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CIBC CAPITAL MARKETS

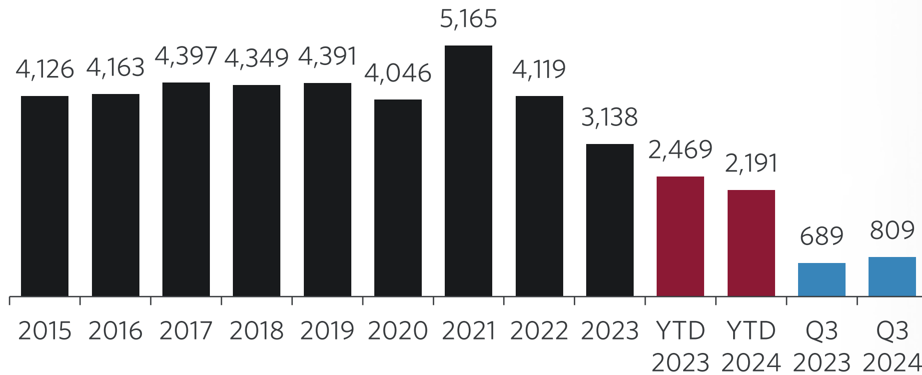
US MIDDLE MARKET MONITOR

M&A and financing update

Q4 2024

Deal volume increases in Q3

US M&A transactions under $500M

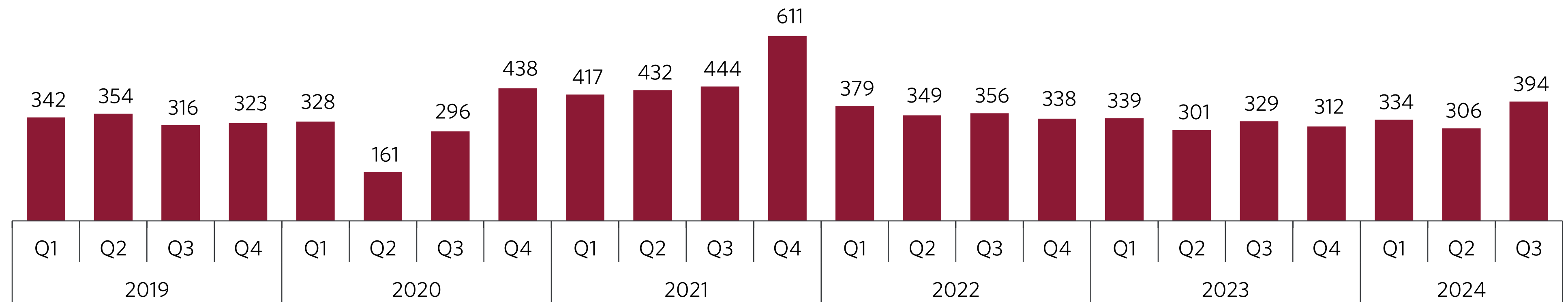


Through Q3 2024, US lower middle market M&A deal volume continued to trend below 2023. According to Robert W. Baird & Co., the number of completed transactions declined by 11.3%, with 2,191 reported transactions through Q3 2024 compared to 2,469 through Q3 2023. However, signs of a potential rebound in transaction volume emerged in Q3 2024 as transaction volume increased 17.4% over Q3 2023. Most notable from the Q3 2024 pick-up in activity was the fact that activity in $100 to $500 million in enterprise value transactions experienced a year-over-year increase of 11.8%. This size category has been hardest hit by the lack of debt availability and the valuation gap between buyers and sellers over the last 18 months. The increase in activity was driven by several factors, including improved financing conditions, stronger financial performance of target companies, and growing confidence among both buyers and sellers.

Source: Robert W. Baird & Co.

