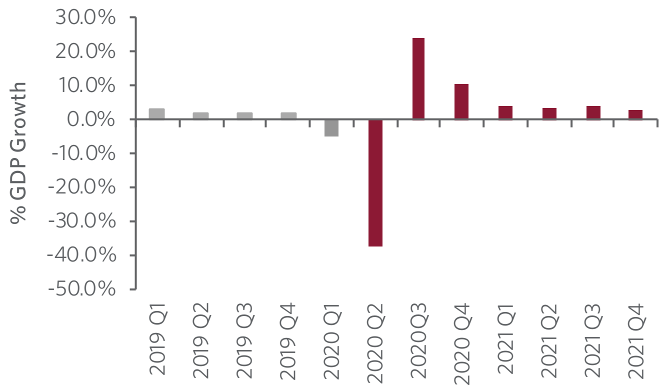
CIBC Cleary Gull

MARKET MONITOR

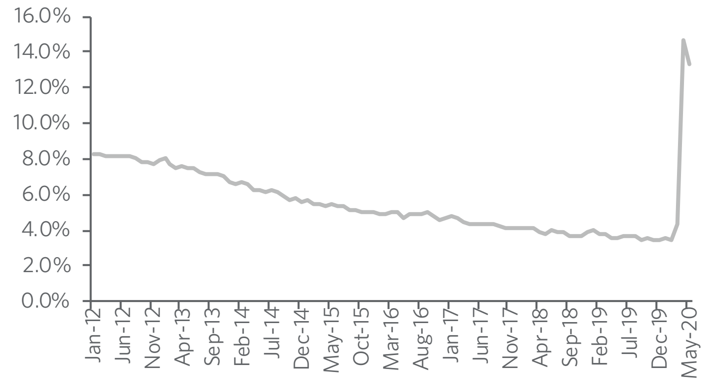
M&A and financing update
2nd Quarter 2020

Quarterly U.S. Gross Domestic Product



Sources: U.S. Department of Commerce and Wells Fargo.

U.S. Unemployment



Source: Federal Reserve Bank of St. Louis.

The path forward

It has been roughly 100 days since the U.S. economy came to an abrupt stop in mid-March. In March and April, we saw M&A transactions pause as buyers, sellers, and lenders tried to assess both the positive and negative impact that the government imposed "shelter-in-place" orders would have on essential and non-essential businesses and consumer confidence. The shutdown led to the U.S. shedding 22.1 million jobs in March and April, according to the U.S. Bureau of Labor Statistics, which caused the U.S. unemployment rate to reach its highest level, in the shortest timeframe, in history.

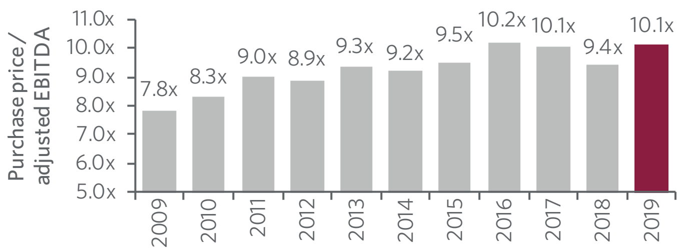
As the U.S. economy was shuttered, there was an unprecedented level of government stimulus through the central bank and the Federal Reserve to support businesses, the capital markets, and furloughed employees. These government actions and programs included 1.5% federal fund rate cuts, the passing of trillions of dollars of aid to businesses through the Payroll Protection Program ("PPP"), the Fed setting up direct asset purchase programs, the creation of the Main Street Lending Program to support small and medium sized businesses, and record levels of unemployment benefits.

Over the last few weeks, we have seen the early stages of initial attempts to reopen the economy to varying degrees in different regions of the country. One report of the economic reopening came from the U.S. Bureau of Labor Statistics which surprisingly reported that 2.5 million jobs were gained in May with over 50% in leisure and hospitality. As businesses such as restaurants, amusement parks, movie theaters, gyms, and hair salons began opening in May in limited capacity and consumers were there to support them.

