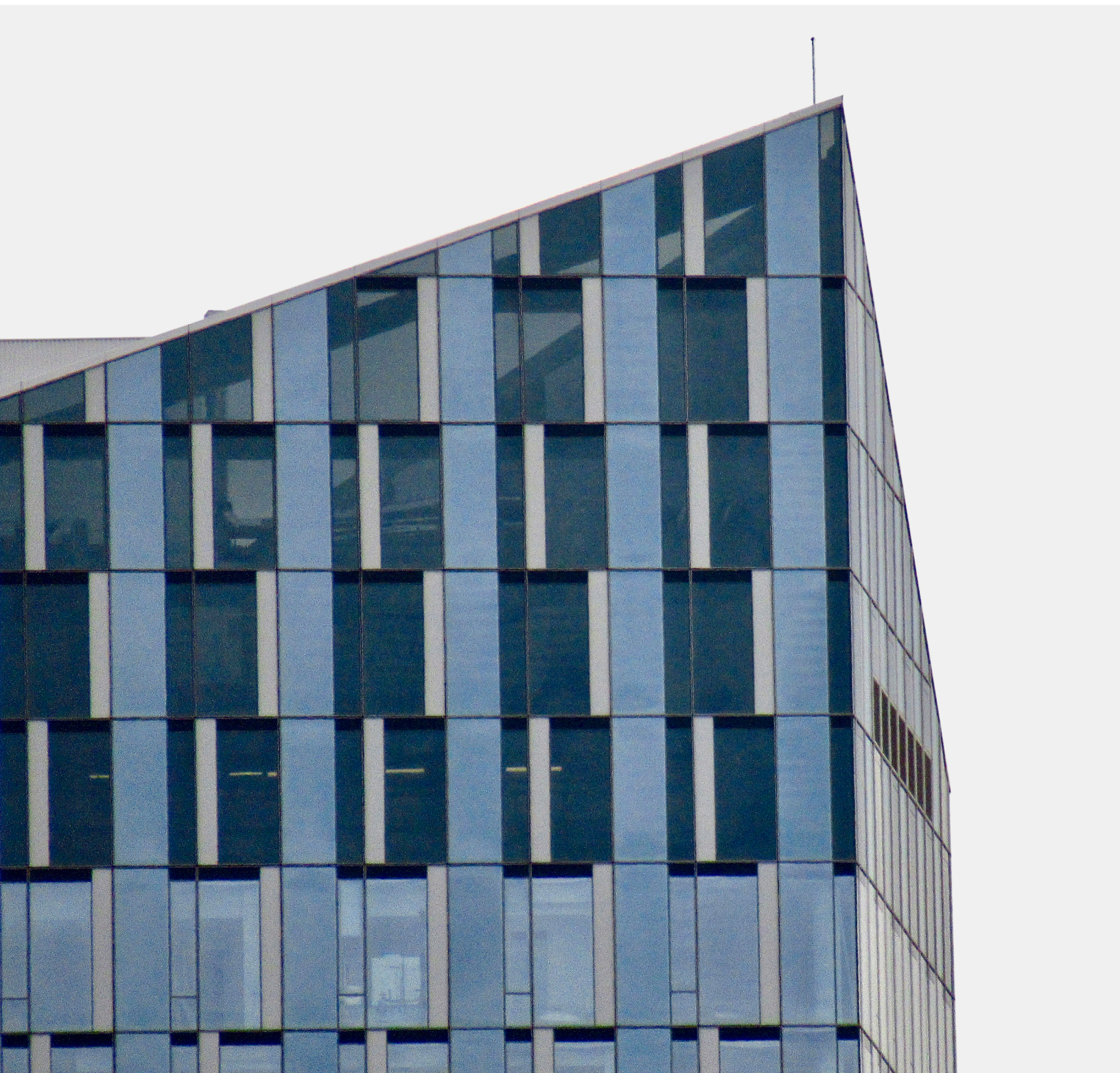




CIBC CLEARY GULL

MARKET MONITOR

M&A and financing update
4th Quarter 2022



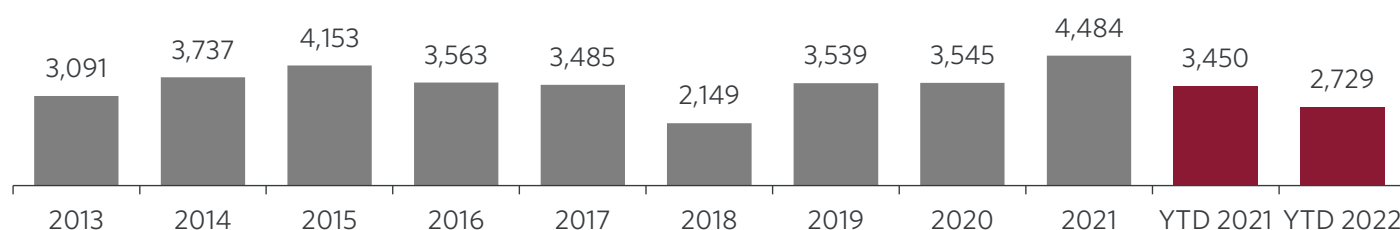
Flight to quality?

