

Middle Market M&A Review
2nd Quarter 2022



Middle market M&A results were mixed in Q1 2022

- ✓ Deal volume rose 11% to 14,570 during the TTM ended March 2022
- ✓ Total deal value increased 32% to \$411 billion during the same period
- ✓ Valuation multiples pulled back to 7.3x TTM adjusted EBITDA in Q1 2022 from 7.5x in the previous quarter

Debt is becoming cost prohibitive, but cash is plentiful

- ✓ Total leveraged loan issuance in the U.S. reached \$217 billion YTD April 2022, down 27% YoY
- ✓ Companies held less cash in Q1 2022 than in 2021, but still significantly more than pre-pandemic amounts
- ✓ Globally, private equity firms held \$1.78 trillion in dry powder as of February 2022

The economic expansion stalls and recession calls grow

- ✓ GDP growth plunged to -1.5% in Q1 2022, a sharp reversal from the 6.9% growth rate recorded in Q4 2021
- ✓ The LEI dipped marginally and has been flat the last three months because of expectations for more moderate growth
- ✓ Consumer confidence weakened for the third consecutive month due to rising inflation and interest rates

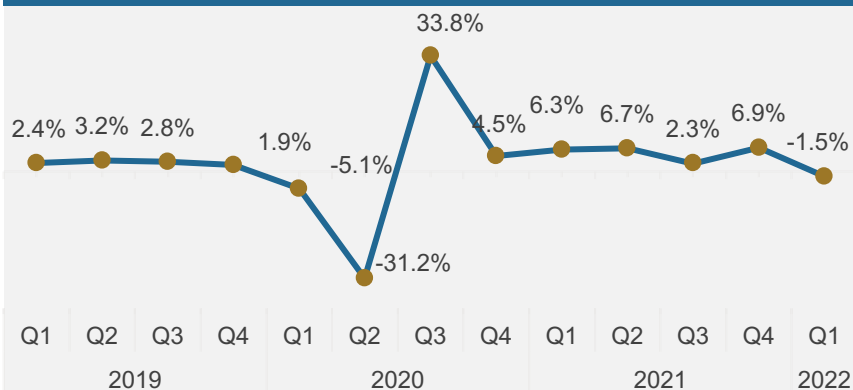
M&A activity likely to slow during the second half

- ✓ Valuations and volumes could drop, especially in industries exposed to supply chain risk
- ✓ Due to its impact on operating earnings, inflation is likely to impact activity more than interest rates
- ✓ The private equity industry may create a floor for M&A activity because of its size and need to put capital to work

Risks to our view

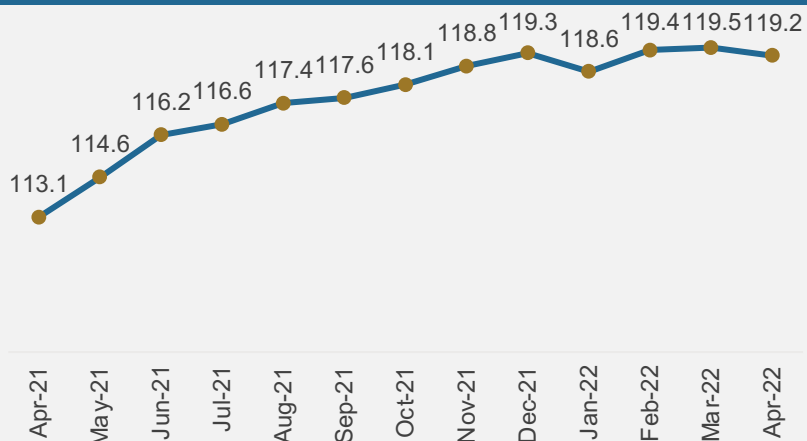
- ✓ The Federal Reserve lifts rates faster or more than expected
- ✓ Russia's invasion of Ukraine and other supply constraints cause inflation to rise unabated
- ✓ The odds of a recession in the next 12 months spike from the current consensus of about 28%

U.S. GDP Growth Rate



- According to the second estimate from the BEA, real GDP contracted by 1.5% in Q1 2022, a significant slowdown from the 6.9% growth recorded in Q4 2021.
- The decline in real GDP in Q1 2022 was driven by declines in private inventory investment, exports, and federal, local and state government spending. Personal consumption expenditures and non-residential and residential fixed investment grew.