On the M&A front, corporations and private equity groups began to find a path forward by implementing creative ways to conduct diligence on stalled transactions that were in process in March and April. Investment bankers, buyers, sellers, lenders and diligence providers began using virtual meetings and management presentations. Private equity groups sent one person or a small team by car, RV or private jet to meet management teams and tour operations to differentiate themselves and complete the important step of meeting the team during diligence. Buyers hired regional diligence providers to conduct onsite diligence and leveraged long-term relationships with lenders and/or utilized fund lines of credit to close transactions during a period of limited debt availability.

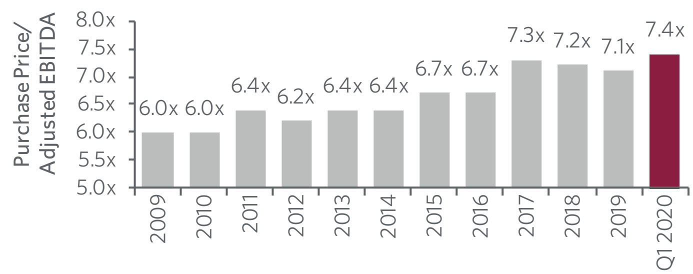
As we head into a period of broader reopening, each region of the U.S. will test whether lifting shelter-in-place orders and social distancing requirements will lead to a spike in COVID cases or if the economic rebound will continue. Currently, GDP is forecast to grow 23.9% in Q3 2020 and 10.6% in Q4 2020 after falling an estimated 37.6% in Q2 2020, according to Wells Fargo. Time will tell whether the flattening of the COVID curve continues and the economy continues to return toward normal during the second half of 2020.

U.S. M&A transaction multiples



Source: PitchBook.

Avg. purchase price/adj. EBITDA multiples for PE-backed LBOs with $10mm - $250mm of EV



Source: GF Data®.

LBO valuation multiples remained strong in Q1 2020

Q1 2020 LBO valuation multiples got off to a very strong start. GF Data® reported the average enterprise value/EBITDA multiples for $10 to $250 million enterprise value leveraged buyouts ("LBOs") was 7.4x. Pitchbook reported the average enterprise value/ EBITDA multiple for all U.S. M&A transactions was 10.1x. The uptick in multiples was driven by the technology and distribution verticals which are perceived as recession-resistant and potentially COVID-resilient. For the quarter, GF Data® reported that valuation multiples for the distribution industry increased from 7.1x in 2019 to 8.9x, a significant surge in an already "frothy" market.

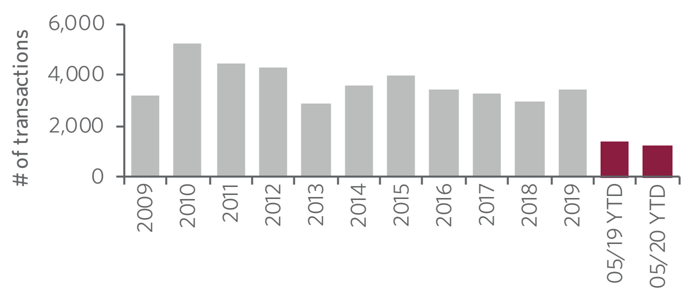
For Q2 2020 we are expecting reported valuation multiples will remain strong for two reasons. First, transactions that closed in April, May or June most likely involved COVID-resilient companies. Second, we heard that many of the closed transactions included "COVID structure" terms such as seller notes, earnouts, or escrows to allocate COVID risk between the parties. Many of these structures are not reflected as a deduct to enterprise value in the reported data.

Historically, there has always been a flight to quality approach to investing coming out of an economic slowdown. It will be interesting to monitor valuations for both COVID "winners" such as e-commerce, software, distribution, and food companies and COVID "losers" in elective healthcare, retail, and hospitality and entertainment. One could argue that any business that grew in Q2 2020 will be more not less valuable once stability returns to the economy because it checks a due diligence box that did not exist, in February: "pandemic resistant".