Remarkable resilience in M&A valuation multiples and LBO financing availability despite a significant decrease in M&A transaction volume and increase in interest rates.

Transaction volumes

Year-to-date middle market (under \$500 million of enterprise value) M&A activity through Q3 2022 continued to slow as dealmakers became more cautious and weighed the impact of inflation, interest rates, and the economy on the decision to launch M&A processes. According to Robert W. Baird & Co., the number of transactions completed through September 2022 were down 21% compared to the same period in 2021. The first half of the year has been plagued by challenging financial conditions which have resulted in an increase of financial and strategic buyers declining to participate in auction processes until more clarity returns to financial forecasts. Macroeconomic concerns have once again become deterrents to dealmaking.

US M&A deal volume for transactions under \$500mm

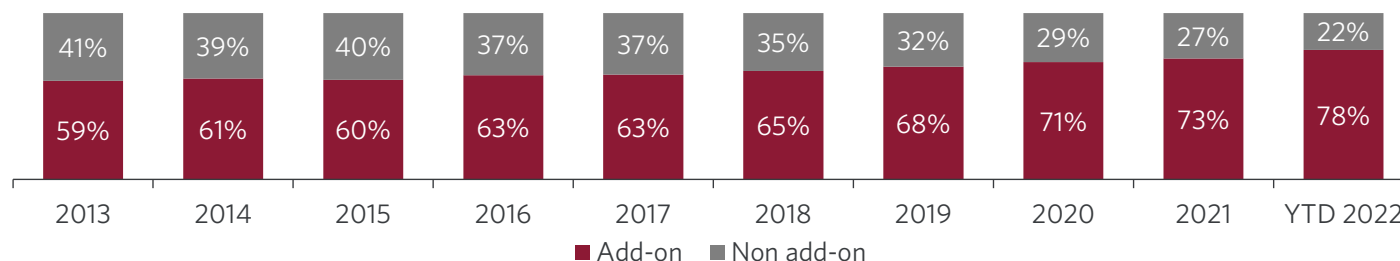


Source: Robert W. Baird & Co.

Focus on private equity activity

According to Pitchbook, in Q3 2022 add-ons reached a record high of 78% of buyout transactions. While overall deal activity has declined over the last three quarters, add-ons have increased as a percentage of closed transactions. Add-on acquisitions are typically smaller in transaction size and are easier to finance. Private equity (“PE”) backed platforms are often able to use an existing acquisition line of credit or equity allocated to add-ons as a competitive advantage in auction processes when surety to close has become of greater concern to sellers. PE firms have long employed buy-and-build strategies to scale existing platform investments, but are likely to increase in a downturn due to lower valuations and companies looking to get out of an uncertain market.

Add-on % of US PE buyout transactions



Source: Pitchbook

PE exit activity has been slowing more with each successive quarter in 2022 compared to a robust 2021. According to GF Data®, a greater percentage of completed deals are high-quality “A” assets, which have above-average financial characteristics, strong management teams, and recession-resistant earnings. The implication is that lower transaction volumes are being driven by a higher number of “B” assets, which are out-of-favor or troubled businesses, that have not transacted or chosen not to sell. In 2021, “B” assets were able to ride the coattails of recurring revenue, high multiple deals to transact at lower multiples. In 2022, buyers and lenders became increasingly cautious and expressed concern around the quality and sustainability of growth and EBITDA for “B” assets. Despite the slowdown in PE exits of lower quality assets, the exit activity for good assets remains “normal” compared to quarterly volumes prior to 2021. According to Pitchbook, PE exits for 2022 are expected to reach the activity levels of previous years, excluding 2021.