PE exit activity rebounds in Q3

US PE exit activity by quarter



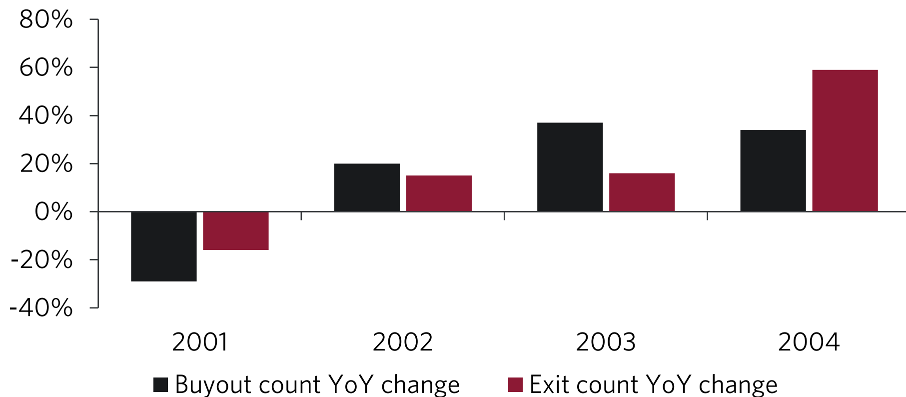
Private Equity (PE) exit activity showed early signs of recovery in Q3 2024, with exit volumes exceeding pre-pandemic levels. Through Q3 2024, PE exit activity totaled 1,034 transactions, compared to 969 transactions during the same period in 2023, an increase of 6.7%. The increase was driven by sponsor-to-sponsor exits which were negatively impacted over the past year by the cost and availability of debt. According to Pitchbook, these exits accounted for 55.6% of Q3 exit count when excluding initial public offerings, up from previous quarters. Despite the rebound in sponsor-to-sponsor deals, this buyer category still remains 17.4% below pre-pandemic levels. As a result, we anticipate that sponsor-to-sponsor exit volume will continue to recover towards the historical ~75% average in 2025 as interest rates decline, portfolio company performance rebounds, and buyer and seller valuation expectations align.

Another factor that will influence PE exit activity is growing pressure from limited partners seeking a return of capital before investing in the next fund. The overall inventory of PE portfolio companies has swelled to 11,567 companies as of Q2 2024, an increase of 26.6% since 2018. During the frothy market of 2021, many PE firms added to their portfolios and, due to a combination of low interest rates and increased competition for new deals, often paid valuation multiples that were above historical averages for similar assets. As a result, many PE firms are waiting for more favorable market conditions or relying on debt paydown to support return thresholds before launching sale processes for portfolio companies that have the potential to experience entry-to-exit multiple compression. Other factors that will influence exit decisions in 2025 include: understanding the impact of the Presidential election; tariffs and US trade policies; and the number of potential future interest rate cuts. While PE-owned, high-quality assets continue to come to market and benefit from frothy valuations tied to the supply-demand imbalance, the majority of portfolio companies are still being held in hopes of more favorable exit conditions. The continued imbalance between record levels of investment capital and fewer high quality, new investment opportunities suggests that significant acceleration in exit activity is needed to normalize the age of inventory for PE-backed companies.

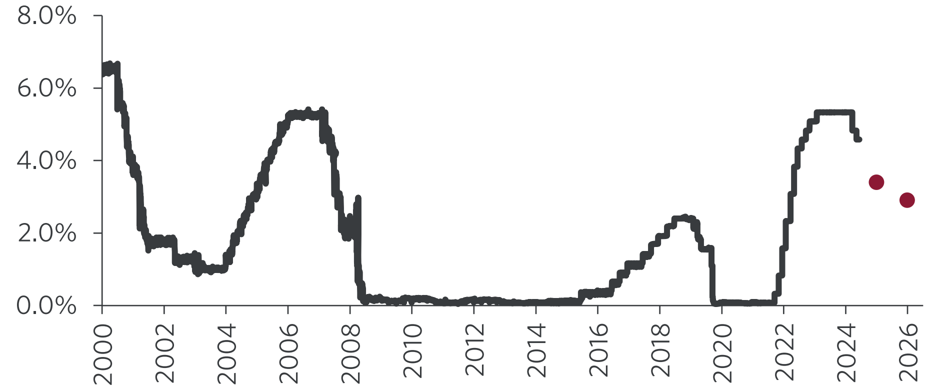
Source: Pitchbook.

