

Middle Market M&A Review  
4<sup>th</sup> Quarter 2022



## Middle market M&A activity decelerated in Q3 2022

- ✓ Deal volume declined 11% YoY to 13,619 during the TTM period ended September 2022
- ✓ Total deal value shrank by 14.6% to \$349.5 billion during the same period
- ✓ Valuation multiples spiked to 8.1x TTM adjusted EBITDA in Q3 2022, a 20-year high

## Macroeconomic headwinds slowed capital formation

- ✓ Leveraged loan issuance in the U.S. fell to \$67.2 billion in Q3 2022, the lowest level since the fourth quarter of 2014
- ✓ The median cash ratio of investment grade companies declined to 18.8% in Q2 2022
- ✓ Dry powder held by global buyout firms shrank to \$810 billion in November 2022

## Economic indicators were mixed

- ✓ Real GDP expanded at an annual rate of 3.2% in Q3 2022, following two consecutive quarters of contraction
- ✓ The LEI for the U.S. decreased by 1.0% to 113.5 in November, continuing a nine month trend
- ✓ The Conference Board Consumer Confidence Index<sup>®</sup> improved in December to 108.3, after back-to-back declines

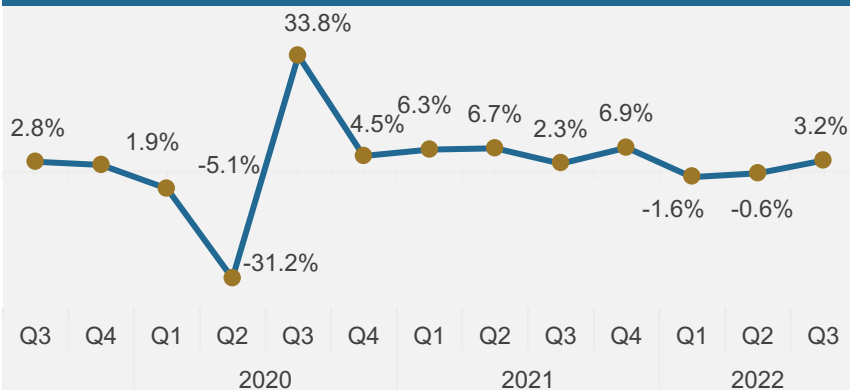
## M&A activity is likely to stabilize and increase in 2023

- ✓ Valuations will likely pull back from all time highs, and volume will likely trend up toward pre-2021 levels
- ✓ Financial buyers will likely be more active as strategic buyers focus on the economy and geopolitical risks
- ✓ Digital transformation, supply chain stabilization, and synergies will likely motivate buyers

## Risks to our view

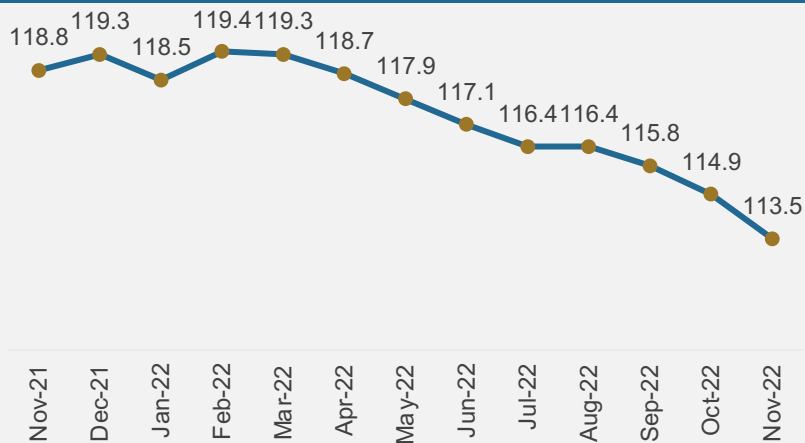
- ✓ The economy falls into a deep, wide or U-shaped recession
- ✓ As the market adjusts to the rising cost of capital, the valuation expectations gap between buyers and sellers widens
- ✓ Volatile input availability and prices create material operational issues for target companies