US PE exit activity YTD Q3 2022



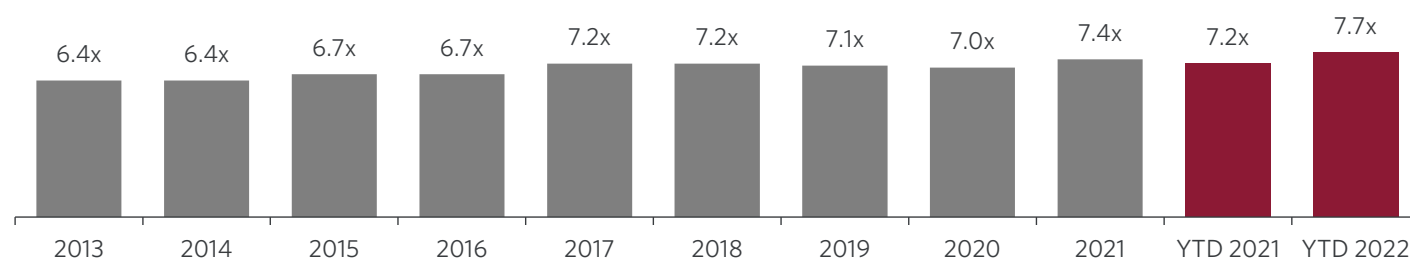
Source: Pitchbook

It is important to remember that transaction volume in 2021 was an outlier year when it comes to M&A transactions. So while PE exits have slowed, PE firms continue to raise record levels of investable capital that needs to be deployed.

Most LBO sector multiples at all-time highs

Valuations in the middle market reached a new peak in Q3 2022, according to GF Data®. It is believed 2022 multiples are being skewed higher because there are far fewer “B” assets transacting in 2022 at lower multiples, which would pull the average down when 2022 is compared to prior periods. The higher proportion of sale processes for high-quality “A” assets closing and processes for lesser quality “B” assets either failing or delaying should continue to skew the average EBITDA multiple higher than historical averages. According to GF Data®, high-quality assets accounted for over 70% of closed transactions during the first three quarters of 2022, compared to the historical average of 56% of transactions.

Average EBITDA multiples for \$10mm - \$250mm of enterprise value PE-backed LBOs



Source: GF Data®

LBOs are only a fraction of all M&A activity but still serve as a useful proxy for valuations overall. The 2022 breakdown of multiples by industry highlights that every vertical, except for retail and technology, are transacting at record levels. Uncertainty in the macroeconomic outlook has caused a decline in public technology stocks, which has rippled through middle market technology deals. Despite the headwinds, investor appetite for technology deals has remained strong and 2022 deal value remains in line with pre-pandemic averages.

According to Pitchbook, the valuation shift has been viewed by investors as a reversion to the mean rather than a systemic shift in the market. On the other hand, valuations on retail deals have declined by 0.6x during 2022, which is attributable to reduced consumer spending as a result of inflation and increased interest rates. According to GF Data®, this could potentially serve as a barometer for broader deal pricing going forward.

Average EBITDA multiples by industry

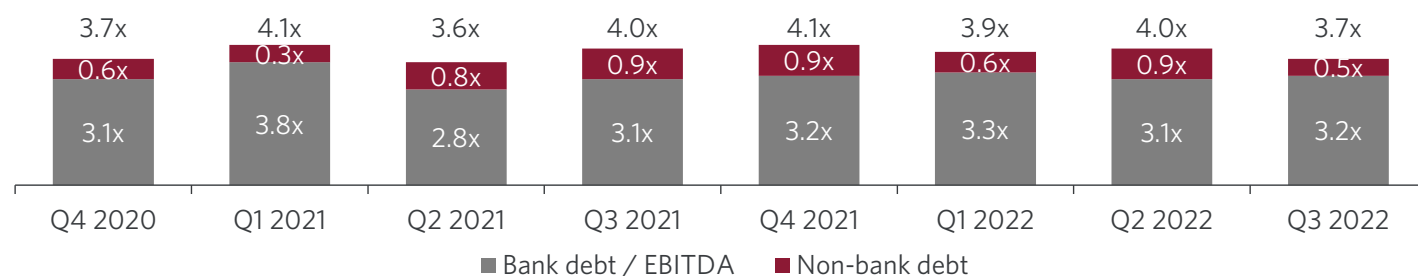
Transaction Size	2003 - 2017	2018	2019	2020	2021	YTD 2022
Manufacturing	6.1x	6.8x	6.5x	6.7x	7.2x	7.4x
Business services	6.5x	7.1x	7.2x	7.1x	7.3x	7.6x
Healthcare services	7.3x	7.8x	8.0x	7.6x	8.0x	8.6x
Retail	6.7x	8.1x	9.3x	6.5x	8.6x	8.0x
Distribution	6.5x	6.9x	7.0x	7.5x	7.3x	7.3x
Media & telecom	7.4x	7.8x	9.4x	8.3x	6.3x	9.1x
Technology	8.2x	9.6x	10.0x	7.6x	10.3x	9.0x
Other	6.2x	7.2x	6.5x	6.2x	7.4x	7.7x

Source: GF Data®

Debt market challenges

According to GF Data®, the average total debt multiple for Q3 2022 was 3.7x, decreasing slightly compared to 3.9x during the first half of 2022. Although total debt multiples have been minimally impacted by rising interest rates and recession concerns, transaction data would suggest that credit has remained available to “A” assets and has become challenging for lower-quality “B” assets. Credit committees within lenders are monitoring end market exposure closely, which is resulting in a significant reduction in interest for supporting cyclical end markets and highly-leveraged LBOs. The result has not only been to support higher valuations and debt multiples for “A” assets compared to “B” assets, but has resulted in fewer “B” assets transacting. Some buyers have addressed the shortfall in available debt by increasing their equity contribution. According to GF Data®, the average equity contribution for platform deals was 57% year-to-date through Q3 2022, compared to 54.5% in 2021. In some cases, PE buyers are closing transactions with 100% equity with the goal of refinancing and recycling the capital in the next 12 to 18 months once the debt markets normalize. Although total debt multiples only decreased slightly, interest rates have increased significantly compared to the first half of the year and are causing debt markets to tighten.