Historical PE activity following interest rate cuts

US PE buyout and exit activity changes from first interest rate cut



Historical and projected federal funds rate



The impact of interest rate cuts on M&A activity can be significant, as evidenced by the 2001-2004 period. Following the Federal Reserve's rate cuts beginning in January 2001, PE buying activity saw a notable upturn, with volume increasing by 38.1% in 2003. Historically, lower interest rates have positively impacted transaction volume because of reduced borrowing costs and improved deal economics. Coming out of a recession, there has always been a lag before companies have the trailing financial performance and the forward financial visibility to launch sale processes. The effect of pent-up demand on exit activity is apparent with exit count increasing by 60.3% in 2004.

The recovery after the dot-com bubble and the recovery from the post-COVID M&A frenzy share striking similarities, particularly the rapid rise and fall of valuations before and after each peak. During the early 2000s, optimism around the internet and easy access to capital drove valuations to unsustainable levels. Similarly, in 2021, M&A activity surged with record valuation multiples fueled by abundant liquidity and low interest rates. However, as inflationary pressures and recession fears increased in 2022, rising interest rates and economic uncertainty led to a sharp correction.

The result was a mismatch between buyer and seller valuation expectations, with sellers unwilling to adjust their price expectations despite changing market conditions, which resulted in a significant uptick of delayed, broken, and pulled transaction processes in 2023 and 2024, further supporting a slowdown in exit activity.

The 2001-2004 period provides insights into how the current interest rate easing cycle might impact current PE exit activity. The prospect of future rate cuts has already influenced the leveraged finance markets, where yields and spreads have declined by over 200 basis points in 2024. Year-to-date deal volume has risen by nearly 12%, suggesting that PE firms are beginning to capitalize on a more favorable interest rate and deal environment in 2025.

Source: Pitchbook, St. Louis Fed.

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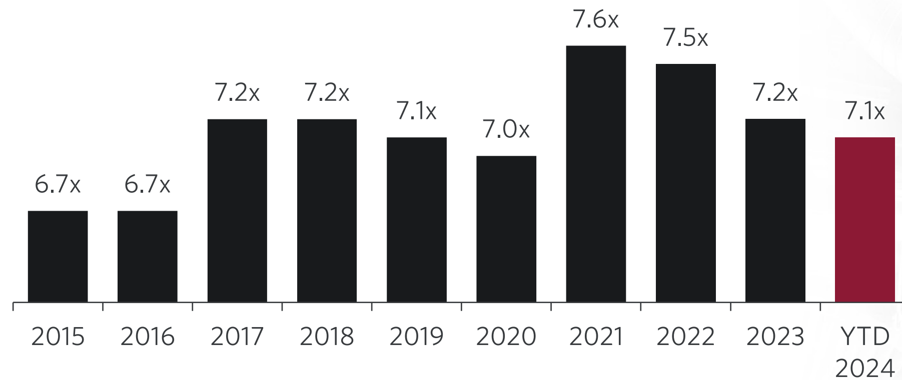
Valuation multiples remain stable



Valuation multiples in the US lower middle market remained consistent with 2023 valuation multiples year-to-date through September 2024 at 7.1x EBITDA, according to GF Data. 2024 average EBITDA multiples are slightly above the 20-year historical average of 6.9x. The relative stability of valuation multiples over the last two years in the lower middle market can be attributed to several factors:

- Ongoing demand for quality assets has maintained competitive tension among buyers, which helps support valuations.
- The return of moderate inflation and the expectation of future rate cuts has created a more predictable and at times aggressive debt market, which has allowed buyers to finance acquisitions at attractive terms, thereby supporting current purchase price multiples.
- A significant portion of deal volume has been the result of add-on acquisitions, which involve strategic fits that justify higher multiples.

As market conditions continue to evolve and improve, we expect these factors are expected to keep valuation multiples at levels comparable to or above historical averages.

Source: GF Data®.