## U.S. GDP Growth Rate



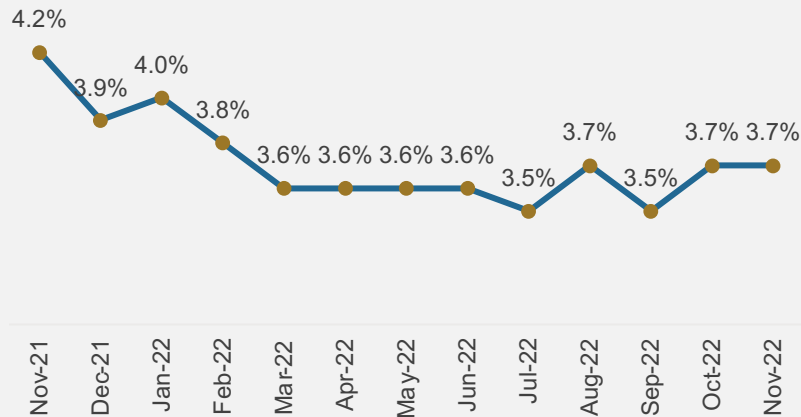
- According to the BEA, real GDP increased at an annual rate of 3.2% in Q3 2022, following two consecutive quarters of contractions and pulling the economy out of a technical recession.
- The growth in real GDP in Q3 2022 primarily reflected increases in exports and consumer spending that were partly offset by a decrease in housing investment.

## Conference Board Leading Economic Index® (LEI)



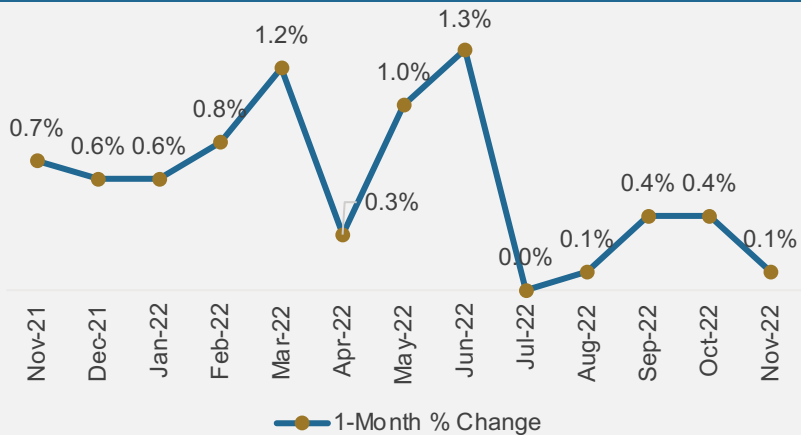
- The Conference Board Leading Economic Index® (LEI) for the U.S. decreased by 1.0% to 113.5 in November, marking the ninth consecutive monthly decline, and indicating that the economy is possibly in the middle of a recession.
- Labor market, manufacturing, and housing indicators weakened, which creates headwinds for economic growth.

## U.S. Unemployment Rate



- The unemployment rate was unchanged at 3.7% in November. Nonfarm payroll employment increased by 263,000 in November, according to the Bureau of Labor Statistics.
- Significant job gains occurred in leisure and hospitality, healthcare, and government. Employment declined in retail trade and transportation and warehousing.

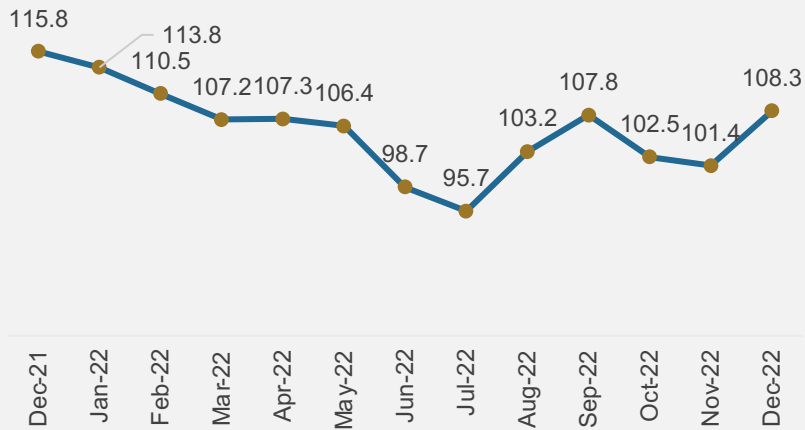
## CPI-All Urban Consumers, Seasonally Adjusted



- The Consumer Price Index for All Urban Consumers (CPI-U) rose by 0.1% in November and 7.7% during the trailing twelve months (TTM) ended November.
- The index for shelter was the largest contributor to the monthly increase, more than offsetting decreases in energy indexes. The food index increased 0.5% over the month, and the energy index decreased 1.6% over the month, as all energy indexes declined.

