. government policy, cross-border deal activity continues to climb, in Canada and globally. And as U.S. middle-market firms pursue targets that facilitate access to new markets and customers, and new products and technologies, it's reasonable to expect that Canada (and its inbound M&A) will benefit.

[3] Read more about the value-creation principles employed by PE firms in our October 28, 2016 Valitas Insights Article.