

Strong Deal Value Masks the Continuing Trend of Declining Transaction Volume

January 2019 set an all-time U.S. record for aggregate transaction value for the month of January at \$216.8 billion, which was 50.8% higher than the monthly average in the last twelve month period, according to Robert W. Baird & Co. For the full year 2018, total transaction value increased by 14.3%, compared to 2017.

Recent transaction value has been heavily influenced by “mega-deals”, each over \$20 billion. In 2018 and early 2019, the mega-deal trend was led by the biotechnology, financial services, and media and entertainment industries, with deals such as the \$71 billion acquisition of 21st Century Fox by The Walt Disney Company.

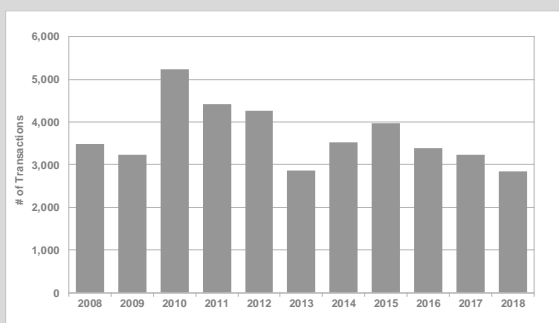
While mega-deals command readers’ attention in the weekly headlines of *The Wall Street Journal* and around the office water cooler, they are increasing transaction value disproportionately to transaction volume, which is actually declining. For the month of January 2019, the number of

completed transactions under \$500 million fell by 29.2%, compared to January 2018, according to Robert W. Baird & Co. Transaction volume for 2018 declined by 12.2%, compared to 2017, and the last year there was a year-over-year increase in transaction volume was 2015. Since then, transaction volume has declined at an average annual rate of just over 10%.

Surprisingly, the number of smaller transactions declined even more than the decrease in the total number of deals. Completed transactions under \$100 million declined 33.0% in January 2019, 16.3% in 2018, and 13.2% per year since 2015. The larger decrease in the number of smaller transactions is unexpected because normally the lower end of the market is less volatile than the market overall.

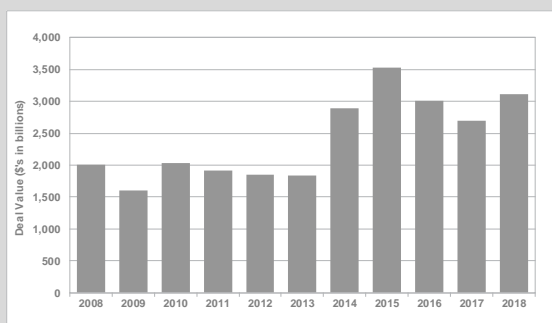
Currently, our “crystal ball” does not provide a clear vision of transaction volume for 2019, but based on our conversations with strategic and financial buyers regarding new year-to-date inbound deal flow and early 2019 results, we could see another year of declining transaction volume.

U.S. M&A Deal Volume for Transactions Under \$500MM



Source: Robert W. Baird & Co.

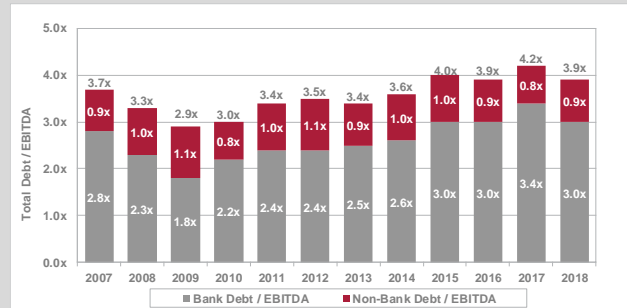
M&A Deal Value



Source: Robert W. Baird & Co.

Senior debt multiples declined slightly from 2017 peak

Average LBO Debt Multiples for Deals with \$10M - \$250M of Enterprise Value



Source: GF Data®

Valuation Multiples Maintain Strong Momentum

The market continued to produce strong average enterprise value/EBITDA multiples in 2018, achieving 9.7x for all reported transactions, according to PitchBook, and 7.2x for private equity-backed leveraged buyouts from \$10 to \$250 million (“LBOs”), according to GF Data®. In Q4 2018, LBOs achieved the highest quarterly average enterprise value/EBITDA multiple for the year at 7.8x, which was 0.5x EBITDA higher than any other quarter in 2018. Interestingly, a “bump” of 0.5x also occurred in Q4 2017, which had an average enterprise value/EBITDA multiple for LBOs of 8.0x.

