

Pursant
INSPIRED PURSUIT

DEAL insider

M&A and Strategic Transaction Insights

THE INVESTMENT BANK THAT ALSO BUILDS THE VALUE OF YOUR BUSINESS



**Inside this edition
of the DEAL insider:**

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The Pursant Deal Insider is a quarterly publication offering analysis of the marketplace and climate for middle market mergers, acquisitions and strategic transactions. Our emphasis is on transactions with a total enterprise value of less than \$250M. Our goal is to arm business owners and other parties with insights to help them prepare for such transactions in order to maximize transaction outcomes.

Q4 2018 Deal Insider – 2018 Overview

2018 was another solid year for M&A. While broader market M&A deal volume was up as much as 50% according to some sources, the lower end of the middle market representing transactions of less than \$250M in total enterprise value (TEV) was more consistent with 2017. Here are our top take-aways from 2018:

1. Encouraging macroeconomic indicators and generally positive business sentiment fueled M&A activity
2. Low interest rates kept borrowing affordable for M&A deals
3. 10,000 baby boomers retiring a day are driving abundant small business acquisition opportunities
4. Deal friendly administration, policy clarity and tax reform helped M&A
5. Limited organic growth options encouraged acquisitive growth initiatives by strategic operators
6. Valuation multiples peaked and softening is starting to be felt
7. With higher multiples, due diligence was rigorous
8. More companies Stress-Testing, Optimizing and Exit Planning to prepare for an exit in the next few years
9. Private Equity's capital abundance and limited deal flow motivated them to do smaller deals
10. "Acquihires" (buying companies to access talent) more common due to extraordinarily low unemployment rates

This year-end 2018 Pursant Deal Insider provides data and insight into what business owners need to know to be a successful buyer and/or seller in 2019.

(Continued...)

Macroeconomic Indicators

Pursant looks at a number of macroeconomic indicators that may impact deals in order to gain insight into M&A and strategic transaction trends. Some of those relevant indicators include GDP, Unemployment, Inflation and Interest Rates. What happens at the global and macro-economic levels eventually impact the Middle Market and Main Street as well.

Chart #1 - Healthy GDP = Healthier businesses and positive sentiment for M&A

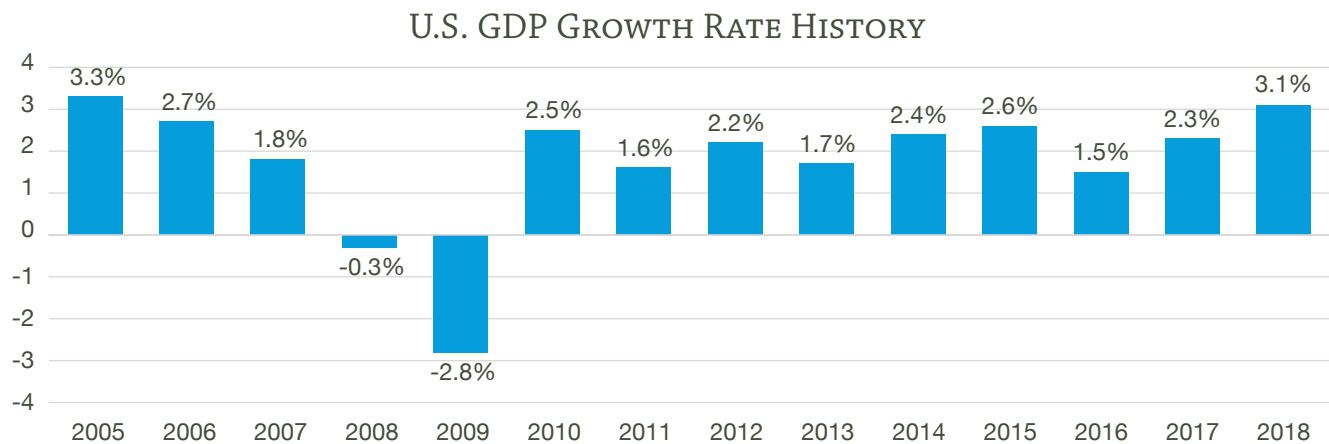


Chart #2 - Low unemployment driving “Acquihire” M&A, buying companies for the primary purpose of acquiring their talent

