



news from the middle

deal perspectives for middle market companies and their advisors

Q3 2018

GREATEST MARKET IN THE HISTORY OF THE WORLD! – WHAT DOES THAT MEAN?

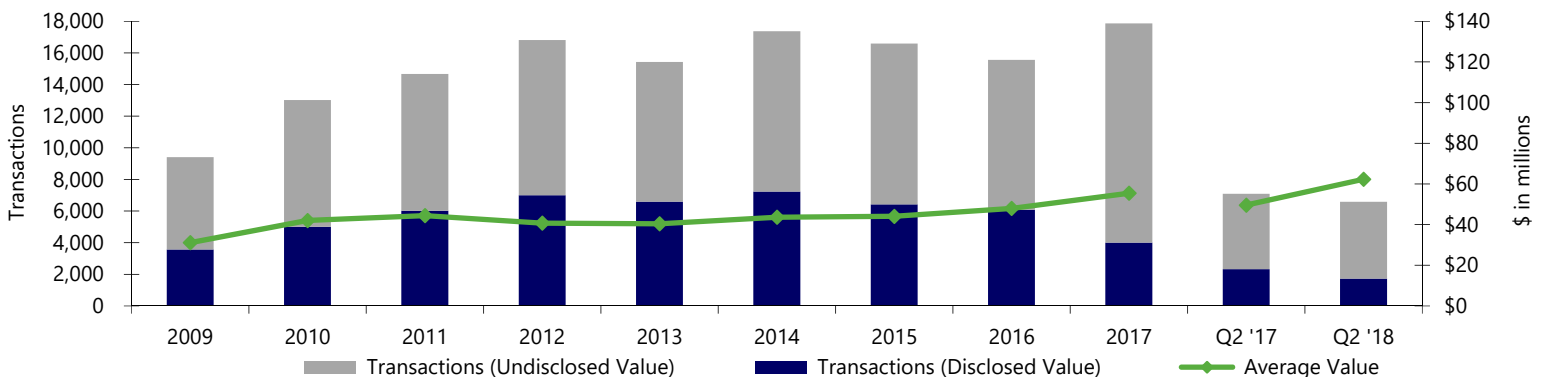
There is no question that the M&A market is white hot. Amidst the longest period of economic expansion in US history, the M&A market has been bolstered by cash-rich companies, cheap and easy access to acquisition financing, significant amounts of private equity (PE) dry powder, and strong optimism in the US economy. The National Federation of Independent Business (NFIB) watched the Small Business Optimism Index rise to 107.9 in July—the second-highest level in history, falling within 0.1 point of the July 1983 all-time high. Overall, Capstone Headwaters is finding that the frothy state of the market is resulting in buyers and investors seeing more opportunities than ever before.

The demand side of the market is very strong. According to Thomson Reuters' 2018 Deal Makers Sentiment Survey, 60.0% of corporations put funding acquisitions within their top three priorities for use of cash reserves during 2018. At the same time, the share of PE deals accounted for 68.0% of all year-to-date middle market activity, the highest level in over ten years. Since PE firms rely heavily on debt for leveraged buyouts and recaps, they will continue to be aggressive while the window for debt raising remains open. Leverage levels are highly correlated with valuations.

There has never been a more important time for M&A service professionals (including financial advisors, lawyers, and accountants) to assist clients in meeting this demand for transactions. The most critical factor for business owners seeking to sell is to select an advisor with detailed knowledge of their industry and broad access to strategic and financial buyers as well as fast and error-free deal execution. While business owners may be getting five to ten calls a week from PE firms, most owners are unaware of the market value of their company let alone the valuation that could be driven by a competitive marketing process. Recently, Capstone Headwaters closed a mandate whose initial fair market value was estimated at 6.0x to 8.0x EBITDA but, after a structured marketing process, resulted in a significant premium of 11.0x EBITDA.