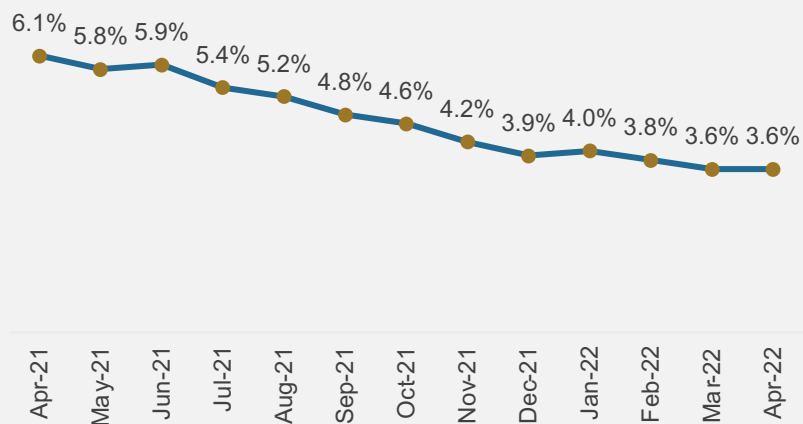
Conference Board Leading Economic Index® (LEI)



- The Conference Board Leading Economic Index® (LEI) for the U.S. declined 0.3% to 119.2 in April. The LEI has been essentially flat the last few months given the moderate growth outlook.
- High inflation, rising interest rates, persistent supply chain bottlenecks and the COVID-19 surge in China pose significant downside risks to the outlook.

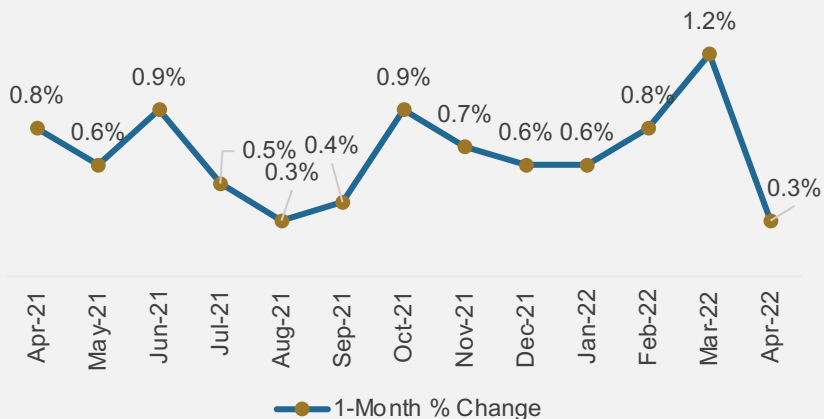
Source: BEA, U.S. Bureau of Labor Statistics, The Conference Board

U.S. Unemployment Rate



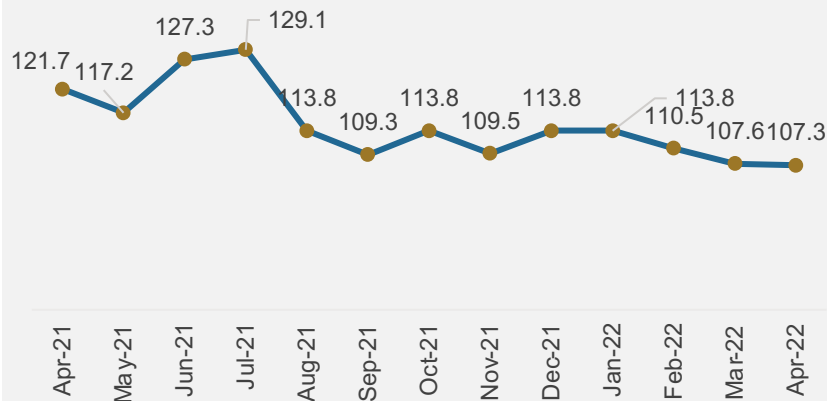
- The unemployment rate remained unchanged at 3.6% in April, the lowest level since February 2020. Nonfarm payroll employment increased by 428,000 in April surpassing the roughly 400,000 new jobs economists were expecting.
- Notable job gains in leisure and hospitality, manufacturing, transportation and warehousing helped drive down the unemployment rate.

