

Middle Market M&A Review
1st Quarter 2022



Middle market M&A continued to soar in Q4 2021

- ✓ Deal volume rose 23% to 15,197 during the TTM ended December 2021
- ✓ Total deal value ballooned 56% to \$432 billion during the same period
- ✓ Valuation multiples jumped to 7.3x TTM adjusted EBITDA in 2021, establishing a new, multi-year high

The market remains awash in debt and equity

- ✓ Total leveraged loan issuance in the U.S. reached a record \$798 billion in 2021
- ✓ S&P 500 companies are sitting on an estimated \$3.8 trillion in cash and equivalents
- ✓ Globally, PE firms held \$1.32 trillion in dry powder as of September 2021

The economic recovery regained momentum, but inflation remains a key concern

- ✓ GDP growth accelerated to 6.9% in Q4 2021 and 5.7% for the full year 2021
- ✓ The LEI slipped for the first time in 11 months in January due to inflation and other concerns
- ✓ Consumer confidence weakened marginally to 110.5, slowed by headwinds related to inflation

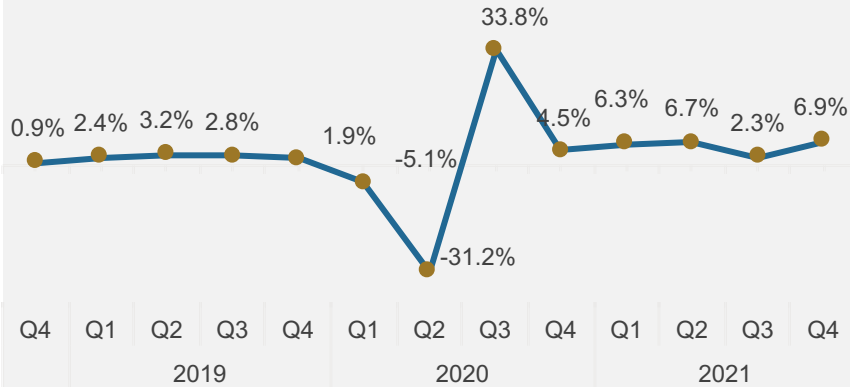
The fundamentals that made 2021 so strong continue in 2022

- ✓ Corporations are pursuing strategic mergers and acquisitions to accelerate growth
- ✓ Sponsors are taking profits and corporations are using divestitures and spinoffs to focus strategically
- ✓ Private equity groups are motivated to put capital to work

Risks to our view

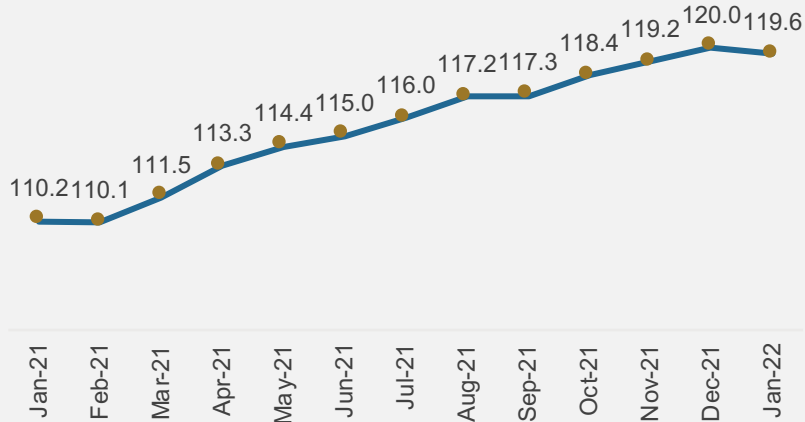
- ✓ Rising inflation leads to materially higher interest rates and lower valuations
- ✓ Supply chain issues, which appear to be easing, linger on or worsen
- ✓ Russia's invasion of Ukraine will exacerbate inflation and supply chain constraints and cause other structural shifts