While many companies realize that the market is strong and that valuations are rich, most do not know how to best prepare themselves to go to market in order to attract competitive bids. Capstone Headwaters has found that this lack of preparation can lead to common mistakes in the M&A process including: reaching out to buyers prematurely; setting unrealistic growth forecasts and missing their numbers mid-process; offering incomplete/unaudited financial exhibits; and insufficiently preparing management for buyer meetings. In this active market, where buyers and investors have the luxury of paying top dollar for the best asset, it's even more important for a company to have the right team by their side when exploring their strategic alternatives.

Middle Market M&A Volume



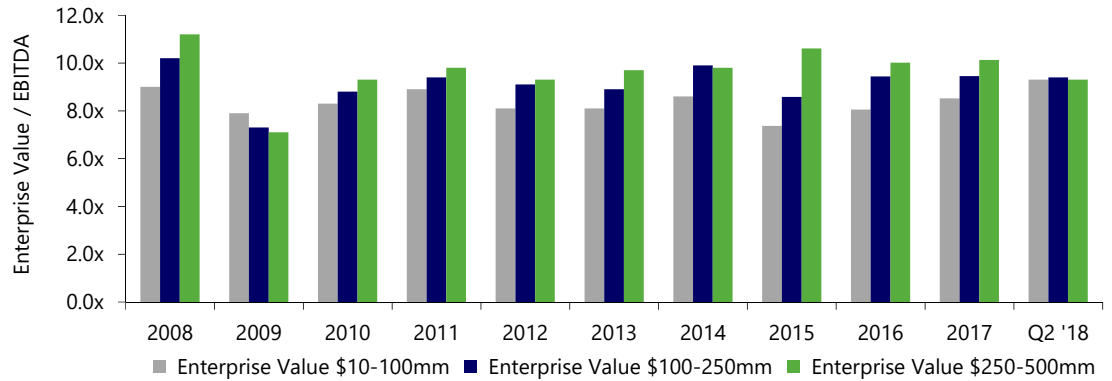
Source: Capital IQ
Note: Enterprise Value < \$500mm



M&A snapshot

AVERAGE MULTIPLES BY TRANSACTION SIZE

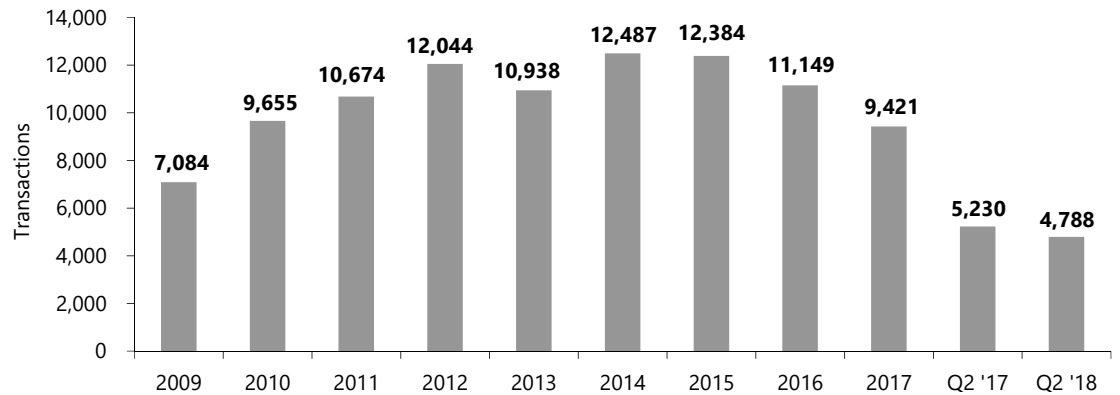
Multiples across the entire middle market have leveled out at a healthy median of 9.3x



