

FEATURED CONTRIBUTOR

M&A OVERVIEW & OUTLOOK



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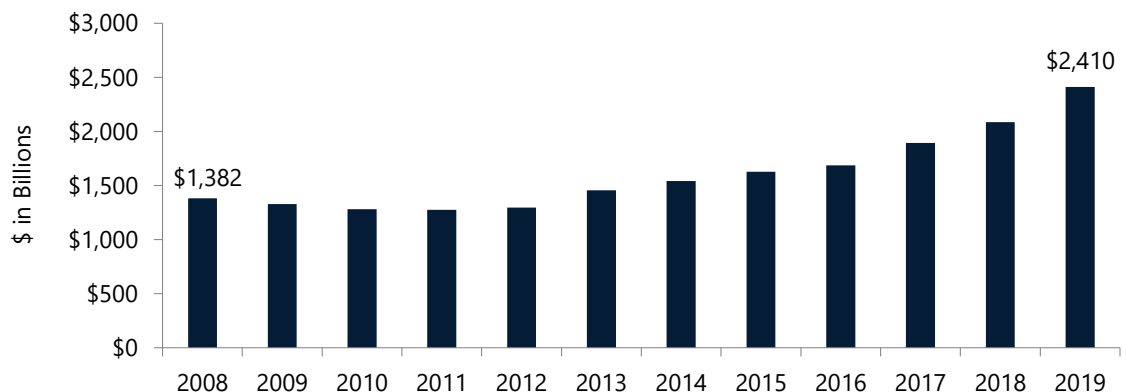
As we enter the final month of Q1 2020, the Coronavirus outbreak has served as a catalyst for market instability in a fear-based environment, threatening to accelerate the slowdown of global growth and wreaking havoc on supply chains. Wall Street's "fear gauge" index spiked while the 10-year treasury yield fell below one percent for the first time. The Fed also moved to reduce the federal funds target—the first non-policy meeting action and the first 50 basis point move since the 2008 financial crisis. While macroeconomic fundamentals, supported by strong employment and consumer sentiment, remained on solid footing through 2019 and into the new year, significant uncertainty has now been introduced into investor thinking. Public markets are functioning well, but are highly volatile after a long period of calm.

As with other historical periods of economic uncertainty, we can expect a slowdown in M&A activity as companies and sponsors turn inward to focus on operational issues and adjustments. For those companies currently in the market, the near term impact on M&A is likely to manifest in a process slowdown with buyers reprioritizing their areas of focus and/or seeking to take advantage of market moves in an attempt to adjust valuations. In addition, we expect heightened emphasis to be placed on deal structure and due diligence, with companies assessing business resilience in the face of economic and political uncertainty.

This potential slowdown follows the close of a robust 2019 in middle market M&A, with deal volume increasing over 10% year-over-year. It is fair to expect a near term dip in new deal launches, but we expect a strong rebound in activity once the dust settles.

The middle market is quite resilient compared to the public markets. Valuations are much more stable. Volumes are driven by ownership transitions and the need for businesses to attain greater scale—these are not market-based catalysts. Private equity buyers have all-time record amounts of cash to invest and are compelled to do so. There have never been more debt providers to this market segment, given the growth of dedicated middle market private debt funds, BDCs, and a recent push by banks to increase loan growth. Despite current headwinds, the positive factors that drove the deal market over the last decade remain in place—factors that together should continue to drive the M&A market in 2020.