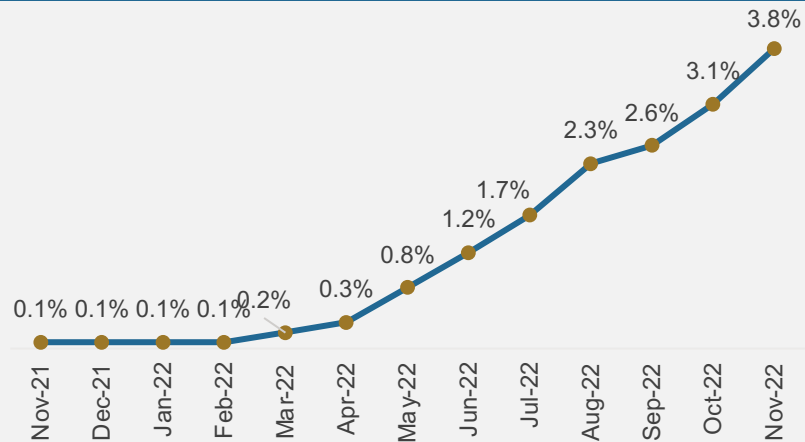
Source: BEA, U.S. Bureau of Labor Statistics, The Conference Board

## Consumer Confidence Index



- The Conference Board Consumer Confidence Index® increased in December to 108.3 following back-to-back monthly declines and reaching its highest level since April 2022.
- Consumers were less pessimistic about the short-term business conditions outlook and more upbeat about the short-term labor market outlook.

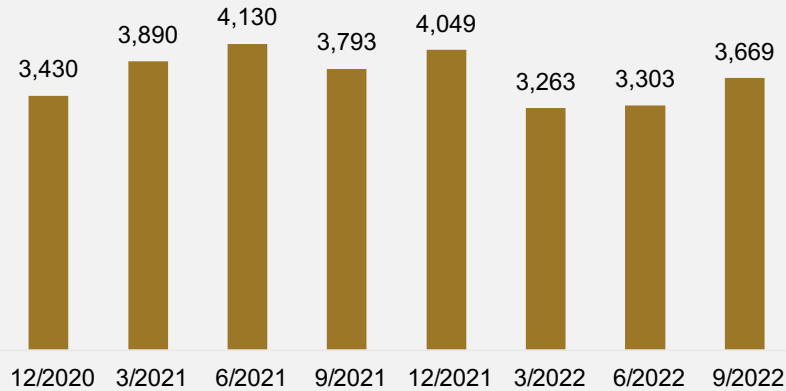
## Effective Federal Funds Rate



- The Federal Open Market Committee (FOMC) continued its monetary tightening policy by hiking interest rates by 50 basis points in December. Fed officials projected a Fed funds rate of 4.25-4.50%.
- The statement from the December FOMC meeting indicates the committee would be prepared to adjust its stance if risks emerge that could impede the attainment of its goals.

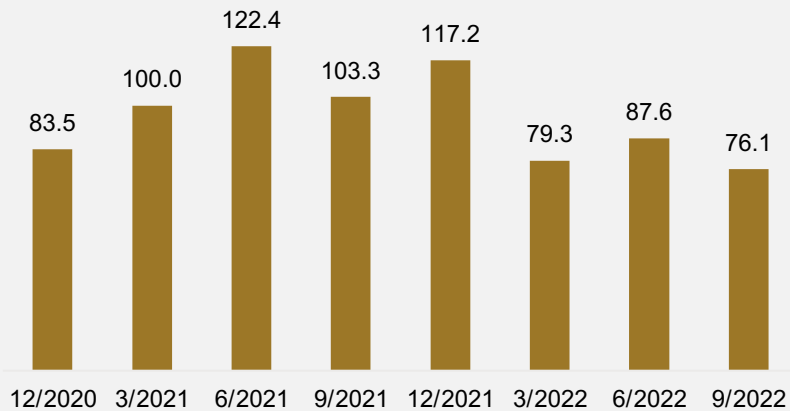
Source: U.S. Census Bureau, The Federal Reserve Bank of St. Louis, The Conference Board, Reuters, Bloomberg