CPI-All Urban Consumers, Seasonally Adjusted



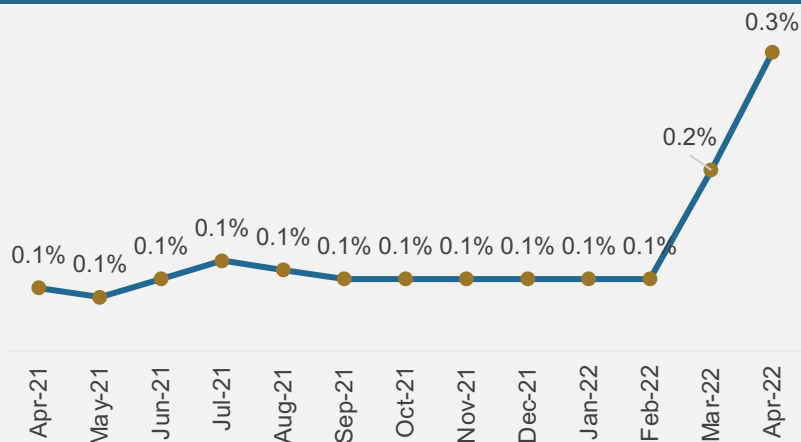
- The Consumer Price Index for All Urban Consumers (CPI-U) increased 0.3% in April, after an uptick of 1.2% the previous month. The index rose 8.3% during the last 12 months.
- The largest contributors to inflation have been shelter, food, airline fares and new vehicles. The food index rose 9.4% in April on an annual basis, the largest increase since April 1981.

Consumer Confidence Index



- The Conference Board Consumer Confidence Index® decreased marginally for the third consecutive month to 107.3 in April because of high inflation and the war in Ukraine.
- Consumer sentiment has cooled somewhat amid high interest rates and persistently high inflation. While vacation plans have been shelved, major purchases like automobiles and appliances have picked up.

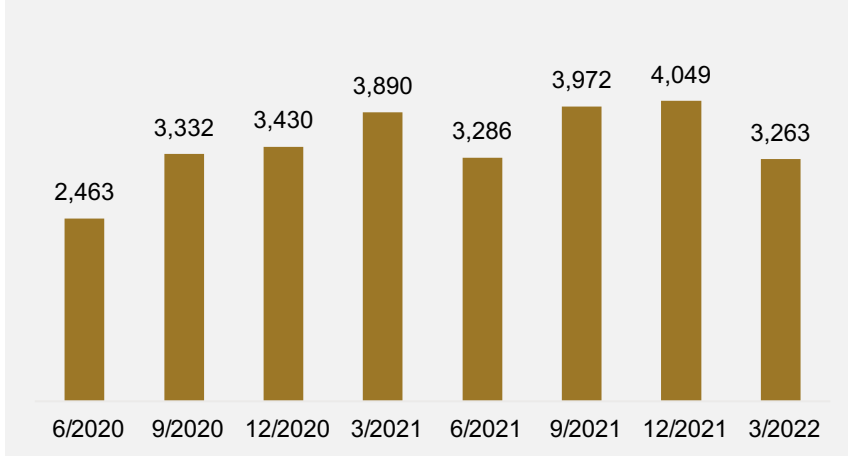
Effective Federal Funds Rate



- The Federal Open Market Committee ("FOMC") signaled the start of monetary tightening policy by hiking interest rates twice in March and April to 0.33%. Fed officials projected a Fed funds rate of 1.9% for 2022 and 2.8% for 2023 and 2024 in their March forecast.
- The minutes from the May FOMC meeting indicate strong support for 50 bps hikes in June and July, highlighting the strong commitment of policy makers toward reigning in inflation.

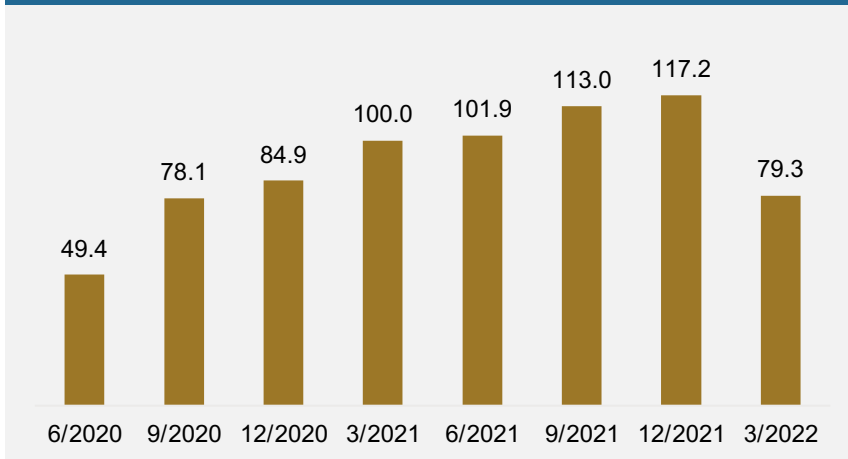
Source: U.S. Census Bureau, The Federal Reserve Bank of St. Louis, The Conference Board, Forbes