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Valuation multiples a “mixed bag” across sectors

Average EBITDA multiples for LBOs by industry

Industry	2003 – 2019	2020	2021	2022	2023	YTD 2024
Manufacturing	6.2x	6.7x	7.1x	7.3x	6.5x	6.8x
Business services	6.7x	7.1x	7.3x	7.4x	7.3x	7.1x
Healthcare services	7.4x	7.6x	8.1x	8.4x	8.9x	8.9x
Retail	7.0x	6.5x	8.3x	8.0x	6.0x	6.1x
Distribution	6.6x	7.5x	7.2x	7.2x	7.1x	7.1x
Media & Telecom	7.6x	8.3x	7.0x	9.1x	7.8x	7.3x
Technology	8.5x	7.6x	10.3	8.1x	10.2x	8.2x

According to GF Data, healthcare services currently command the highest multiples, maintaining an average of 8.9x EBITDA in 2024. This reflects ongoing strong demographic tailwinds which support growing demand for services and perceived stability in the healthcare sector. These factors have consistently attracted premium valuations, in addition to healthcare’s position as essential and non-discretionary.

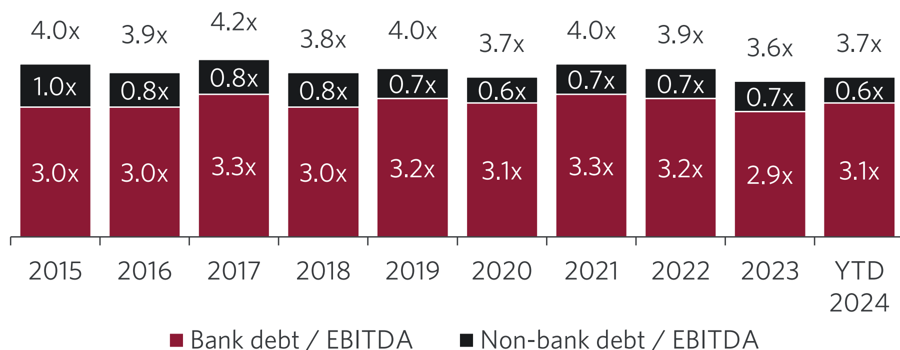
Valuation multiples for the business services and distribution sectors have remained stable and consistent post-COVID. These sectors continue to benefit from steady cash flows and scalable business models, making them attractive targets for buyers seeking recession and pandemic resistant business models. Manufacturing, on the other hand, has experienced some volatility post-COVID tied to supply chain issues, OEM inventory rationalizations in late 2023 and early 2024, and reshoring initiatives. The decline in valuation multiples in 2023 can be linked to good businesses that experienced multiple contraction during a period of declining performance tied to the OEM inventory rationalization that began in July 2023. Sellers during this time were willing to take a lower multiple and proceed with the transaction instead of pausing the transaction process. Valuation multiples have rebounded in 2024 to 6.8x, now that sellers and buyers have more confidence in financial forecasts.

The technology sector’s valuation multiples declined from 10.2x EBITDA in 2023 to 8.2x EBITDA year-to-date in 2024. As interest rates rose in 2023 and early 2024, the discount rates applied to future cash flows increased, leading to lower valuations for technology companies that often rely on projected growth rather than current profitability.

Source: GF Data®.

Debt availability remains steady

Annual average LBO debt multiples for $10mm - $500mm LBOs



Annual average LBO debt multiples for $10mm - $500mm LBOs by deal size

Enterprise Value	2003 - 2018	2019	2020	2021	2022	H1 2023
$10mm - $25mm	3.4x	3.6x	4.0x	3.7x	3.7x	4.0x
$25mm - $50mm	3.6x	3.4x	3.9x	3.7x	3.4x	3.0x
$50mm - $100mm	3.9x	3.6x	3.8x	4.0x	3.5x	3.7x
$100mm - $250mm	4.4x	4.7x	4.4x	4.1x	3.9x	4.1x
$250mm - $500mm	4.9x	4.8x	5.4x	5.1x	4.2x	4.4x
Total	3.7x	3.7x	4.0x	3.9x	3.6x	3.7x

According to GF Data, YTD 2024 total debt multiples averaged 3.7x EBITDA for LBOs under $500 million in enterprise value, which is consistent with the historical average and slightly higher than the 3.6x EBITDA recorded in 2023. The stability in the debt markets reflects improving lending conditions as commercial banks and private debt funds compete for quality assets with more competitive pricing and terms.