## 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 ~11% to 13,619 during TTM 9/30/22, compared to 15,243 during TTM 9/30/21.
- Deal activity for Q3 2022 shrunk by ~3.3% on a YoY basis as 3,669 transactions were completed. Although this represents a slowdown over 2021, deal activity increased by ~11% on a sequential QoQ basis following the 3,303 deals completed in Q2 2022.

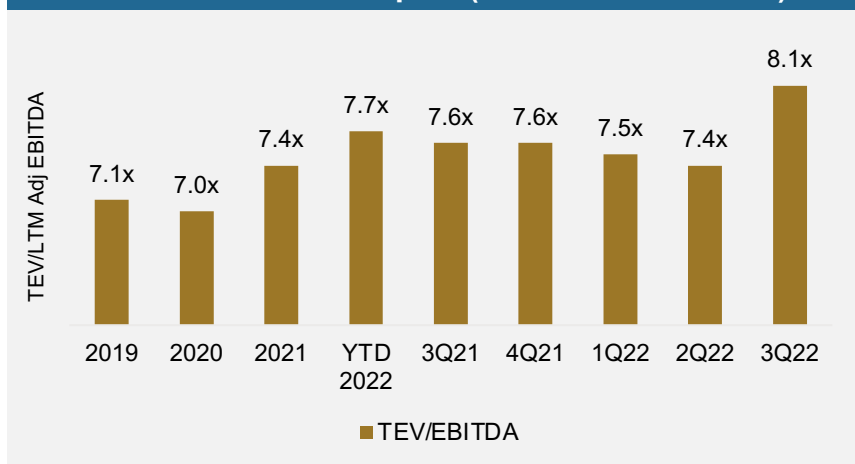
## U.S. Target Mid-Market M&A (\$ Billion, Last 3 Months)



- Deal value during TTM 9/30/22 reached \$349.5 billion, a decrease of ~14.6% compared to the TTM 9/30/21 period.
- Deal value in Q3 2022 decreased to \$76.1 billion, down ~13% from \$87.6 billion in Q2 2022. Deal value in Q3 2022 was down ~26.3% on a YoY basis.

Source: Refinitiv

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



Source: GF Data®

- Valuations averaged 8.1x TTM adjusted EBITDA during Q3 2022, a sharp increase over Q2 2022 and the highest reading since GF Data started tracking multiples 20 years ago.
- Average valuations for YTD 2022 reached 7.7x TTM adjusted EBITDA, up from the full year average of 7.4x in 2021.