Source: Capital IQ
Note: includes multiples 3x-16x

CORPORATE BUYER ACTIVITY

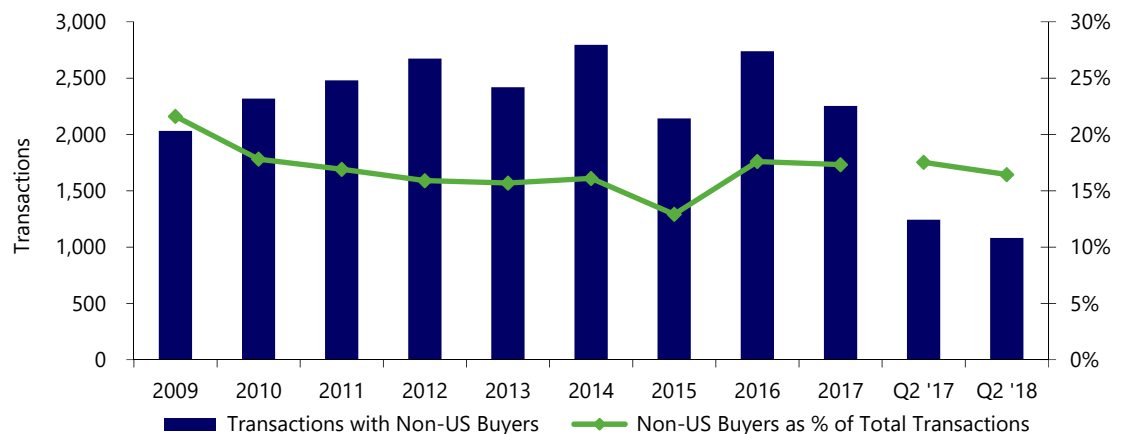
Corporate buyer activity slipped 8.5% compared to Q2 2017 as competition for quality deals is high



Source: Capital IQ
Note: Enterprise Value < \$500mm

FOREIGN BUYER ACTIVITY

The share of deals completed by foreign buyers dipped year-over-year from 17.5% to 16.4%



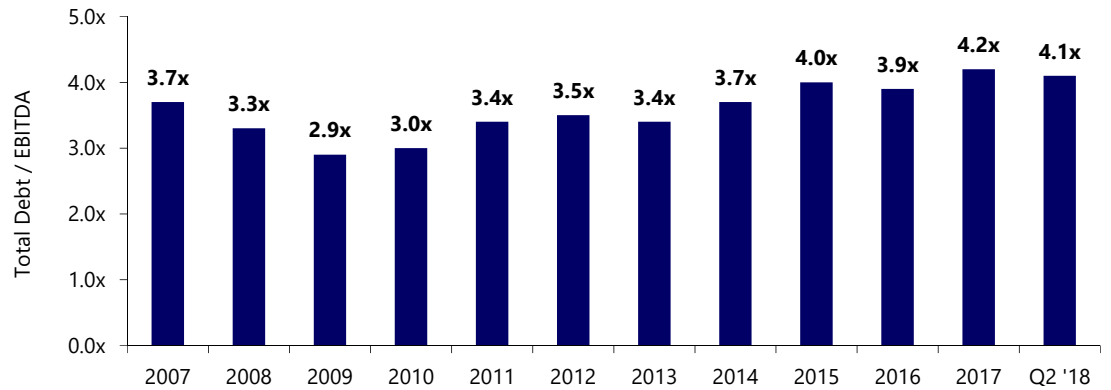
Source: Capital IQ
Note: Enterprise Value < \$500mm



