

Middle Market M&A Review  
4<sup>th</sup> Quarter 2021



## Middle market M&A reached new highs in Q3 2021

- ✓ Deal volume increased 20% to 14,228 during the trailing twelve months ended September
- ✓ Total deal value swelled 56% to \$394 billion during the same period
- ✓ Valuation multiples expanded to 7.6x TTM adjusted EBITDA, beating the levels seen in the pre-pandemic period

## Debt and equity continue to fuel the market

- ✓ Total leveraged loan issuance in the U.S. continued to increase to \$740.9 billion during the first eleven months of 2021
- ✓ 15 non-financial companies are sitting on nearly 40% of the \$2.77 trillion cash held by all companies in the S&P 500
- ✓ Globally, 25 PE firms hold 22.3% of the record \$2.286 trillion in total global dry powder

## Economic recovery stumbled on Delta concerns, but outlook remains positive

- ✓ GDP growth slowed to 2.1% in Q3 2021 due to concerns about the COVID Delta variant and supply chain constraints
- ✓ The Leading Economic Index<sup>®</sup> (LEI) improved for the eighth consecutive month in October to 118.3
- ✓ Consumer confidence remained positive despite inflationary pressures, increasing to 113.8

## 2021 momentum is likely to spill into 2022

- ✓ After the COVID-induced pause, pent up demand is powering acquisitions and divestitures
- ✓ The pandemic is causing family and founder owned businesses to rethink their priorities and plans
- ✓ The potential increase in the capital gains tax rate motivated sellers to pull forward their exit timeframe

## Risks to our view

- ✓ Rising inflation leads to materially higher interest rates and lower valuations
- ✓ The Omicron variant of COVID-19 leads to lower economic activity and business confidence
- ✓ Supply chain issues, which appear to be easing, linger on or worsen

# Macroeconomic Indicators

## USA GDP Growth Rate



- Per the second estimate from the BEA, real GDP expanded by 2.1% in Q3 2021, a sharp decline over the 6.7% (revised) in Q2 2021.
- Growth in real GDP in Q3 2021 was driven by increases in personal consumption expenditures, private inventory investment, state and local government spending, and non-residential fixed investment, and partially offset by decreases in residential fixed investment, exports and federal government spending.

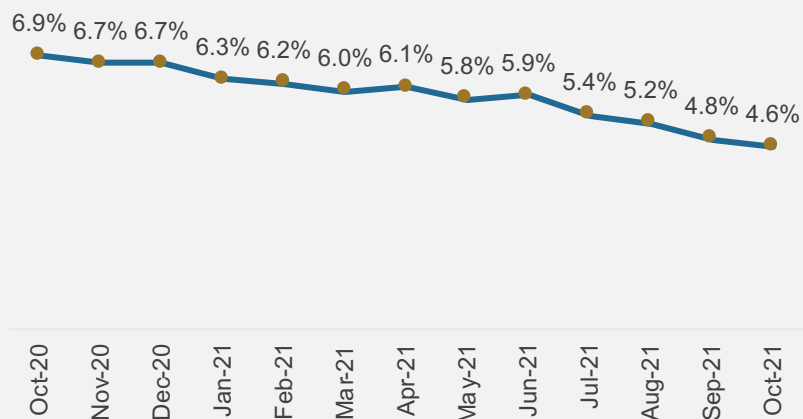
## Conference Board Leading Economic Index® (LEI)



- The Conference Board Leading Economic Index® (LEI) for the U.S. improved by 0.9% to 118.3 in October, marking the eighth consecutive monthly increase as hope grew that the worst of the Delta variant of COVID-19 was behind us.
- Rising prices and supply chain issues are significant headwinds that are likely to continue well into 2022. However, growth forecasts for the fourth quarter remain robust at an annualized rate of 5.0%.

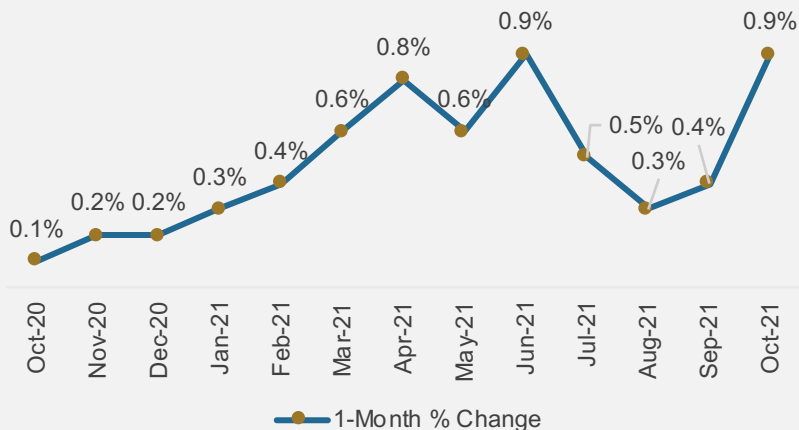
Source: BEA, US Bureau of Labor Statistics, The Conference Board