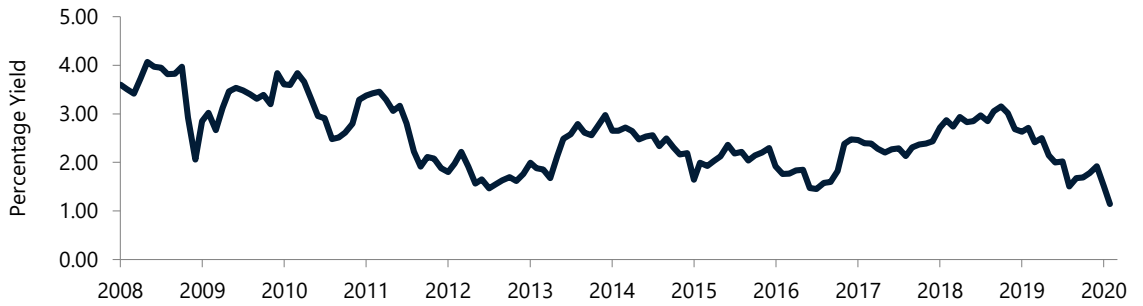
Global Private Equity Dry Powder



Source: PitchBook
Note: 2019 as of 06/30/19, latest available data

U.S. 10-YEAR TREASURY YIELD

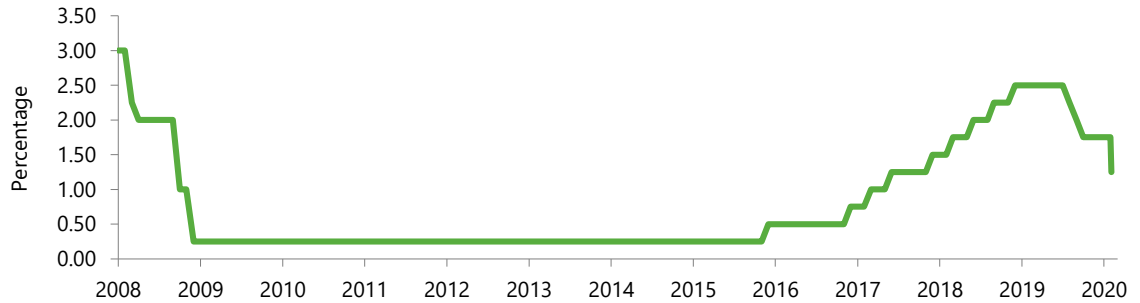
Investors diversifying towards safe assets placed downward pressure on yields through much of 2019



Source: FactSet

FEDERAL FUNDS TARGET RATE

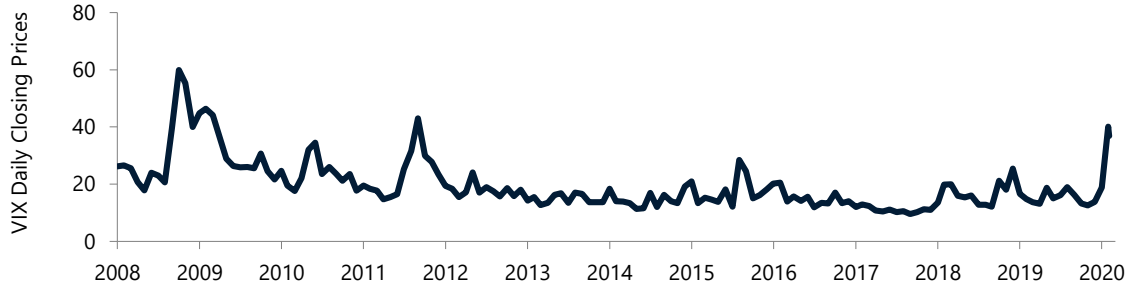
After raising rates in recent years, the Federal Reserve reduced its target rate to 1%-1.25% in March 2020



Source: FactSet

CBOE VOLATILITY INDEX

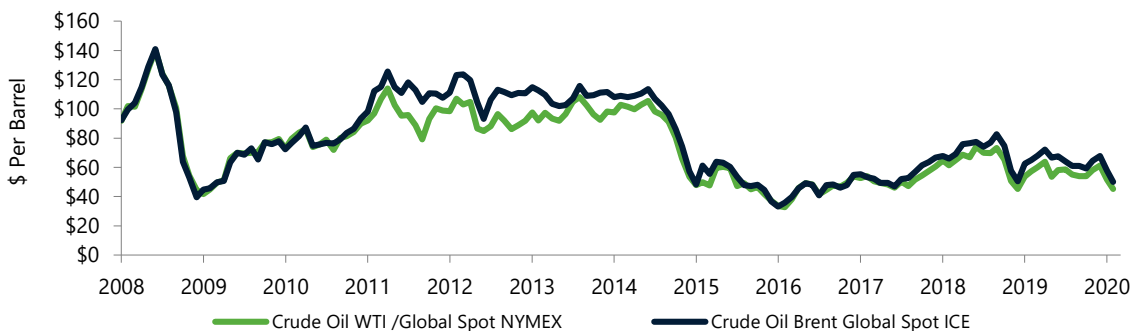
Volatility remained relatively muted throughout 2019 as public markets continued to test all-time highs