M&A snapshot

PRIVATE EQUITY DEBT MULTIPLES

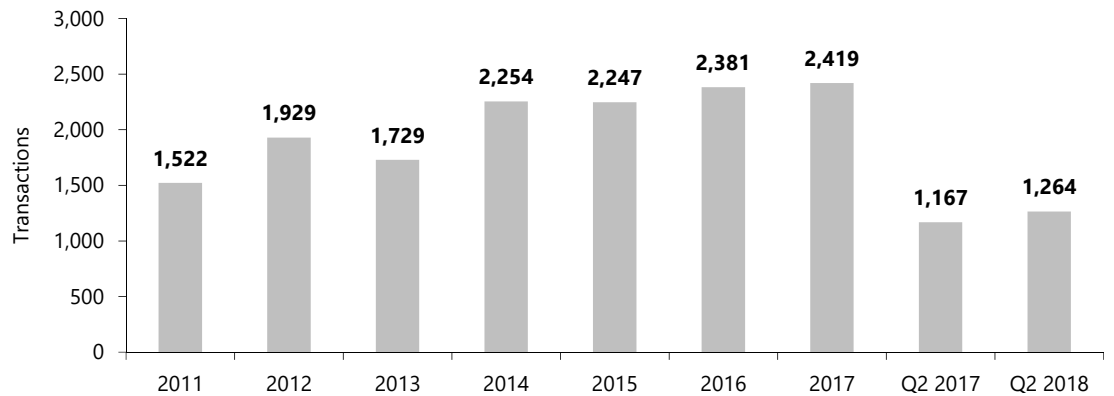
Leverage ratios for private equity firms remain highly favorable at 4.1x EBITDA



Source: GF Data Resources
Note: includes multiples 3x-15x, Enterprise Value \$10-\$250mm

PRIVATE EQUITY BUYER ACTIVITY

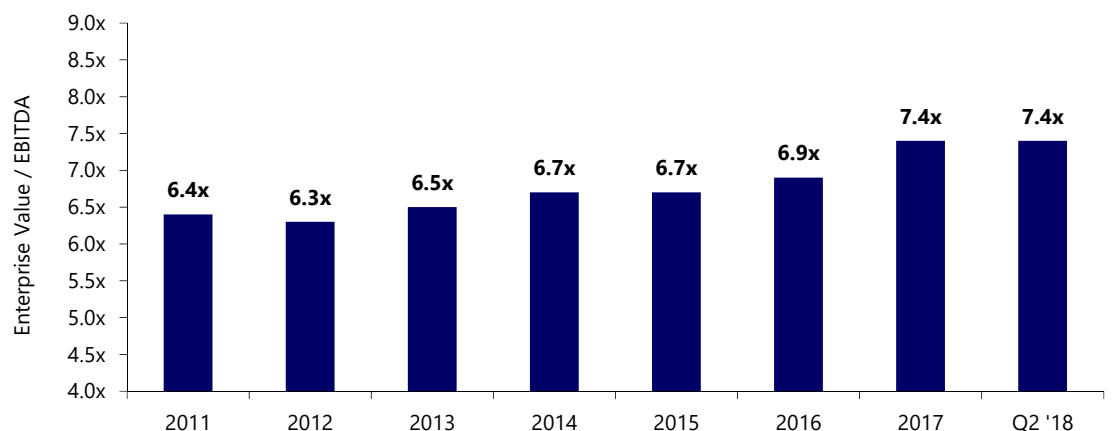
Despite the dip in overall middle market M&A volume, deals by private equity buyers rose modestly



Source: Pitchbook
Note: Pitchbook changed methodology to only include buyout deals as of Q3 2017. All data reflects new methodology.

PRIVATE EQUITY MULTIPLES

The average EBITDA multiple paid by private equity buyers is at a premium of 7.4x



Source: GF Data Resources
Note: includes multiples 3x-15x, Enterprise Value \$10-\$250mm



BUILT FOR THE MIDDLE MARKET



Capstone Headwaters is an elite investment banking firm dedicated to serving the corporate finance needs of middle market business owners, investors and creditors. Capstone Headwaters provides merger & acquisition, private placement, corporate restructuring and financial advisory services across 16 industry verticals to meet the lifecycle needs of emerging enterprises. Headquartered in Boston, MA and Denver, CO, Capstone Headwaters has 19 offices in the US, UK and Brazil with a global reach that includes over 300 professionals in 33 countries.