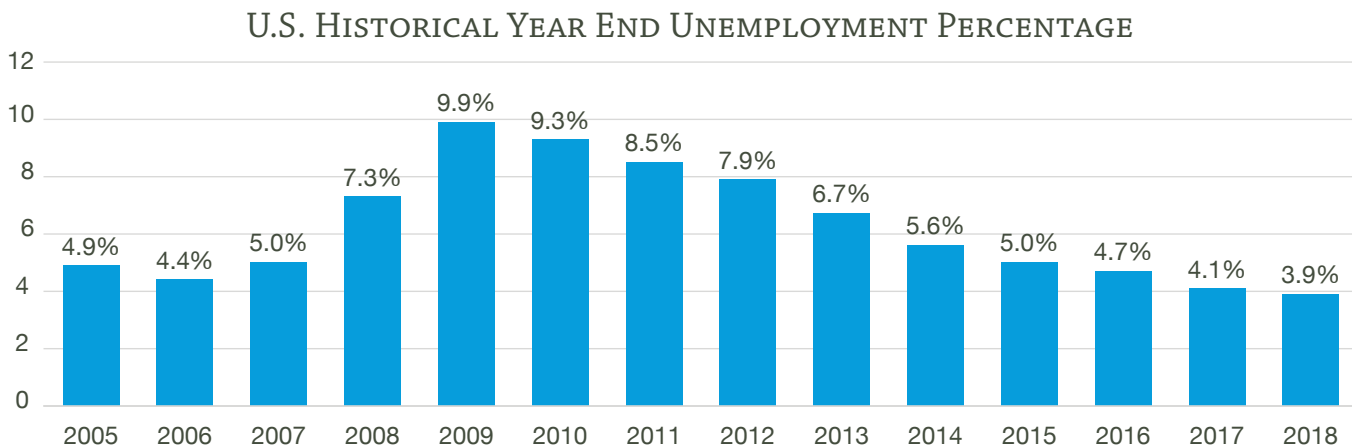


Chart #3 - Inflation is an indicator for Interest Rate direction which drives borrowing and valuation behaviors in M&A

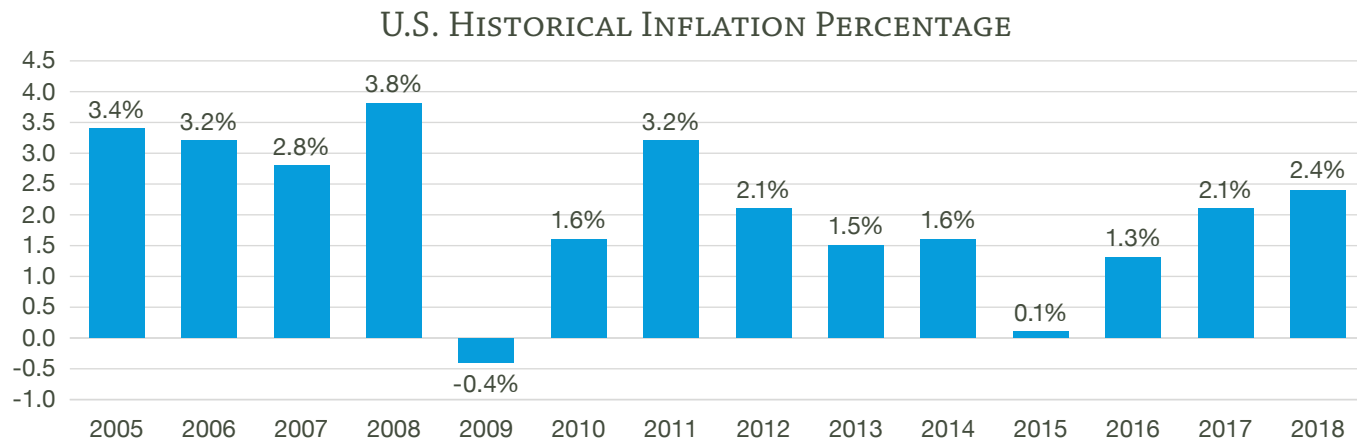


Chart #4 - The cost of capital affects the market's appetite for borrowing to buy companies. As rates increase, there will be downward pressure on multiples when borrowing is involved.