Notably, smaller deals in the $10-$25 million enterprise value range saw buyers maximize leverage so far in 2024, borrowing 4.0x EBITDA, up from 3.7x in 2023. The increase in the usage of leverage here, alludes to a higher level of confidence in current and future performance of the target companies. Leverage for larger deals in the $100-$250 million enterprise value range has increased to 4.1x in 2024 from 3.9x in 2023, as the percentage of platform investments increased versus add-ons.

Over time, these trends highlight a gradual strengthening of the leverage markets following the COVID disruptions, real estate issues, rising interest rates, and economic uncertainty.

Sources: GF Data®, Pitchbook.

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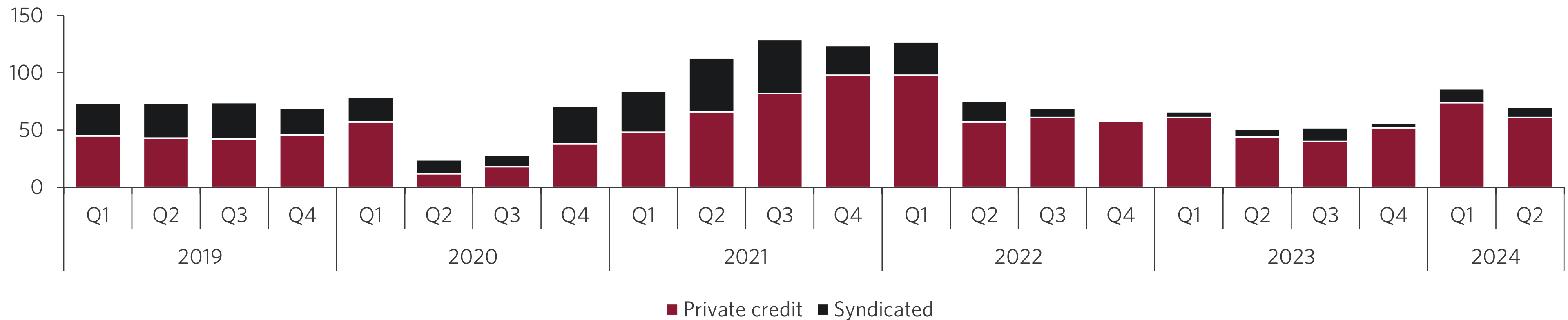
Private credit remains strong, but sees increased competition

Count of LBOs financed in syndicated vs private credit markets



Over the past few years, private credit funds have steadily gained prominence as the leading financing source for LBOs. This trend has been driven by these funds offering borrowers covenant and repayment flexibility, speed to close, and larger loan hold sizes compared to traditional syndicated lenders, which are often slower to respond, have smaller hold sizes, and are bound by regulatory constraints that influence amortization and terms.

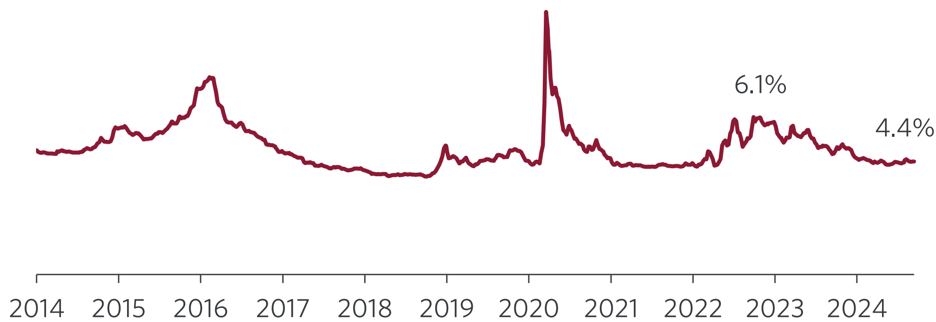
During the first half of 2024, private credit continued to provide the majority of LBO financing, funding 87% of all deals, up from 61% in 2019. The market share growth reflects the flexibility of private credit lenders amidst broader economic uncertainties and the ability to provide tailored financing solutions. In contrast, over the last two years traditional banks were essentially absent while managing issues within their commercial real estate portfolios which caused regional banks to pause their participation in the syndicated loan market. As a result, sponsors increasingly turned to private credit for its ability to offer higher leverage levels, covenant-light structures, and low amortization during periods of economic uncertainty, which are particularly attractive for middle market transactions.