In 2018, a majority of the LBO transactions (61%) reported to GF Data® had what it considers to be “above-average” financial characteristics. The two enterprise value segments that benefited the most from strong financial characteristics were the \$25 to \$50 million and \$50 to \$100 million transaction segments which reported quality premium EBITDA multiples that were 0.9x and 2.3x higher than the historical averages for the segments, respectively. GF Data® described the rationale for the outsized premiums for

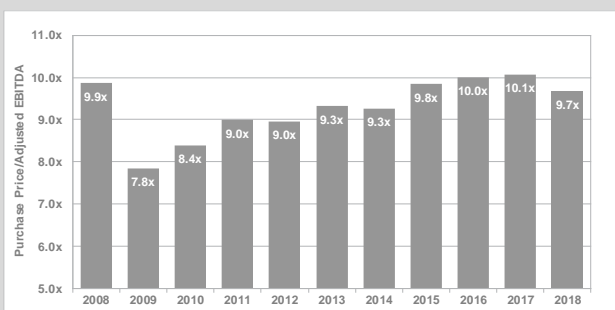
companies in these size ranges as the market rewarding “B” properties in “A” segments (e.g. healthcare) with higher valuations.

LBO Debt Multiples Decline

The average total debt/EBITDA multiple for \$10 to \$250 million enterprise value LBOs was 3.9x in 2018, a decline from the record high of 4.2x EBITDA achieved in 2017, according to GF Data®. Private equity firms provided more equity to make up for the reduction in debt, with only 31.3% of the reported transactions utilizing maximum available debt. The decrease in available debt was not uniform across all industries. For example, business services transactions experienced a decline in available debt to fund transactions from 4.7x EBITDA in 2017 to 3.9x EBITDA in 2018.

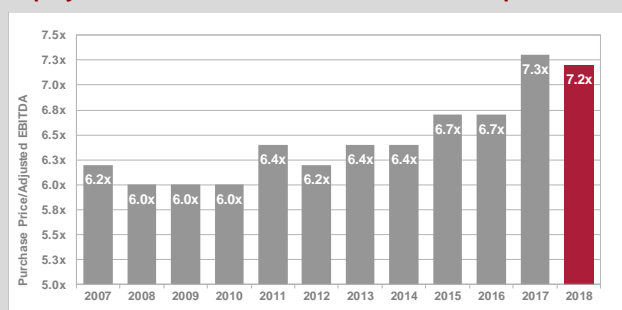
For the first quarter of 2019, the compression of total debt multiples continued with average total debt/EBITDA multiples decreasing approximately 0.5x EBITDA, compared to Q1 2018, for borrowers ranging from <\$5.0 million to over \$20 million of EBITDA, according to SPP Capital Partners.

U.S. M&A Transaction Multiples



Source: PitchBook

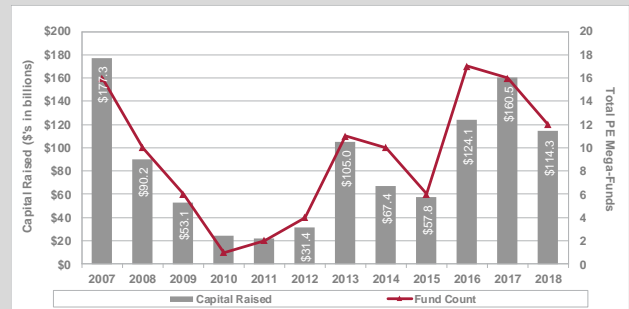
Average Purchase Price/Adjusted EBITDA Multiples for Private Equity-Backed LBOs with \$10M - \$250M of Enterprise Value



Source: GF Data®

Mega-Funds (>\$5 billion) accounted for 4.5% of the funds raising capital, but 42.5% of the total capital raised in 2018

PE Mega-Fund Fundraising Activity



Source: PitchBook

Private Equity Proliferation: They're not all Alike

We hear many sweeping generalizations about private equity (i.e., “they destroy companies” or “they make companies perform better”), often based on anecdotal experience or observation, that greatly oversimplify. It’s like saying “people in the Midwest are thrifty”, which may be a reasonable characterization, but still fairly describes only a portion of the population. With the large number of private equity (“PE”) firms – estimated at over 18,000 by PitchBook – we feel it is more useful to think of this as a market with many segments and sub-segments.

