

Middle Market M&A Review
3rd Quarter 2022



Middle market M&A activity continued to moderate in Q2 2022

- ✓ Deal volume declined 7% YoY to 13,753 during the TTM ended June 2022
- ✓ Total deal value shrank by 2% to \$376.6 billion during the same period
- ✓ Valuation multiples eased to 7.4x TTM adjusted EBITDA in Q2 2022 from 7.5x in the previous quarter

Macroeconomic headwinds started to affect the availability of capital

- ✓ Total leveraged loan issuance in the U.S. reached \$276.9 billion YTD July 2022, down ~50% YoY
- ✓ Cash and liquid securities held by investment grade companies declined by a record 20% YoY in H1 2022
- ✓ Buyout firms held \$873 billion of dry powder as of June 1, 2022, slightly above the amount at the end of 2021

Economic recovery continues to slip in the face of monetary tightening

- ✓ GDP contracted by -0.6% in Q2 2022, marking the beginning of a technical recession
- ✓ The LEI declined for the fifth consecutive month as deteriorating key indicators increased the risk of recession
- ✓ Consumer confidence and spending plans improved, reversing three consecutive months of decline

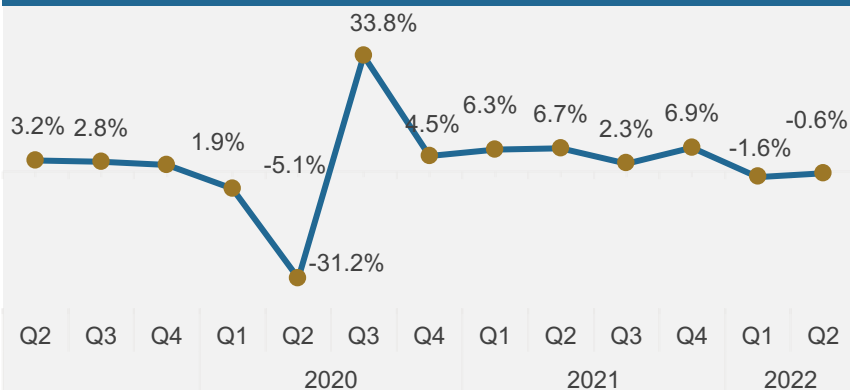
M&A activity is likely to continue its slower pace through year-end

- ✓ Valuations and volumes will likely finish lower in 2022 as uncertainty reigns
- ✓ As pandemic-related stimulus wears off and inflation persists, investors are likely to see more distressed opportunities
- ✓ Private equity could put in a floor of sorts for M&A activity because of its size and need to put capital to work

Risks to our view

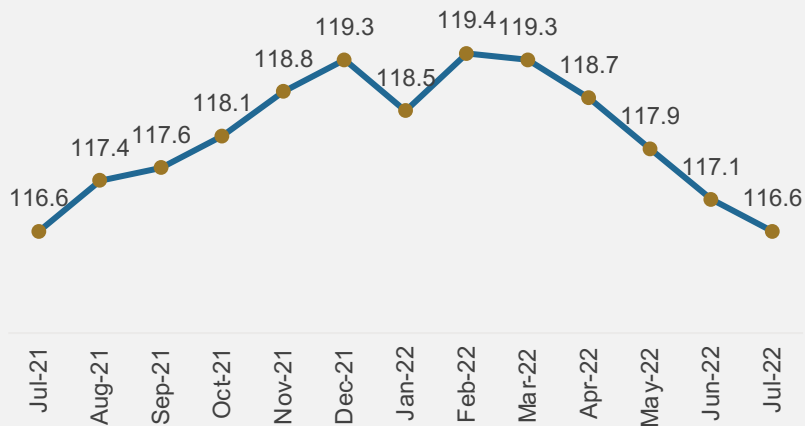
- ✓ Business and consumer confidence turn materially negative
- ✓ The Federal Reserve raises rates faster or more than expected
- ✓ As winter approaches, Russia's invasion of Ukraine and other supply constraints cause more severe disruptions

U.S. GDP Growth Rate



- Per the second estimate from the BEA, real GDP contracted by 0.6% in Q2 2022, a marginal improvement over Q1 2022, which pulled back 1.6%.
- The compression in real GDP in Q2 2022 was driven by declines in private inventory investment, residential fixed investments, and federal, local and state government spending, but offset by exports and consumer spending.