While we have not yet seen the full resurgence of the syndicated loan market, CIBC expects the syndicated market to regain its footing in 2025 based on an improving macroeconomic environment, anticipated interest rate cuts, and increased competition among traditional banks and private credit funds. These factors have already led to more favorable credit terms, greater debt availability and lower rates which has helped to drive M&A activity in the second half of 2024.

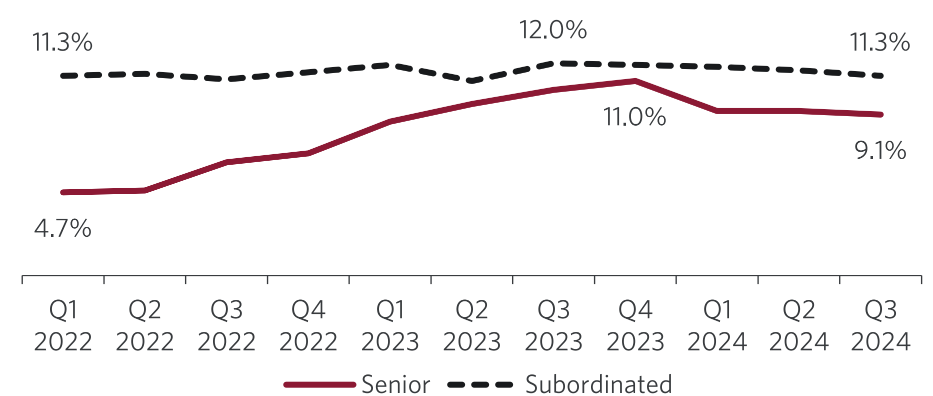
Source: Pitchbook.

Credit spreads and pricing tighten

Spread to maturity for high-yield leveraged loans



Debt pricing by quarter

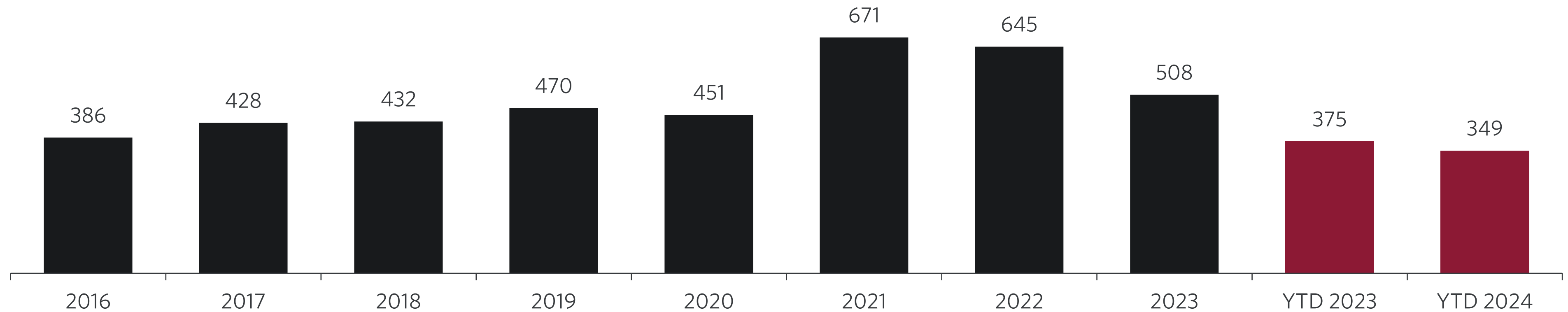


Credit spreads peaked in late 2022 and early 2023 as the syndicated loan market retrenched amid economic uncertainty, which opened the door for direct lenders to price transactions with little competition. Spreads have gradually compressed as competition among lenders intensified and market conditions stabilized. In Q3 2024, spreads for high-yield loans reached their lowest levels since early 2022, signaling increased risk appetite among lenders and greater borrower confidence due to several factors. First, the leveraged finance market has seen a resurgence in traditional lender participants and a record level of new private debt funds raised which has increased competition for deals. Direct lenders continue to compete by offering more flexible terms at higher unitranche rates to win deals. Second, easing inflationary pressures and expectations of future rate cuts have contributed to lower borrowing costs across the board and made financing more accessible for deal making.