U.S. GDP Growth Rate



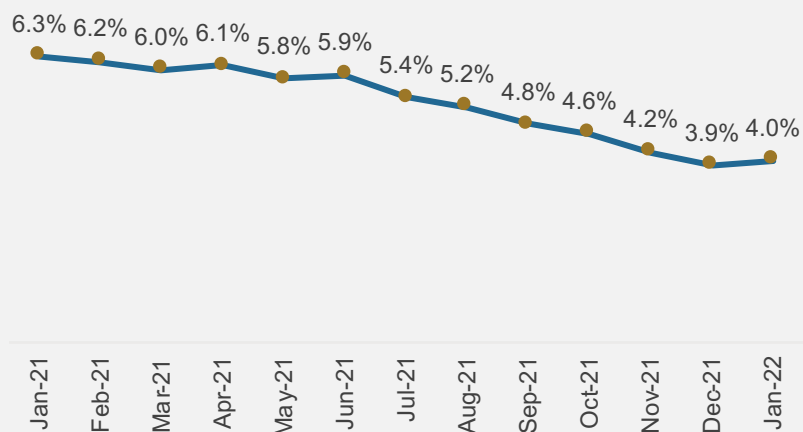
- Per the advance estimate from the BEA, real GDP increased by 6.9% in Q4 2021, a significant uptick from the 2.3% (revised) in Q3 2021.
- Growth in real GDP in Q4 2021 was driven by increases in personal consumption expenditures, exports, private inventory investment, and non-residential fixed investment, and partially offset by decreases in state and federal government spending.

Conference Board Leading Economic Index® (LEI)



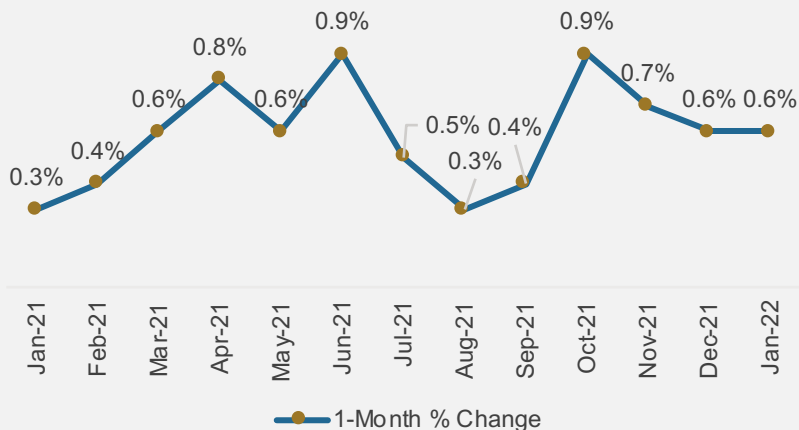
- The Conference Board Leading Economic Index® (LEI) for the U.S. sank 0.4% to 119.6 in January, marking the end of a 10-month run of successive increases that started February 2021.
- Concerns about the Omicron wave, high inflation and supply chain disruptions contributed to the decline.

U.S. Unemployment Rate



- The unemployment rate continued to trend downward to 3.9% in December before increasing marginally to 4.0% in January. Nonfarm payroll employment increased by 467,000 in January, which beat expectations.
- Notable job gains in leisure and hospitality, professional and business services, retail trade, transportation and warehousing helped drive down the unemployment rate.

CPI-All Urban Consumers, seasonally adjusted



- The Consumer Price Index for All Urban Consumers (CPI-U) increased 0.6% in January, the same rate as the previous month. The index rose 7.5% on an annual basis in 2021, the largest 12-month increase since the period ending February 1982.
- The largest contributors to inflation have been energy, shelter and food. The index for all items, less food and energy, have risen by more than 0.5% for the seventh time in the last 10 months.