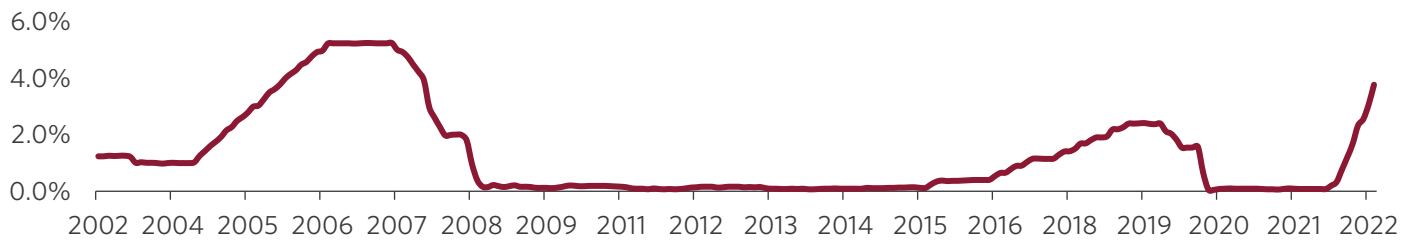
Average LBO debt multiples for deals with \$10mm - \$250mm of enterprise value



Source: GF Data®

Federal Reserve interest rate increases earlier in 2022 had minimal impact on the lower middle market, but these increases became evident in the third quarter. Senior debt pricing increased approximately 2.0%, to 6.5%, and direct lending interest rates are currently SOFR + 600-800 bps, which is the equivalent of mezzanine debt pricing. Direct lending deals are still being completed, but rate increases are causing private credit activity to slow. It is important to remember that compared to historical rates, current interest rates are still low and dealmaking will continue despite higher rates.

Historical US Federal Funds Rate



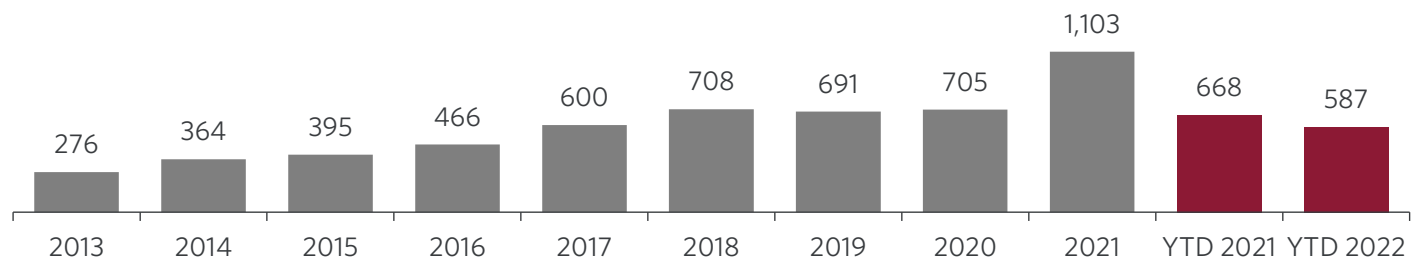
Source: GF Data®

Sector Focus – Software and Technology

Software transaction demand persists despite market headwinds

While software M&A has certainly faced more headwinds than in 2021's record year for dealmaking, buyers remain interested in completing transactions for high-quality companies. Macroeconomic uncertainty and higher interest rates have had a negative effect on larger software companies accessing public and venture capital funding, marked by significant stock price decreases, widespread layoffs, and diminished fundraising ability. According to Pitchbook, 587 software M&A deals totaling \$129 billion in value have been completed in the U.S. year-to-date in 2022 through Q3. While this is down approximately 24% over the same period in 2021, it is in line with historical averages for the past 10 years. Of note, technology transactions accounted for nearly 30% of private equity transaction volume year-to-date in 2022 according to Pitchbook, demonstrating the growing importance of technology companies and their resilience to market volatility and recessionary fears relative to companies in other industries.

US software PE deal activity



Source: Pitchbook

Firm overview

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CIBC is a 150 year-old financial institution that provides US clients with tailored commercial banking, wealth management, personal and small business financial solutions, as well as cross-border banking services to clients with North American operations.

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

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