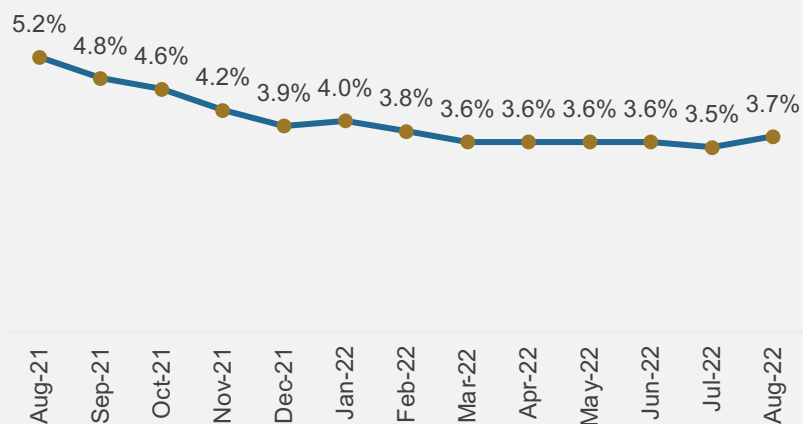
Conference Board Leading Economic Index® (LEI)



- The Conference Board Leading Economic Index® (LEI) for the U.S. declined 0.4% to 116.6 in July, marking the fifth consecutive monthly decline and raising the risk of recession in the near term.
- Volatility in the equity market, as well as slowing in the labor market, housing construction and manufacturing orders, are signaling widespread economic weakness.

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

U.S. Unemployment Rate



- The unemployment rate increased by 0.2% to 3.7% in August, after reaching a multi-year low in July. Nonfarm payroll employment increased by 315,000 in August, a slowdown but still notable additions in a tight labor market.
- Significant job gains occurred in professional and business services, health care, and retail trade, despite the uptick in the unemployment rate.

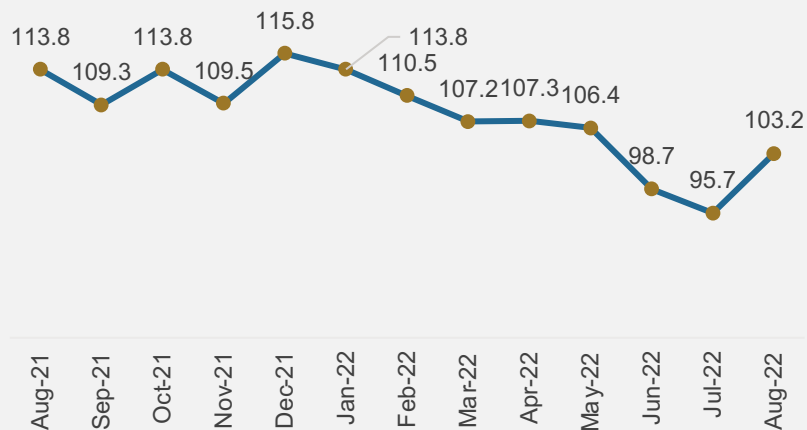
CPI-All Urban Consumers, Seasonally Adjusted



- The Consumer Price Index for All Urban Consumers (CPI-U) was unchanged in July, after an increase of 1.3% in June. The index rose 8.5% during the trailing twelve months (TTM) ended July, a decline compared to the 9.1% advance during the TTM ended June.
- The gasoline index fell in July but was offset by increases in the food and shelter indexes. Notably, the food index has increased 10.9% during the TTM, the largest annual increase since May 1979.