The velocity of 2019 deal volume continued into early 2020

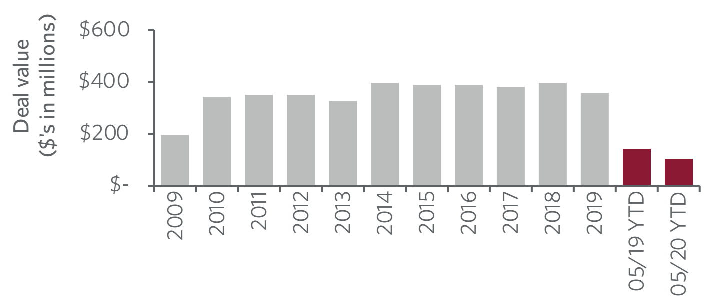
May 2020 saw the number of completed transactions under $500 million decline 31.4% compared to May 2019, according to Robert W. Baird & Co. This was the second straight month of almost record low deal volume with May posting the fewest number of reported transactions since December 1996. All things considered, the fact that 229 deals under $500 million closed in May is extraordinary. The deal volume is being led by COVID-resilient software, technology and business service companies. Through May, the total number of completed transactions under $500 million declined 7.7%, compared to YTD May 2019. We anticipate that reported deal volume will remain below historical averages until the debt markets are open and confidence is restored to company forecasts, but the stronger than expected volume in May and the uptick in new deal flow in June will hopefully translate to the start of a rebound in transaction volume. We are also expecting the markets to experience an increase in special situation transactions during the second half of 2020.

U.S. M&A deal volume for transactions under $500MM



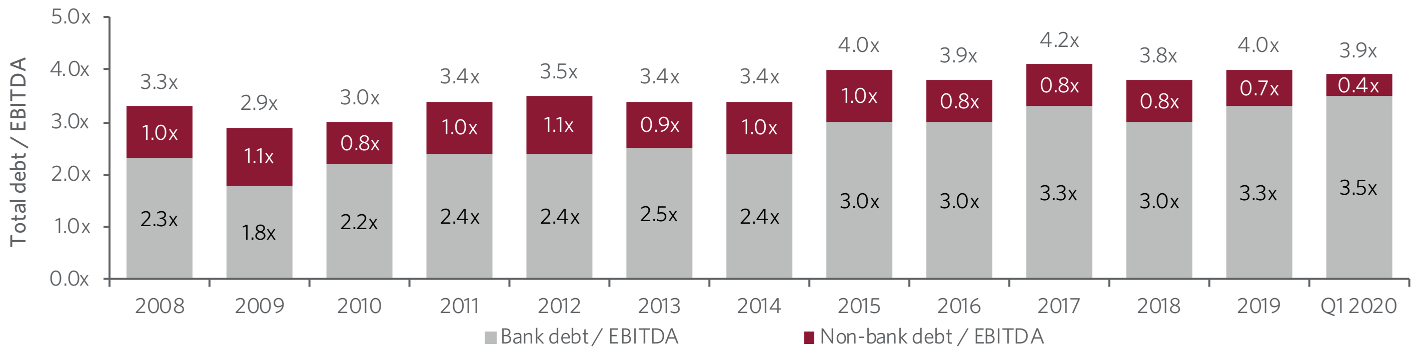
Source: Robert W. Baird & Co.

U.S. M&A deal value



Source: Robert W. Baird & Co.

Average platform LBO debt multiples for deals with $10mm – $250mm of enterprise value



Source: GF Data®.

Debt markets remained aggressive in Q1 2020, but limited debt availability is expected for new deals for the balance of the year

The average total debt/EBITDA multiple for private equity-backed LBOs from $10 to $250 million was 3.9x in Q1 2020, according to GF Data®. Debt availability continued to be an important catalyst fueling the seller's market in Q1 2020 with the average senior debt/EBITDA multiple recording its highest average in the last five years at 3.5x. One particular area of the debt markets that influenced the high level of senior debt availability was 56% of LBOs and add-ons supported by senior only or unitranche facilities that averaged 3.9x EBITDA. Despite the record levels of debt availability in January and February of this year, private equity groups continued to fund over 50% of transactions with a lower debt level than the market would support.