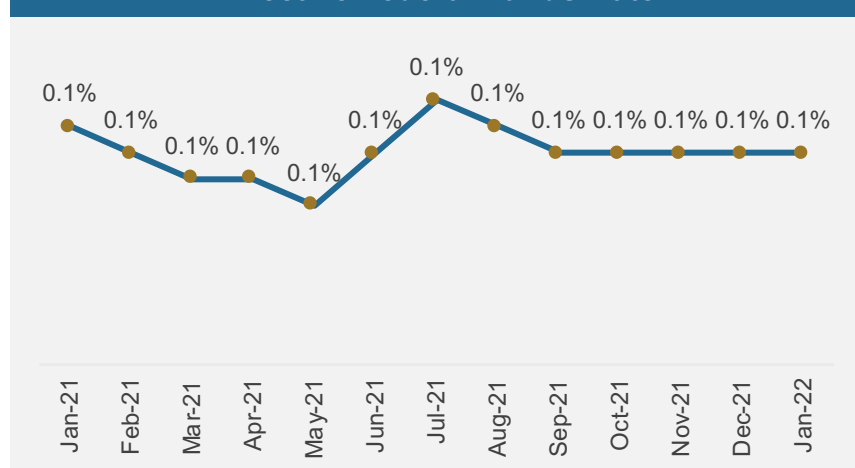
Source: BEA, U.S. Bureau of Labor Statistics, The Conference Board

Consumer Confidence Index



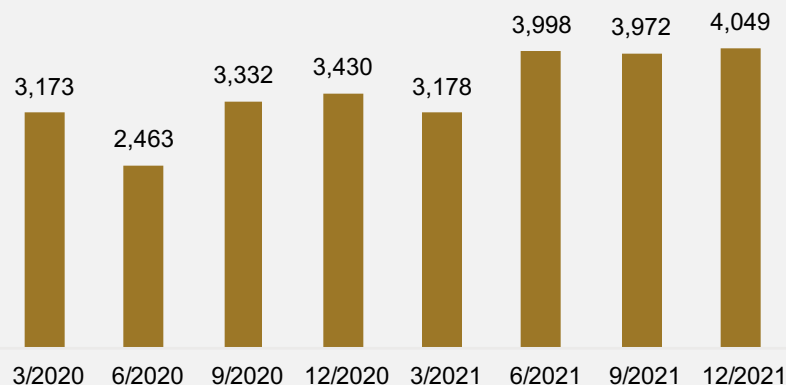
- The Conference Board Consumer Confidence Index® decreased marginally for the second consecutive month, to 110.5 in January, because of concerns about persistently high inflation.
- Consumer sentiment about short-term growth remained positive, but expectations are for moderate growth during the first half of 2022. Rising prices are expected to slow down consumer spending on homes, automobiles and major appliances.

Effective Federal Funds Rate



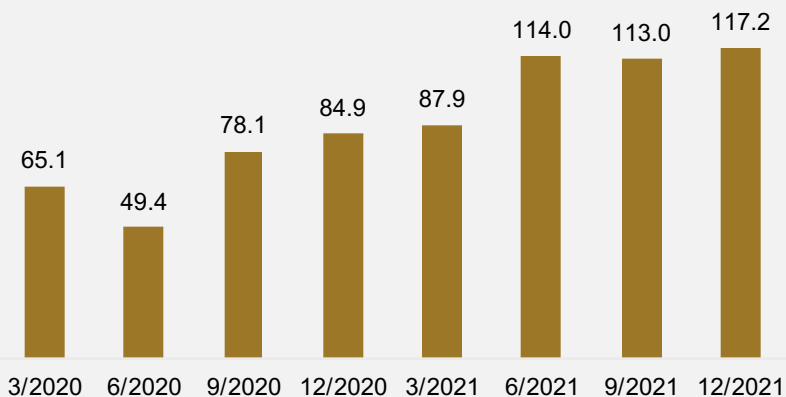
- The Federal Open Market Committee ("FOMC"), in its January meeting, voted to keep the federal funds rate unchanged at 0.00% to 0.25%, but signaled the start of a cycle of interest rate hikes to begin in March.
- With inflation well above the long-term target of 2% and continued improvement in the labor market, the Federal Reserve is expected to hike interest rates by 25-50 basis points a few times this year.