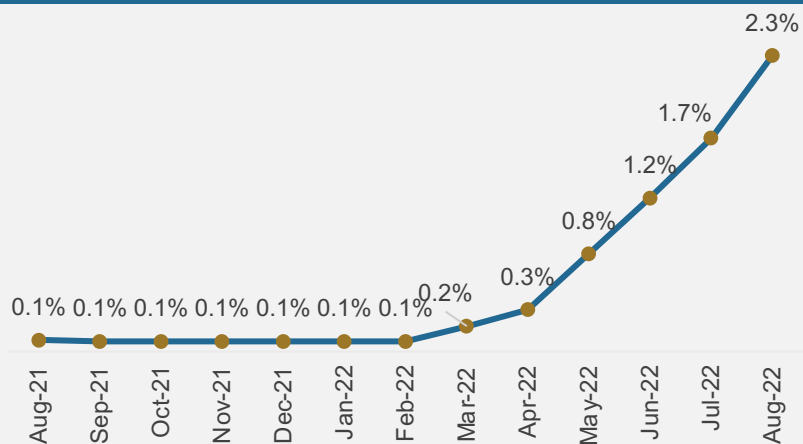
Source: BEA, U.S. Bureau of Labor Statistics, The Conference Board

Consumer Confidence Index



- The Conference Board Consumer Confidence Index® increased to 103.2 in August, as purchasing intention and vacation intention reached an 8-month high, reversing three consecutive months of decline.
- Despite an improvement in spending plans, persistently high inflation and additional rate hikes pose significant risks to sustained economic growth in the near term.

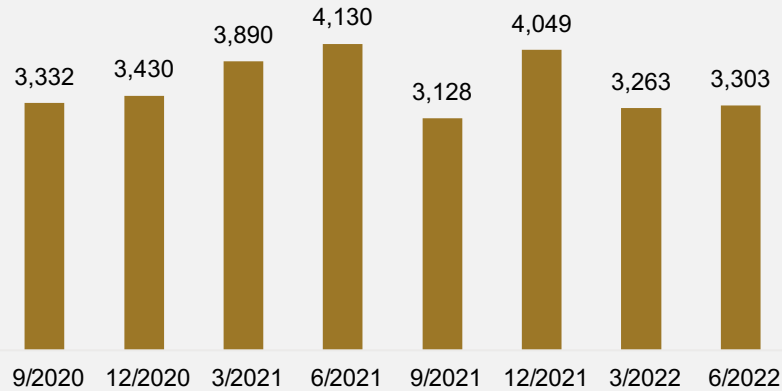
Effective Federal Funds Rate



- The Federal Open Market Committee ("FOMC") continued its monetary tightening policy by hiking interest rates for the fourth time in July 2022, marking the fastest pace of rate increases since the early 1980s. Fed officials projected a Fed funds rate of 2.25-2.50% for 2022.
- The minutes from the July FOMC meeting point to a slowdown in the pace of rate increases, starting September, to strike a balance between inflation and economic growth.

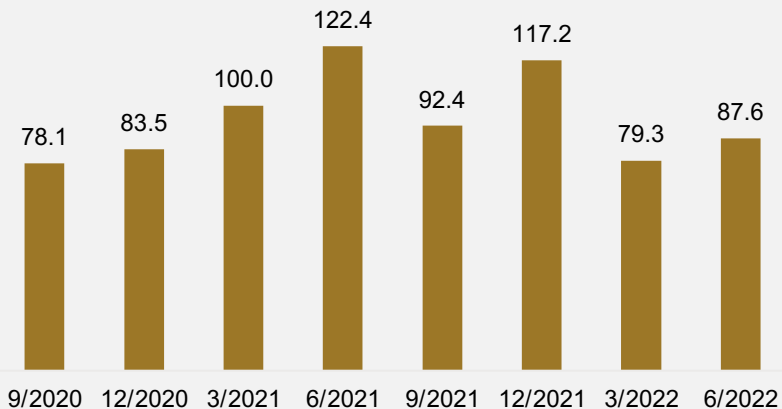
Source: U.S. Census Bureau, The Federal Reserve Bank of St. Louis, The Conference Board, Reuters, Bloomberg

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 down ~7% to 13,753 during TTM 6/30/22, compared to 14,782 during TTM 6/30/21.
- Deal activity for Q2 2022 shrunk by ~20.0% on a YoY basis as 3,303 transactions were completed. Although this represents a slowdown over 2021, deal activity increased marginally by ~1.2% on a sequential QoQ basis following the 3,263 deals concluded in Q1 2022.