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



- According to Refinitiv, U.S. target middle market M&A announced deal volume was up ~11% to 14,570 during TTM 3/31/22 compared to 13,115 during TTM 3/31/21.
- Deal activity for the quarter ended 3/31/22 shrunk by ~16.0% on a YoY basis as 3,263 transactions were completed. Deal activity declined by ~19% on a sequential QoQ basis following the new high of 4,049 in Q4 2021.

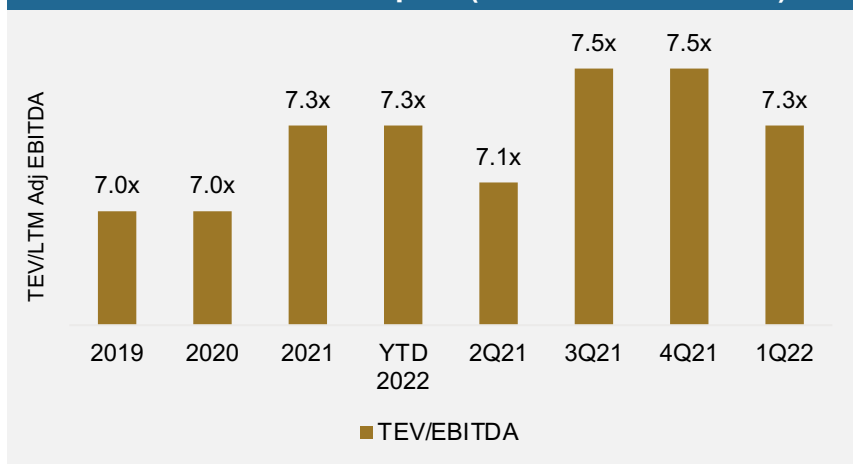
U.S. Target Mid-Market M&A (\$ Billion, Last 3 Months)



- Deal value during TTM 3/31/22 reached \$411.4 billion, an increase of ~32% over the TTM 3/31/21 period.
- Deal value in Q1 2022 contracted sharply to \$79.3 billion, a decline of ~32% from the record level of \$117.2 billion seen in Q4 2021. Deal value in Q1 2022 was down ~21% on a YoY basis.

Source: Refinitiv

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



Source: GF Data®

- Valuations averaged 7.3x TTM adjusted EBITDA during Q1 2022, down from the high of 7.5x in Q4 2021.