Senior debt pricing averaged 9.1% during Q3 2024, down from 11.0% in 2023. This reduction reflects improved lending conditions as commercial banks became more active in the market, offering competitive terms to borrowers. Subordinated debt pricing also decreased slightly, with average coupons falling to 11.3% in Q3 2024 from 12.0% in 2023.

Source: GF Data®.

Software and technology – IT services



In 2024, IT services M&A transactions in the US and Canada declined by 6.9% year-over-year through Q3, according to data from S&P Capital IQ. This follows a 21.2% decline in 2023 and 3.9% in 2022. This decline reflects a challenging dealmaking environment marked by depressed PE exit activity and more caution on the part of larger and publicly traded strategic acquirers. Despite the overall year-over-year decrease, 2024's transaction volume is in line with pre-COVID levels.

While these recent transaction volumes indicate negative trends for the IT services market on the surface, the segment has shown more resiliency than pure software M&A. Software M&A continues to experience softness after the 2021 peak. In addition, an increasing number of buyers are expressing interest in the IT services sector for several reasons:

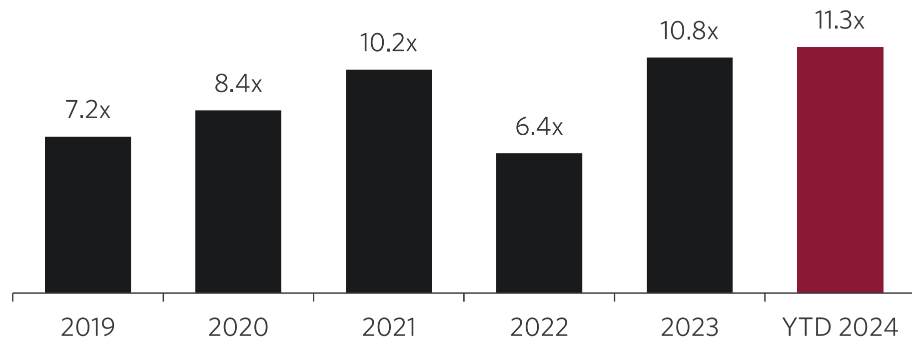
- IT services represents a massive growth opportunity for buyers because it remains highly fragmented and ripe for consolidation
- Several mega-trends, such as cloud and AI adoption, are driving significant growth for the sector
- The increasing complexity and mission-critical nature of IT systems, combined with rising cybersecurity threats, requires a trusted outsourced partner
- In-house IT staff counts are shrinking, which is driving increased outsourcing and highly sticky relationships that cannot be unwound

CIBC has also recently observed IT services as an attractive entry point to technology investments for private equity investors that have historically focused on lower-technology industries. Compared to pure software companies that typically trade on ARR multiples and are more daunting to diligence due to technology risk, IT services companies tend to trade on EBITDA multiples and are often insulated from technology risk due to a vendor- and technology-agnostic approach.

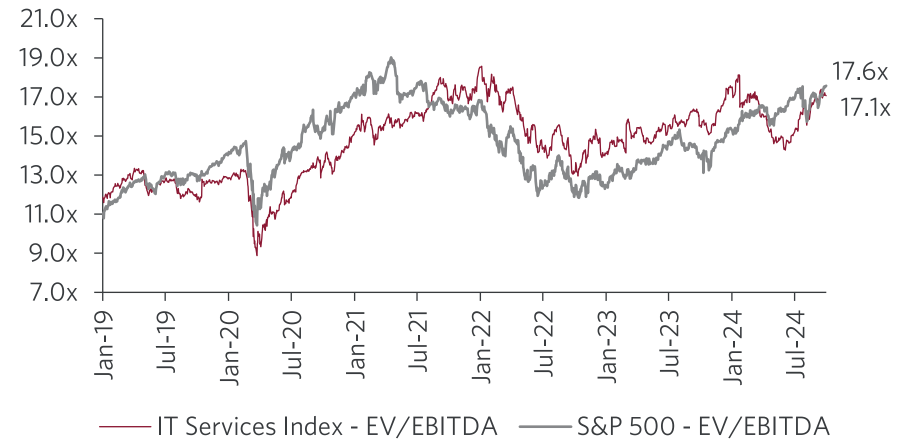
Source: S&P Capital IQ.