An obvious distinction can be drawn between venture and buyout funds. Venture funds typically invest in early stage, technology-based companies expecting significant growth often by disrupting, transforming or creating markets. Buyout funds favor established companies expecting growth in free cash flow by traditional means, such as expansion in existing markets, entering new markets, lowering costs, acquisitions, and/or deploying capital more effectively.

Size matters. PE funds range from hundreds of thousands to billions of available capital. Funds of all sizes generally commit 5% to 20% of their capital to each company’s investment or opportunity, and have little or no interest in a

deal that is too big or too small in relation to their target investment size.

Most PE investors have a strict discipline in investing to own 100% of a company, a controlling interest, or a minority interest. Typically they have pre-determined whether they will invest in equity or debt of a company, or both. Most also have a well-defined style of interaction of the companies in which they invest, ranging from being extremely involved to quite passive.

Industry expertise has become one of the most, if not the most, important criteria for matching investment opportunities with PE funds. Some obtain their expertise through experience; others through research, still others through affiliations with current or former CEOs, consulting relationships, and/or operating partners. Whatever the source for their expertise, a knowledgeable PE fund is much more likely to properly value an opportunity.

In middle market M&A, where there is more often than not the potential for a PE buyer or investor, it is important to match each opportunity with the funds that fit – including their type and size, control orientation, preferred investment security, level of involvement, and industry expertise.

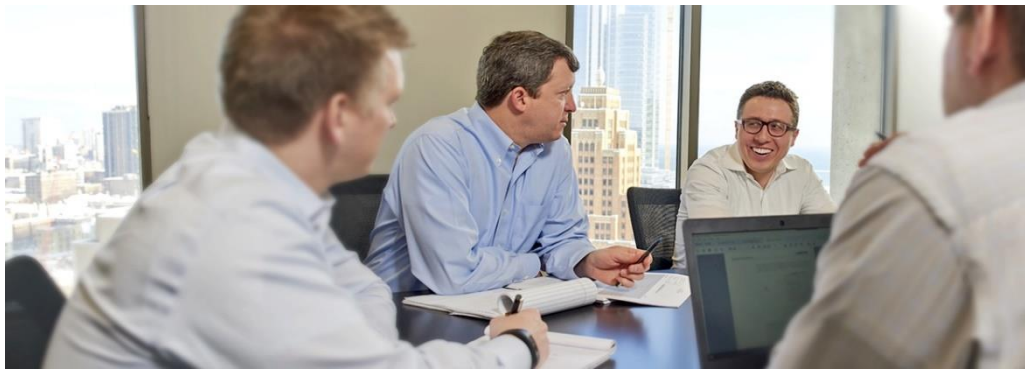
Private equity funds quest for high margin, recurring revenue, recession-resistant businesses is driving outlier valuations

TEV/EBITDA – Buyouts with Above-Average Financial Characteristics

TEV	2003 - 2013	2014	2015	2016	2017	2018	Total	N =
\$10M-\$25M	5.5x	6.1x	6.1x	5.8x	6.7x	6.3x	5.7x	560
\$25M - \$50M	6.2x	6.7x	7.0x	6.7x	7.0x	7.4x	6.5x	449
\$50M - \$100M	6.8x	7.8x	8.6x	7.7x	8.7x	9.8x	7.5x	328
\$100M - \$250M	7.7x	7.6x	10.0x	9.7x	9.7x	8.9x	8.6x	162
Total	6.1x	6.8x	7.3x	7.2x	7.8x	7.9x	6.7x	
N =	901	95	122	115	129	137		1499

Note: N for 2003 - 2013 encompasses eleven years of activity.

Source: GF Data®



Firm Overview

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