## USA Unemployment Rate



- The unemployment rate continued to trend downward to 4.6% in October, a two-percentage point decline over September. Nonfarm payroll employment increased by 531,000 in October; despite recent gains, unemployment levels remain well above the pre-pandemic level of 3.5%.
- Notable job gains in leisure and hospitality, professional and business services, and manufacturing helped drive down the unemployment rate.

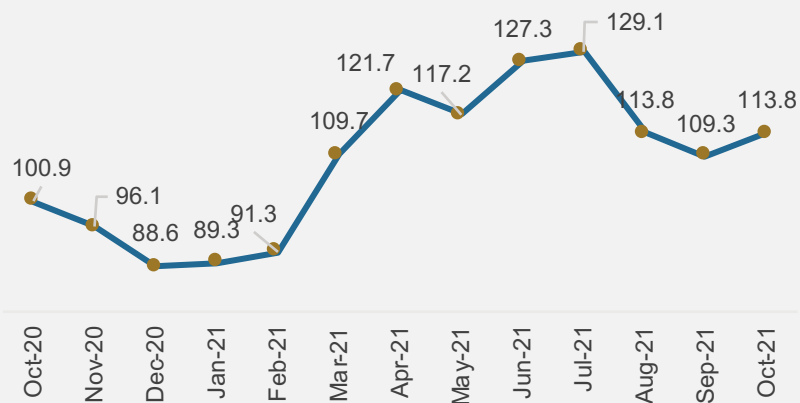
## CPI-All Urban Consumers, seasonally adjusted



- The Consumer Price Index for All Urban Consumers (CPI-U) increased to 0.9% in October, equaling the recent high set in June. The index rose by 6.2% in October on an annual basis, its sharpest increase since 1990.
- The largest contributors to inflation have been energy, shelter, food, used cars and trucks, and new vehicles.

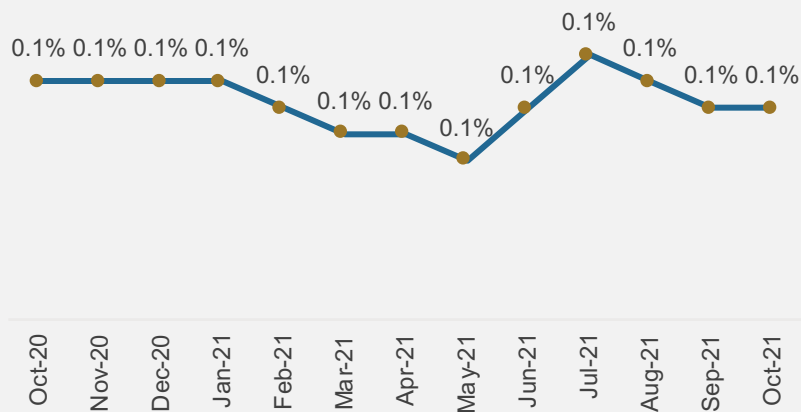
Source: BEA, US Bureau of Labor Statistics, The Conference Board

## Consumer Confidence Index



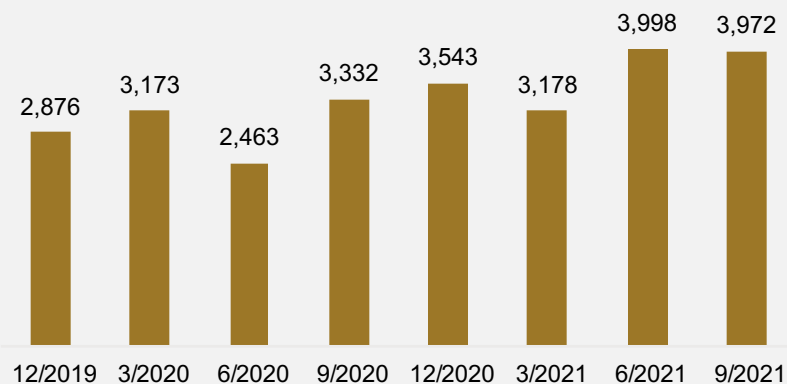
- The Conference Board Consumer Confidence Index® improved marginally in October to 113.8 as concerns about the Delta variant of COVID-19 eased, following two consecutive months of steep declines.
- Consumer sentiment remained upbeat despite inflationary fears, as spending on personal services and travel staged a comeback. Purchases of automobiles, homes, and major appliances are expected to be strong through 2021.