## Purchase Price Multiples Across TEV Ranges

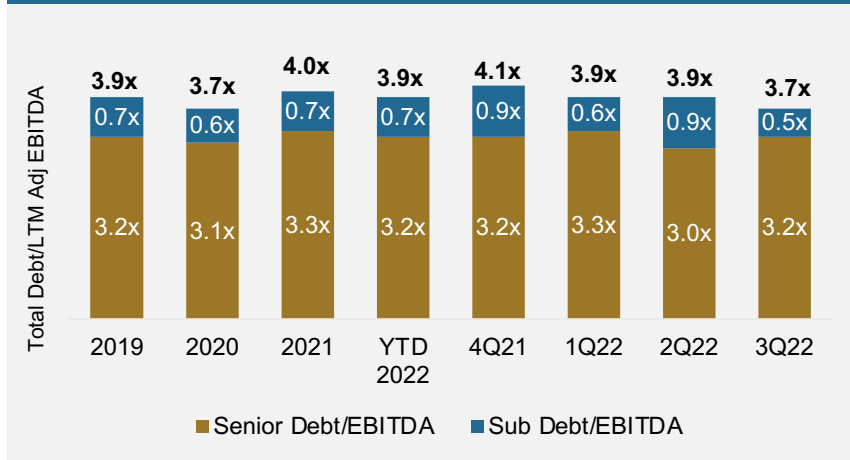
### Total Enterprise Value (TEV)/EBITDA

TEV (in \$m)	2003-2017	2018	2019	2020	2021	YTD 2022	Total
10-25	5.7x	6.0x	6.1x	5.9x	6.1x	6.6x	5.9x
25-50	6.4x	6.9x	7.0x	6.7x	7.2x	7.1x	6.6x
50-100	7.3x	8.9x	7.5x	8.0x	8.4x	8.8x	7.7x
100-250	8.0x	8.8x	9.2x	8.7x	9.3x	9.7x	8.5x
Spread between \$10-25 m & \$100-250 m	2.3x	2.8x	3.1x	2.8x	3.2x	3.1x	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 3.1x during YTD 2022.
- The quality premium slipped to 17% during YTD 2022, a notable decline from 31% in 2021.

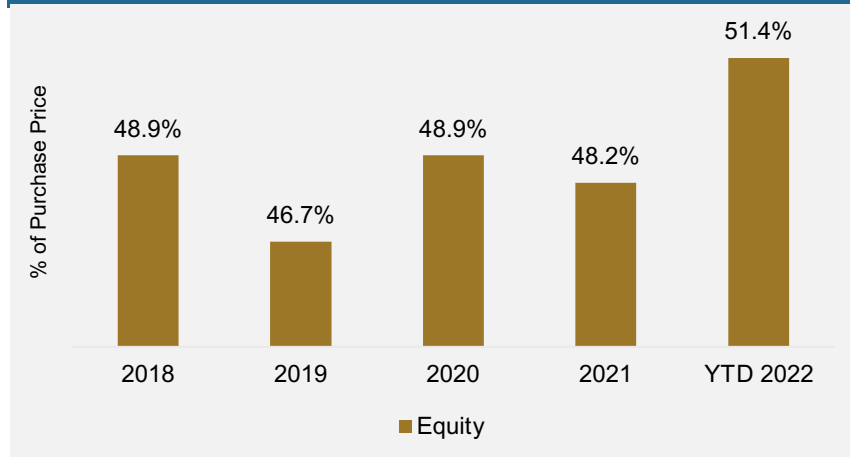
## Leverage Multiples (\$10-\$250 Million TEV)



Source: GF Data®

- Total debt to EBITDA declined to 3.7x in Q3 2022.
- Senior debt to EBITDA increased to 3.2x in Q3 2022 from 3.0x in the previous quarter, and above the 12-quarter average of 3.1x.
- Subordinated debt to EBITDA contracted notably to 0.5x from 0.9x in Q2 2022, and below the 12-quarter average of 0.7x.

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



Source: GF Data®

- Equity contributions increased to 51.4% during YTD 2022.
- Average equity contributions in the \$10-25 million TEV range surged to 46.9% during YTD 2022, from 37.2% in full year 2021.
- Equity contributions in the \$50-100 million TEV range increased to 57.7% during YTD 2022, from 55.7% in full year 2021.



## Leveraged Lending Volume

- According to Loan Commentary & Data (LCD), total leveraged loan issuance in the U.S. fell to \$67.2 billion in Q3 2022, the lowest level since the fourth quarter of 2014.
- Total institutional loan volume reached \$190 billion during YTD 2022, well below the average of the past five years (\$294 billion).
- Institutional loan issuance in Q3 2022 declined to \$21.4 billion and was the lowest figure recorded since Q4 2009.

## Cash Held by Corporations

- U.S. corporate cash ratios have declined due to headwinds created by rising interest rates, high inflation and a slowdown in economic activity.
- The median cash ratio of investment grade companies declined to 18.8% in Q2 2022, breaking through the pre-pandemic level of 19.5% in Q4 2019.
- The median cash ratio for non-investment grade companies remained above pre-pandemic levels at 30.2%, but recorded a decline from 34.2% in Q1 2022.

## Private Equity Dry Powder

- According to Preqin, global buyout firms held \$810 billion of dry powder as of November 2022, continuing its downward trend from its peak of \$909 billion in 2020.
- The proportion of global private equity dry powder to AUM fell to 23% in 2022, at least a 20-year low, as high valuations and volume in 2021 eroded cash reserves.

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