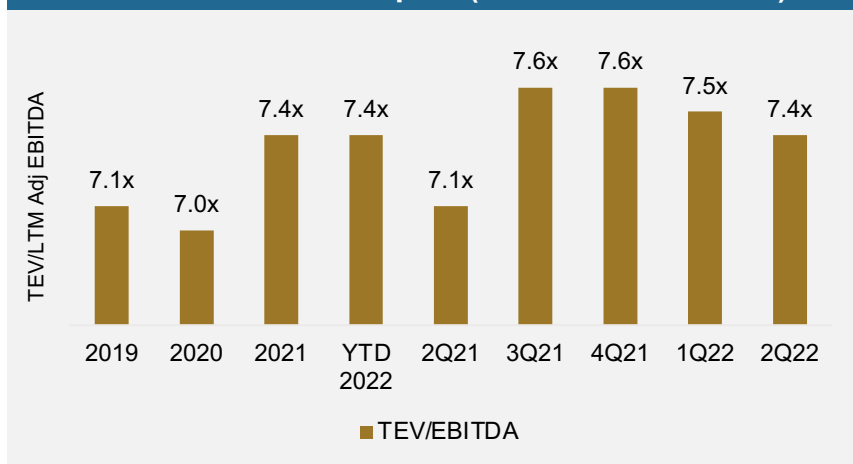
U.S. Target Mid-Market M&A (\$ Billion, Last 3 Months)



- Deal value during TTM 6/30/22 reached \$376.6 billion, a decrease of ~2% compared to the TTM 6/30/21 period.
- Deal value in Q2 2022 increased to \$87.6 billion, up ~10% from \$79.3 billion in Q1 2022. Deal value in Q2 2022 was down ~28.4% on a YoY basis.

Source: Refinitiv

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



Source: GF Data®

- Valuations averaged 7.4x TTM adjusted EBITDA during Q2 2022, down from 7.5x in Q1 2022 and marking the second consecutive quarterly decline.
- Average valuations for YTD 2022 reached 7.4x TTM adjusted EBITDA, in line with the full year average in 2021.
- While there has been ongoing talk of recession, valuations have held up.

Purchase Price Multiples Across TEV Ranges

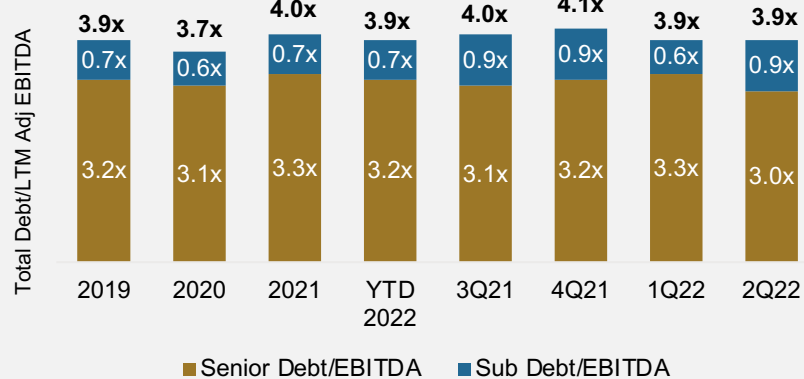
Total Enterprise Value (TEV)/EBITDA

TEV (in \$m)	2003-2017	2018	2019	2020	2021	YTD 2022	Total
10-25	5.7x	6.0x	6.1x	5.9x	6.1x	6.3x	5.8x
25-50	6.4x	6.9x	7.0x	6.7x	7.2x	6.7x	6.6x
50-100	7.3x	8.9x	7.5x	8.0x	8.4x	9.2x	7.6x
100-250	8.0x	8.8x	9.2x	8.7x	9.3x	9.3x	8.4x
Spread between \$10-25 m & \$100-250 m	2.3x	2.8x	3.1x	2.8x	3.2x	3.0x	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 3.0x during YTD 2022.
- The quality premium increased to 26% during YTD 2022, but remains below the 31% quality premium in 2021.
- Valuations in the \$10-25 million TEV range experienced a sharp decline to 5.8x TTM adjusted EBITDA in Q2 2022, from 6.7x in the previous quarter.