Source: FactSet

OIL SPOT PRICES

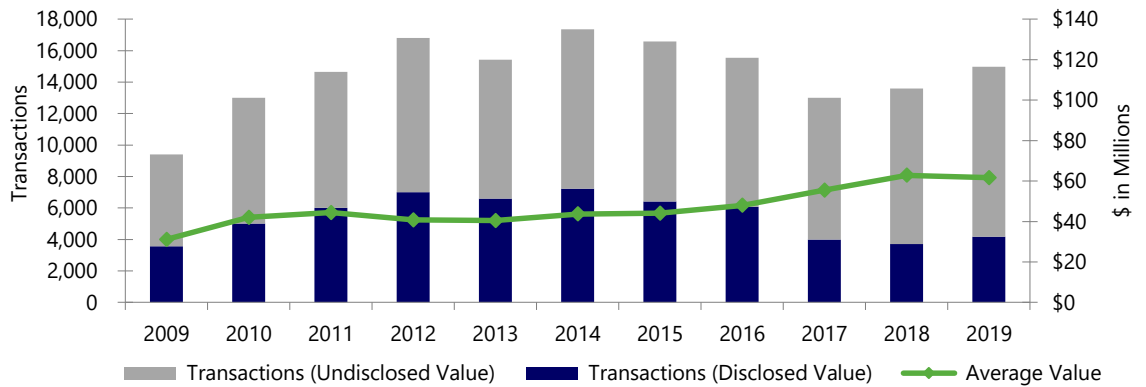
Oil prices continue to be dictated by OPEC and Russian production policies with prospects of further cuts in 2020



Source: FactSet

MIDDLE MARKET M&A VOLUME

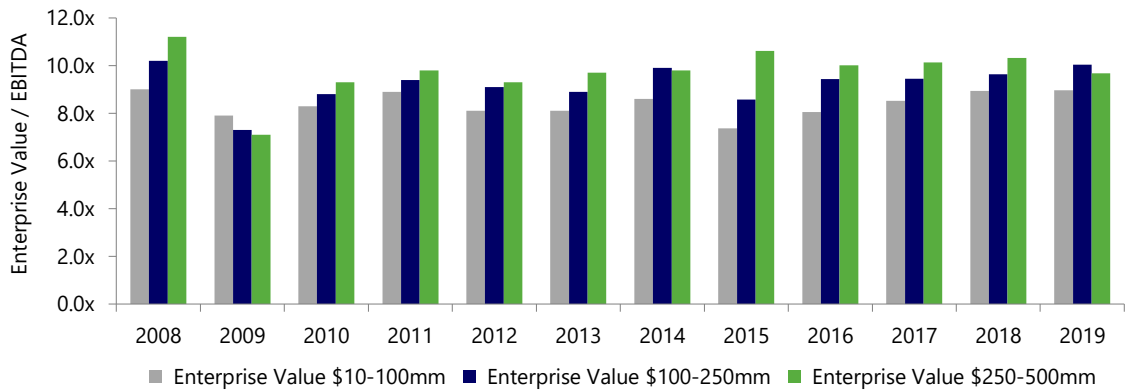
M&A activity in 2019 saw the highest transaction volume since 2016 and increasing 10.3% year-over-year



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

AVERAGE MULTIPLES BY TRANSACTION SIZE

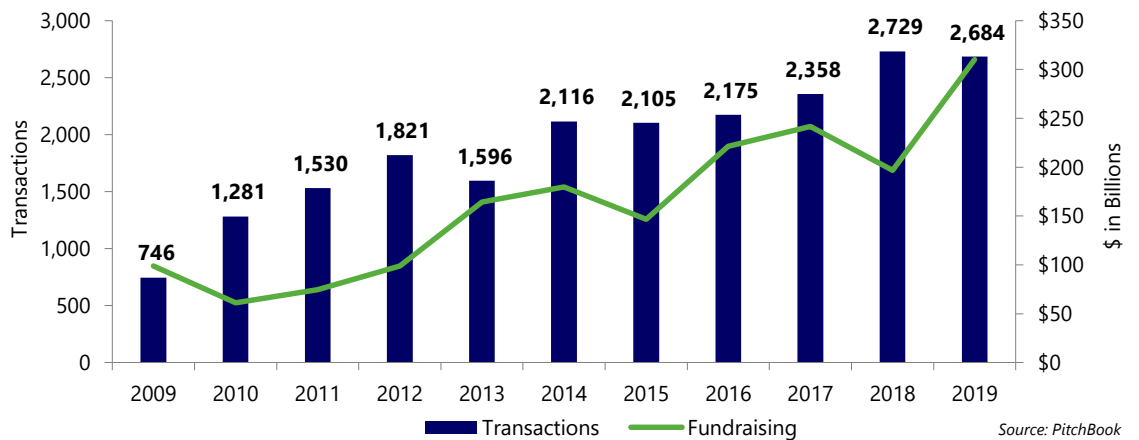
Multiples in the \$100-\$250mm transaction range outpaced all other segments in 2019 at 10.0x EBITDA



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

PRIVATE EQUITY BUYER ACTIVITY

The number of closed private equity transactions declined slightly, while fundraising levels increased substantially



Source: PitchBook



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 life cycle 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 450 professionals in 40 countries.