## Effective Federal Funds Rate



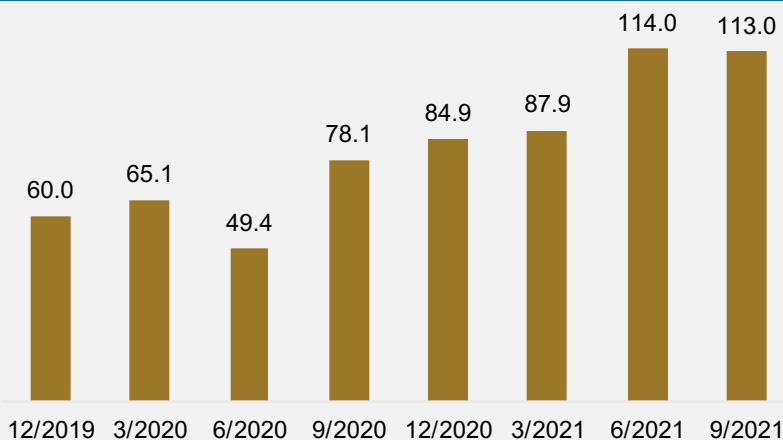
- The Federal Open Market Committee ("FOMC") in its December meeting voted unanimously to keep the federal funds rate unchanged at a range of 0.00% to 0.25%.
- With the economy healing, but price gains pinching consumers, officials are dialing back bond purchases and getting in position to raise interest rates (three are possible next year).

## US Target Mid-Market M&A (# Deals, Last 3 months)



- According to Refinitiv, U.S. target Mid-Market M&A announced deal volume was up ~20% at 14,228 during TTM 9/30/21, compared to 11,844 during TTM 9/30/20.
- Deal activity for the quarter ended 9/30/21, increased by 19.2% on a YoY basis, as 3,972 transactions were completed. Deal activity declined marginally by ~1% on a sequential QoQ basis on the heels of a record setting Q2, which saw 3,998 deals completed.

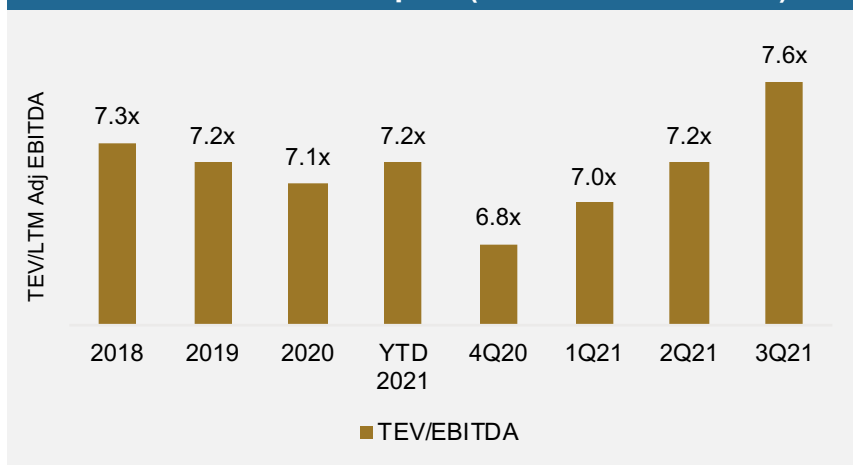
## US Target Mid-Market M&A (\$ billion, Last 3 months)



- Deal value during TTM 9/30/21 reached \$394 billion, an increase of ~56% over the TTM 9/30/20 period.
- Deal value in Q3 2021 equaled \$113 billion, almost matching the record high of \$114 billion recorded in Q2 2021. Deal value in Q3 2021 was up ~45% on a YoY basis.

Source: Refinitiv

## Purchase Price Multiples (\$10-250 million TEV)



Source: GF Data®

- Valuations continued their upward trajectory reaching 7.6x TTM adjusted EBITDA during Q3 2021, materially higher than the levels seen in the run-up to the pandemic.
- This is partly attributable to a greater proportion of platform acquisitions, which tend to fetch higher valuations.