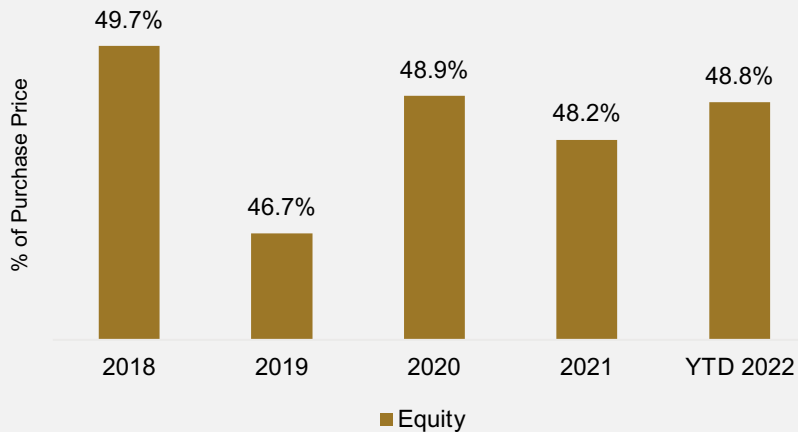
Leverage Multiples (\$10-\$250 Million TEV)



Source: GF Data®

- Total debt to EBITDA remained unchanged at 3.9x in Q2 2022.
- Senior debt to EBITDA dropped sharply to 3.0x in Q2 2022, from 3.3x in the previous quarter, and below the 12-quarter average of 3.1x.
- Subordinated debt to EBITDA increased to 0.9x from 0.6x in Q1 2022, and above the 12-quarter average of 0.7x.

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



Source: GF Data®

- Equity contributions increased to 48.8% during YTD 2022, although platform deals required higher equity contributions of 54.0% during the same period.
- Average equity contributions in the \$10-25 million TEV range eased to 42.9% during YTD 2022 but remain substantially higher than the 37.3% seen in 2021.
- Equity contributions in the \$50-100 million TEV range swelled to 58.7% during YTD 2022.

Leveraged Lending Volume

- According to Loan Commentary & Data (LCD), total leveraged loan issuance in the U.S. reached \$276.9 billion through July 2022, ~50% lower than the same period in 2021.
- Total institutional loan volume reached \$152.6 billion during YTD 2022, down ~40% over the comparable period in 2021.
- July 2022 issuance was only \$1.8 billion, surpassing the previous record low of \$2.3 billion in July 2007, as investors recalibrate in the face of inflation and higher interest rates.

Cash Held by Corporations

- Cash and liquid securities held by companies with investment grade ratings declined by a record 20% YoY in H1 2022, greater than the 15% drop in Q1 2022.
- The drawdown in cash is seen as a response to high inflation, which erodes the value of cash holdings. Conserving cash to fund share buybacks is also less attractive following the Inflation Reduction Act's 1% excise tax on buybacks.
- The median cash ratio (cash and cash equivalents to current liabilities) of investment grade issuers declined to 21.5 in Q1 2022, from 29.1 a year earlier, but remains above pre-pandemic levels (19.5).

Private Equity Dry Powder

- According to Preqin, buyout firms held \$873 billion of dry powder as of June 1, 2022, up marginally from \$870 billion at the end of 2021.
- Excluding venture capital firms, investment companies held \$1.86 trillion of dry powder in June 2022, up 3% over the \$1.81 trillion maintained in 2021.
- Buyout dry powder declined in 2021 for the first time since 2012, as buyout deal volume outpaced buyout fundraising.

Source: Pitchbook, Financial Times, Wall Street Journal, Preqin, Markets Group

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