Software and technology – IT services (continued)

Annual average EBITDA multiples for IT services companies



IT services vs S&P 500



According to data from Capital IQ, valuations for IT services companies have continued to show strength through Q3 2024 reaching an average of 11.3x EBITDA. The 2024 multiple was an increase over 2023's already strong 10.8x multiple and a substantial improvement over 2022 when EV/EBITDA multiples for publicly reported transactions were down significantly given the market pullback due to economic and interest rate concerns. While this data has some limitations since valuation multiples for many IT services transactions are not reported, this broadly matches CIBC's experience that buyers recognize the need to pay double-digit EV/EBITDA multiples for high quality IT services platforms.

Source: S&P Capital IQ.

CIBC US Middle Market at-a-glance

Highlights

Nationally recognized middle market investment banking team with global reach.

Experienced and talented team has completed hundreds of transactions representing billions in transaction value.

Clients include **private companies, private equity funds, and corporations.**

Differentiated approach to achieving client goals through disciplined and transparent transaction processes.

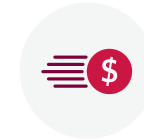
Investment banking services

M&A Advisory

- Execute transactions up to $500 million in enterprise value
- Specialize in sell-side transactions
- Conduct targeted buy-side advisory services

Capital Placement

- Raise up to $250 million in debt and/or equity
- Provide capital structure advice for management buyouts and recapitalizations



Financial Advisory

- Strategic alternative analyses
- Special situations transactions

Focus industry verticals

Consumer

Business Services

Healthcare

Industrials

Software & Technology

Recent CIBC US Middle Market transactions

AUTO-DS
has been acquired by
fiverr.

EarthLite
WORLD'S #1 BRAND IN MASSAGE
a portfolio company of

Branford Castle Partners
has been acquired by
VALESCO INDUSTRIES

NELLO CORPORATION
a portfolio company of
BECKNER CLEVY PARTNERS
has been acquired by management and
MAIN ST CAPITAL CORPORATION

Athletica SPORT SYSTEMS
a portfolio company of
FULCRUM CAPITAL PARTNERS
has been acquired by
REICHMANN SEGAL CAPITAL PARTNERS

STAINLESS FOUNDRY & ENGINEERING, INC.
a portfolio company of
Guard Hill Holdings
has been acquired by
ASHLAND CAPITAL PARTNERS

BestRx PHARMACY SOFTWARE
has been acquired by
RedSail TECHNOLOGIES
a portfolio company of
FP FRANCISCO PARTNERS

VAPOR POWER INTERNATIONAL
a portfolio company of
Stone Pointe, LLC
MIDWEST MEZZANINE FUNDS
has been acquired by
THERMON

ARMOR ANIMAL HEALTH
DETECT. DEFEND. DELIVER.
a portfolio company of
GOLDNERHAWN
has been acquired by
VSI

Merlot Vango TARPING SOLUTIONS
a portfolio company of
Continuim EQUITY PARTNERS
has been acquired by
SAFE FLEET
OAK HILL CAPITAL

IDENTITI
has partnered with
KEYSTONE CAPITAL

pfi InStore
a portfolio company of
CFB
KVCI
DIAMOND STATE VENTURES
Mid States Capital L.P.
NORTHCREEK
has been acquired by
ONWARD | CAPITAL
and
MERIT CAPITAL PARTNERS

MUTHIG INDUSTRIES, INC.
has been acquired by
LFM capital

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