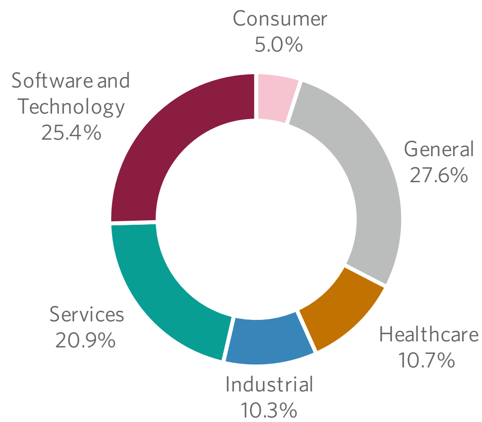
Starting around March 12th, the debt markets paused as financial uncertainty became the norm, non-essential businesses were closed, and employees were sent home. For the transactions that closed in Q2, we have not heard of a closing that was not already in process prior to mid-March. This is important because lender visits to the companies that were acquired had already occurred before travel restrictions were implemented.

Q2 reported data will most likely not be a great predictor for the future because of the amount of stress and uncertainty that was present in the debt markets as companies closed, lenders focused on PPP loans for their clients, and the lack of visibility regarding company performance for the balance of 2020 became the norm. We have heard from several lenders and private equity groups that closed transactions in Q2 that leverage multiples tightened by 0.5x to 1.5x total debt/EBITDA and pricing increased 100 to 300 basis points between the issuance of a term sheet and the final commitment to fund the deal.

As the beginning of Q3 2020 approaches, we are hearing from a very select number of traditional banks and direct lenders that the debt market are beginning to slowly open but the bar is higher to fund a new deal and relationships are more important than ever. While the cash flow markets are showing some signs of life, there are still two due diligence requirements that are challenging for lenders and borrowers. First, lenders need to be able to travel to visit the company and meet the management team while most are working from home and still have travel restrictions in place. Second lenders require is a strong-performing company that is tracking on or above its budget and it has good visibility for the balance of the year.

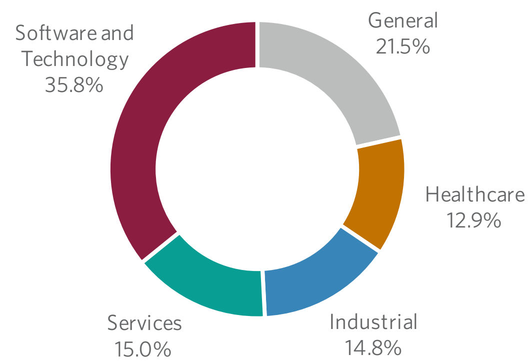
We anticipate that new deal announcements will continue to be reported during the second half of 2020, however, we are not expecting the debt markets to be fully open to pre-COVID levels of availability because of continued instability in portions of the economy which has led to the inability to accurate forecast financial performance. We are also anticipating that lenders will need to focus more attention on their current portfolio in Q3 and Q4 2020 as current borrowers request covenant relief and request additional liquidity to help support growth as the economy reopens.

U.S. Private Equity Fundraising by Sector from 2017 – YTD May 2020



Source: PitchBook.

U.S. Private Equity Fundraising by Sector YTD May 2020



Source: PitchBook.

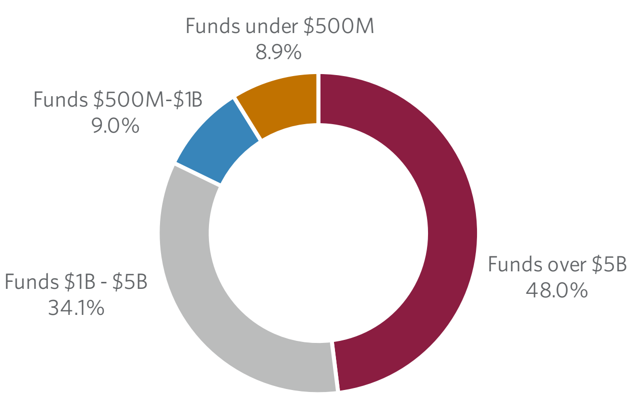
How will the $740 billion private equity overhang be invested post-COVID?

According to PitchBook, the amount of private equity ("PE") funds raised but not invested in the U.S. ("overhang") grew 89% to $740 billion from 2008 to 2019. Most PE firms commit to their investors to invest funds within 3 to 7 seven years. Accordingly, any significant COVID-related slowdown in M&A activity will only pent-up demand in the private equity community to invest the overhang. Which sectors and what size transactions are likely to be most affected?