U.S. Target Mid-Market M&A (# Deals, Last 3 months)



- According to Refinitiv, U.S. target Mid-Market M&A announced deal volume was up ~23% to 15,197 during TTM 12/31/21, compared to 12,398 during TTM 12/31/20.
- Deal activity for the quarter ended 12/31/21 increased by 18.0% on a YoY basis, as 4,049 transactions were completed. This represents a new high, rising by 1.9% on a sequential QoQ basis and beating the previous record set in Q2 2021, which saw 3,998 deals completed.

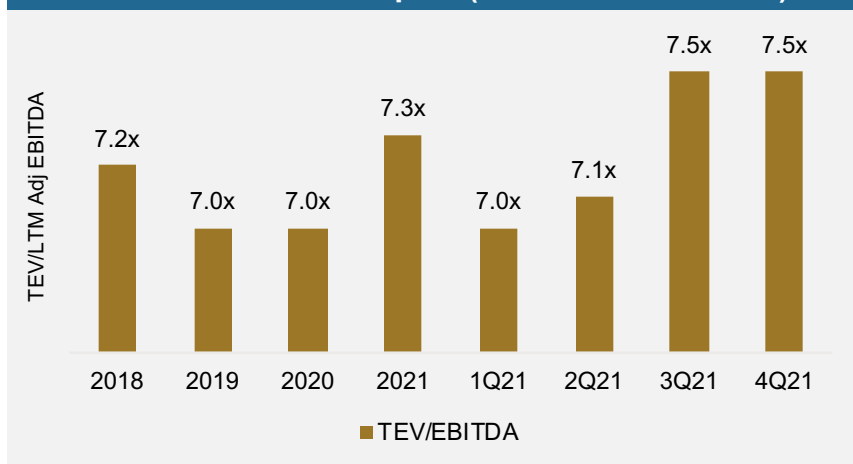
U.S. Target Mid-Market M&A (\$ billion, Last 3 months)



- Deal value during TTM 12/31/21 reached \$432.1 billion, an increase of ~56% over the TTM 12/31/20 period.
- Deal value in Q4 2021 set a record of \$117.2 billion, topping the record high of \$114.0 billion recorded in Q2 2021. Deal value in Q4 2021 was up ~40% on a YoY basis.

Source: Refinitiv

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



Source: GF Data®

- Valuations averaged 7.5x TTM adjusted EBITDA during Q4 2021, unchanged from Q3 2021, and representing the highest level since Q4 2018.
- Average valuations for 2021 reached 7.3x TTM adjusted EBITDA, the highest level in the last 5 years.
- The high proportion of high quality acquisition targets in Q4 2021, which command a quality premium, helped push up valuations.