Purchase Price Multiples Across TEV Ranges

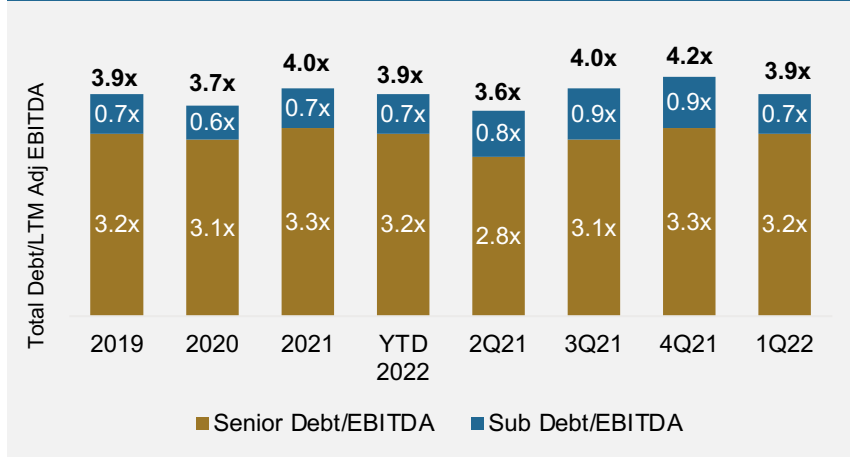
Total Enterprise Value (TEV)/EBITDA

TEV (in \$m)	2003-2017	2018	2019	2020	2021	YTD 2022	Total
10-25	5.7x	5.9x	6.1x	5.9x	6.1x	6.6x	5.8x
25-50	6.4x	6.9x	6.9x	6.8x	7.0x	6.9x	6.5x
50-100	7.1x	8.8x	7.5x	8.0x	8.3x	8.5x	7.5x
100-250	7.9x	8.7x	9.3x	8.6x	9.0x	9.3x	8.3x
Spread between \$10-25 m & \$100-250 m	2.2x	2.8x	3.2x	2.7x	2.9x	2.7x	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) moderated further to 2.7x in YTD 2022.
- Valuations in the \$10-25 million TEV range showed an uptick to 6.6x TTM EBITDA in Q1 2022 from 6.3x at the end of the preceding quarter.

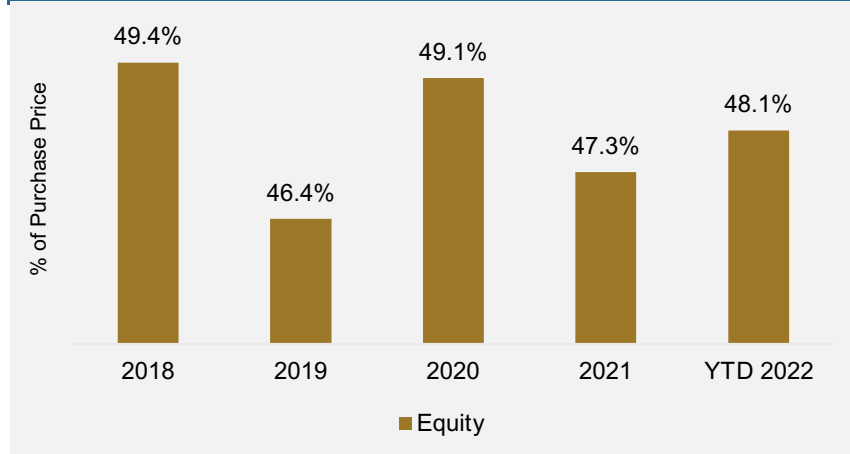
Leverage Multiples (\$10-\$250 Million TEV)



Source: GF Data®

- Total debt to EBITDA eased to 3.9x in Q1 2022 from 4.2x in Q4 2021.
- Senior debt to EBITDA dropped marginally to 3.2x in Q1 2022 but remained slightly higher than the 12-quarter average of 3.1x.
- Subordinated debt to EBITDA fell to 0.7x from 0.9x in Q4 2021, in line with the 2021 average.

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



Source: GF Data®

- Equity contributions increased to 48.1% in YTD 2022, although platform deals required higher equity contributions of 52.2% during the same period.
- Average equity contributions in the \$10-25 million TEV range increased markedly to 50.5% in YTD 2022 from 35.6% in Q4 2021.
- Equity contributions in the \$25-250 million TEV range declined in YTD 2022.

Leveraged Lending Volume

- According to S&P Global, total leveraged loan issuance in the U.S. reached \$217.4 billion through April 2022, about 27% lower than the level achieved during the same period in 2021.
- Total institutional loan volume reached \$152.6 billion in YTD 2022, down 103.2% over the same period in 2021.
- A combination of economic headwinds (e.g., Ukraine war, supply chain disruptions) and interest rate hikes have pushed issuance down and costs up.

Cash Held by Corporations

- Companies held less cash in Q1 2022 than in 2021, but still significantly more than pre-pandemic amounts.
- According to the U.S. Census Bureau, U.S. Corporations held \$254 billion total cash on hand and in U.S. banks.
- \$298.9 billion of share buybacks have been announced through March 2022, about 11% higher than the \$269.8 billion recorded for the same period in 2021.

Private Equity Dry Powder

- According to Preqin, private equity groups held \$1.78 trillion in dry powder as of February 2022.
- This represents an increase of 35% since September 2021, and is very near the all-time high of \$1.81 trillion recorded in January 2022.
- 25 private equity groups hold about \$460.1 billion or approximately 26% of all dry powder, according to data from S&P Global Market Intelligence and Preqin.

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