Recently, funds focused on the software & technology and services markets have captured an increasing portion of Limited Partner ("LP") dollars invested accounting for 51.9% of the ~$700 billion raised since 2017. It is also safe to assume that funds not specifically focused on these sectors will increase their allocation to the services and software & technology markets because they are proving to be more "pandemic resilient" than others. As a result, a substantial majority of the private equity capital overhang could be focused on the same deals, driving enhanced competition and fueling higher valuations. Fundraising completed during the COVID pandemic in early 2020 supports the shift toward sectors that are perceived to be pandemic resistant. So far in 2020, funds focused on software and technology and services have accounted for 67.9% of the funds raised.

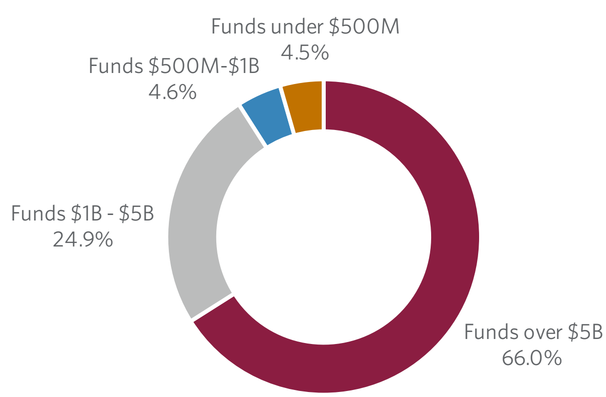
Over 82% of the capital since 2017 was allocated to funds over $1 billion. As a result, one can conclude that the majority of the dry powder will be focused on platforms that are over $200 million in enterprise value and subsequent add-on acquisitions. While a lower percentage of capital is allocated to the lower middle market for businesses with enterprise values below $100 million, the 18% represents over $100 billion in dry powder raised by funds that are under $1 billion in size. In addition, many of these businesses will be attractive add-on targets for platforms supported by $1+ billion funds.

U.S. Private Equity Fundraising by Fund Size from 2017 – YTD May 2020



Source: PitchBook.

U.S. Private Equity Fundraising by Fund Size YTD May 2020



Source: PitchBook.

Firm overview

CIBC Cleary Gull is a nationally recognized boutique investment banking firm with a global reach. We advise private equity funds, entrepreneurs, and small publicly traded companies on mergers and acquisitions, private debt and equity financings and recapitalizations and other transactions.

Our talented team has completed hundreds of middle market transactions delivering more than $8 billion in value. With an average of more than 20 years of deal experience, our skilled senior investment bankers bring knowledge, integrity and relentless determination to deliver great outcomes for our clients.

Global reach

CIBC Cleary Gull is a member of the International Association of Investment Bankers. The IAIB (iaib.org) is a global network of investment banking firms in Asia, Australia, Europe, and North and South America working together to broaden their reach and leverage their expertise.

Contact us for more information on CIBC Cleary Gull and our Investment Banking services.

Contacts:

Kevin Li
Managing Director and Head,
U.S. Investment Banking
312 564-2957
kevin.li@cibc.com

Ronald Miller
Managing Director and Head,
CIBC Cleary Gull
414 291-4528
ronald.miller@cibc.com

Patrick Bremmer
Managing Director
414 291-4548
patrick.bremmer@cibc.com

Ryan Chimenti
Managing Director
414 291-4531
ryan.chimenti@cibc.co

Rob Gjerlow
Managing Director
312 564-2785
rob.gjerlow@cibc.com

Gregory Gorlinski
Managing Director
414 291-4559
gregory.gorlinski@cibc.com

Ryan Olsta
Managing Director
414 291-4555
ryan.olsta@cibc.com

John Peterson
Managing Director
414 291-4551
john.peterson@cibc.com

Eric Reuther
Managing Director
312 564-2786
eric.reuther@cibc.com

Christopher Larsen
Executive Director
414 291-4547
christopher.larsen@cibc.com

James Olson
Executive Director
414 291-4552
james.olson@cibc.com

Patrick Ringsred
Executive Director
414 291-4553
patrick.ringsred@cibc.com