Purchase Price Multiples across TEV ranges

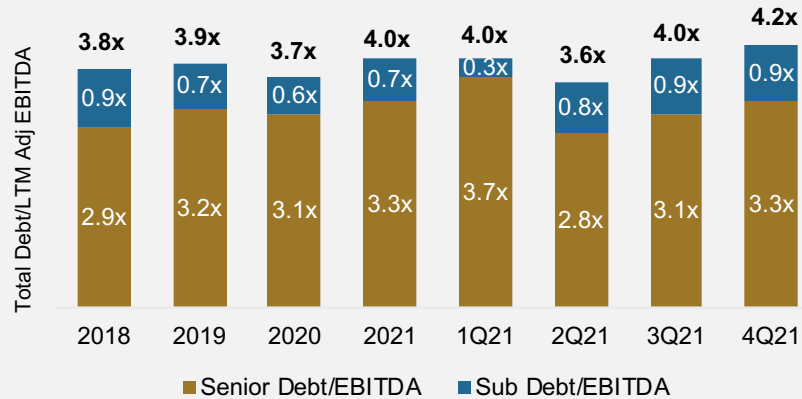
Total Enterprise Value (TEV)/EBITDA

TEV (in \$m)	2003-2016	2017	2018	2019	2020	2021	Total
10-25	5.6x	6.3x	5.9x	6.1x	5.9x	6.2x	5.7x
25-50	6.2x	6.6x	6.9x	6.9x	6.8x	7.0x	6.5x
50-100	6.9x	8.2x	8.8x	7.5x	8.0x	8.3x	7.4x
100-250	7.7x	9.0x	8.7x	9.3x	8.6x	9.0x	8.3x
Spread between \$10-25 m & \$100-250 m	2.1x	2.7x	2.8x	3.2x	2.7x	2.8x	2.6x

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) moderated to 2.8x in 2021.
- The quality premium has grown over time, from 10% before 2017 to 30% in 2021.

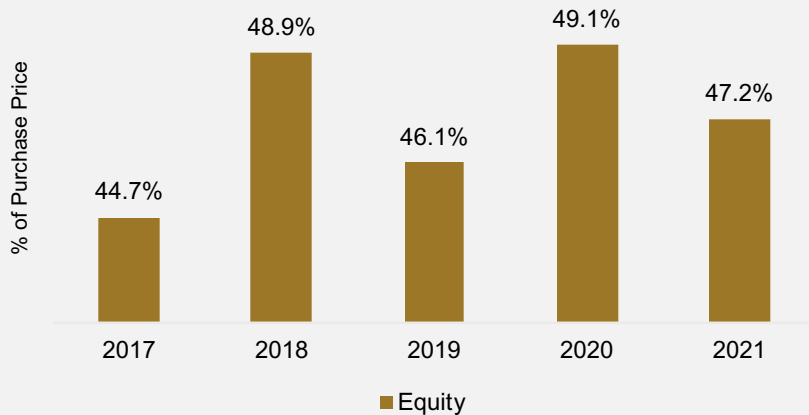
Leverage Multiples (\$10-\$250 million TEV)



Source: GF Data®

- Total debt to EBITDA increased to 4.2x in Q4 2021 from 4.0x in Q3 2021.
- Senior debt to EBITDA rose to 3.3x in Q4 2021, equalling the five-year high set in 2017.
- Subordinated debt to EBITDA remained unchanged from the previous quarter at 0.9x, slightly below the previous high of 1.0x seen in 3Q19 and 3Q20.

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



Source: GF Data®

- Equity contributions shrank to 47.2% in 2021, approaching pre-pandemic levels, although platform deals required higher equity contributions of 53.4% during the year.
- Average equity contributions in the \$10-50 million TEV range decreased.
- Equity contributions in the \$50-250 million TEV range were roughly 55%, suggesting further headroom for valuation expansion in the sub-\$50 million TEV range.

Leveraged Lending Volume

- According to S&P Global, total leveraged loan issuance in the U.S. reached \$798 billion in 2021, more than double the \$395 billion issuance in 2020.
- Total institutional loan volume reached a record \$615 billion in 2021, breaking the previous high of \$503 billion set in 2017.
- Analysts expect 2022 to be another year of strong issuance, although not at the same record-setting level as 2021.

Cash Held by Corporations

- Companies in the S&P 500 held \$3.78 trillion in cash and cash equivalents at the end of the third quarter of 2021, up from \$3.41 trillion a year before and \$2.19 trillion from the 2019 period, according to data provider S&P Global Market Intelligence.
- 15 non-financial firms in the S&P 500 are sitting on cash and investments of more than \$1 trillion, according to Investor's Business Daily.
- The above accounts for roughly 40% of the cash and equivalents held by all companies in the S&P 500.

Private Equity Dry Powder

- According to Preqin, private equity groups held \$1.32 trillion in dry powder, as of September 2021.
- Global private equity fundraising is projected to increase from \$645 billion in 2022 to \$813 billion in 2026, further boosting dry powder.
- 25 private equity groups hold about 22% of all dry powder, according to data from S&P Global Market Intelligence and Preqin.

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