## Purchase Price Multiples across TEV ranges

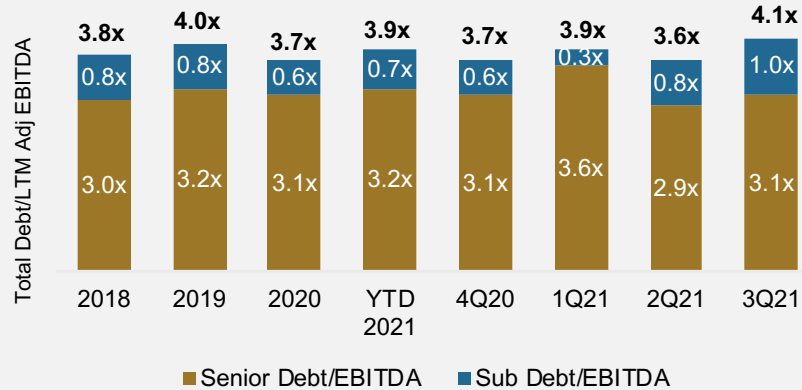
### Total Enterprise Value (TEV)/EBITDA

TEV (in \$m)	2003-2016	2017	2018	2019	2020	YTD 2021	Total
10-25	5.6x	6.3x	5.9x	6.1x	5.9x	6.0x	5.7x
25-50	6.2x	6.6x	6.9x	6.9x	6.8x	7.1x	6.5x
50-100	6.9x	8.2x	8.8x	7.5x	8.0x	8.2x	7.3x
100-250	7.7x	9.0x	8.7x	9.3x	8.6x	8.9x	8.2x
Spread between \$10-25 m & \$100-250 m	2.1x	2.7x	2.8x	3.2x	2.7x	2.9x	2.5x

Source: GF Data®

- The size premium or spread between the upper middle market (\$100-250 million TEV) and lower middle market (\$10-25 million TEV) grew to 2.9x in Q3 2021.
- In addition to high growth and strong margins, institutional ownership is contributing to quality premiums.
- Valuations in the \$25-50 million TEV range expanded the most, touching 7.8x in Q3 2021.

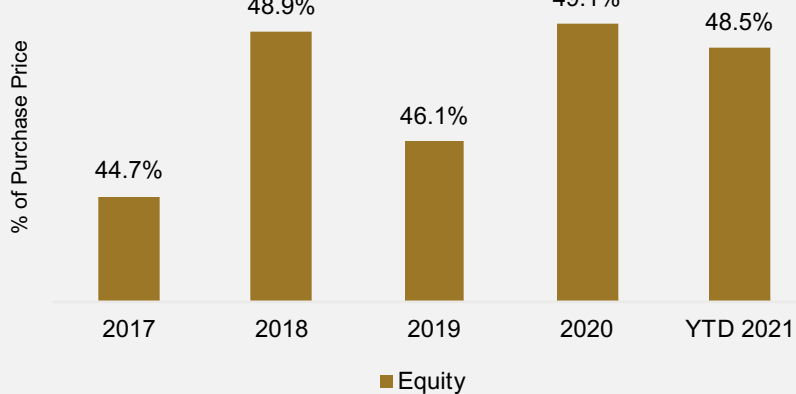
## Leverage Multiples (\$10-\$250 million TEV)



Source: GF Data®

- Total debt to EBITDA surged to 4.1x in Q3 2021 from 3.6x in Q2.
- Senior debt to EBITDA increased to 3.1x from 2.9x, but was lower than pre-COVID levels.
- Subordinated debt to EBITDA increased to 1.0x, reaching the previous highs set in 3Q19 and 3Q20.

## Equity Contributions (\$10-\$250 million TEV)



Source: GF Data®

- Greater availability of debt has enabled buyers to fund higher valuations with slightly lower equity contributions.
- Equity contributions reached 48.5% YTD 2021, below the high of 49.1% observed in 2020.
- Transactions in the \$100-250 million TEV range required more equity (53.3% in Q3 2021) because of competitive pressures.



## Leveraged Lending Volume

- According to S&P Global, total leveraged loan issuance in the U.S. continued to increase to \$740.9 billion during the first eleven months of 2021, ~88% more than the total annual issuance in 2020.
- Total institutional loan volume during the first three quarters of 2021 was \$472 billion, beating the previous high of \$397 billion for the comparable period in 2017.
- LBO volume for the first three quarters of 2021, at \$119.8 billion, reached a post-global financial crisis high, but trails the all-time high of \$123.0 billion in 2007.

## Cash Held by Corporations

- S&P 500 cash and equivalents increased 16% during the trailing twelve months compared to 6% growth in debt.
- 15 non-financial companies in the S&P 500 are sitting on cash and investments of more than a \$1 trillion, according to Investor's Business Daily.
- This accounts for nearly 40% of the \$2.77 trillion held by all companies in the S&P 500.

## Private Equity Dry Powder

- According to Preqin, buyout firms have raised more than \$714 billion during 2021.
- Globally, 25 private equity firms hold \$509.81 billion in dry powder, or capital committed by investors that has not been invested or allocated, according to data from S&P Global Market Intelligence and Preqin as of August.
- The firms hold 22.3% of the record \$2.286 trillion in total global dry powder, Preqin estimates show.

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