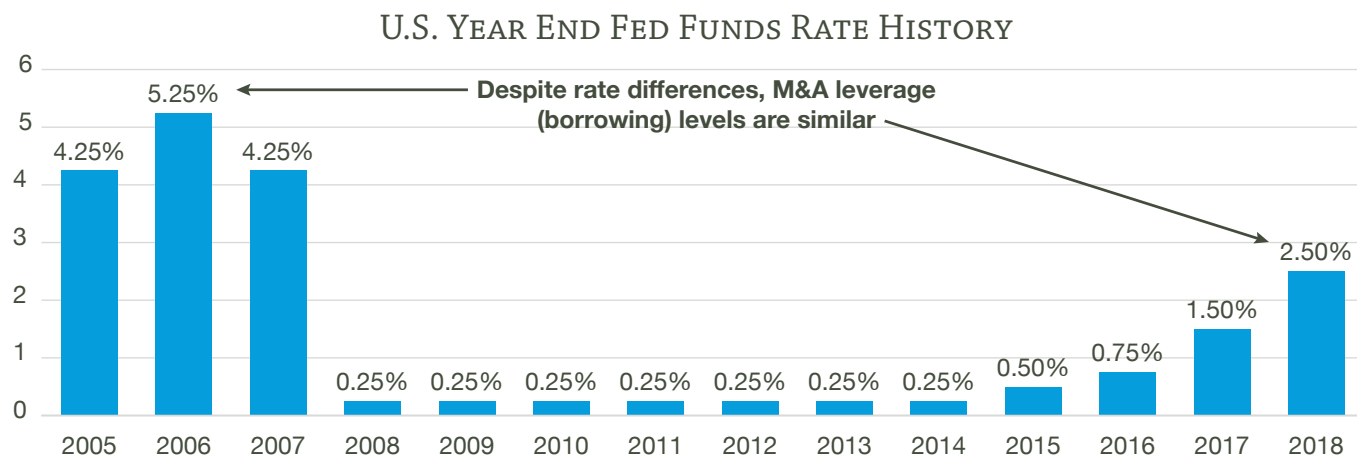


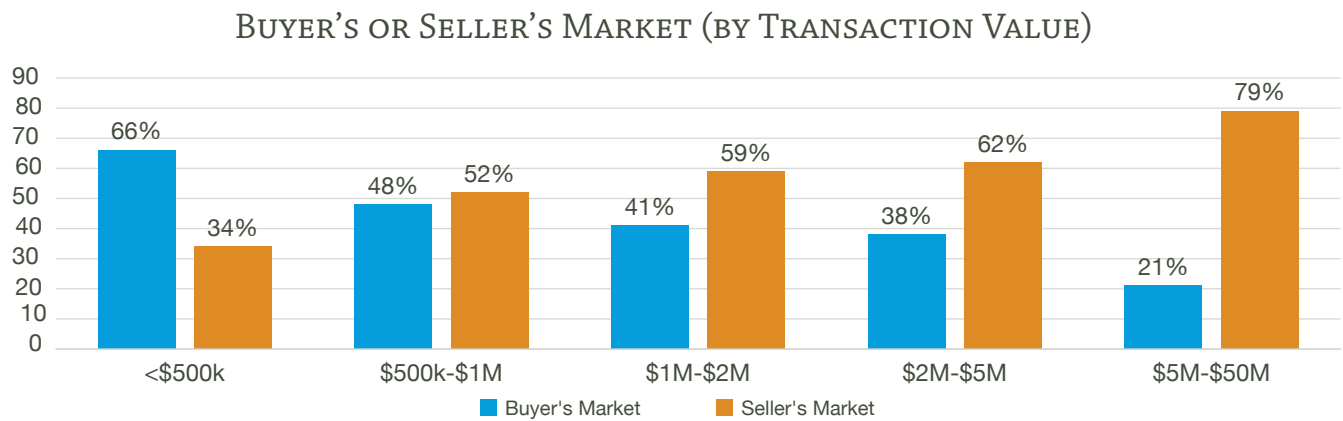
Chart #5 - Overall, retirement remained the #1 reason to sell in 2018. With 10,000 baby boomers retiring each day, this trend is expected to continue.

WHY OWNERS ARE SELLING

Deal Size	#1 Reason	#2 Reason	#3 Reason
<\$500k	Retirement	New Opportunity	Burnout
\$500k-\$1M	Retirement	Burnout	New Opportunity
\$1M - \$2M	Retirement	New Opportunity	Health Issues
\$2M - \$5M	Retirement	Burnout	Family Issues
\$5M - \$50M	Retirement	Family Issues/Burnout	New Opportunity

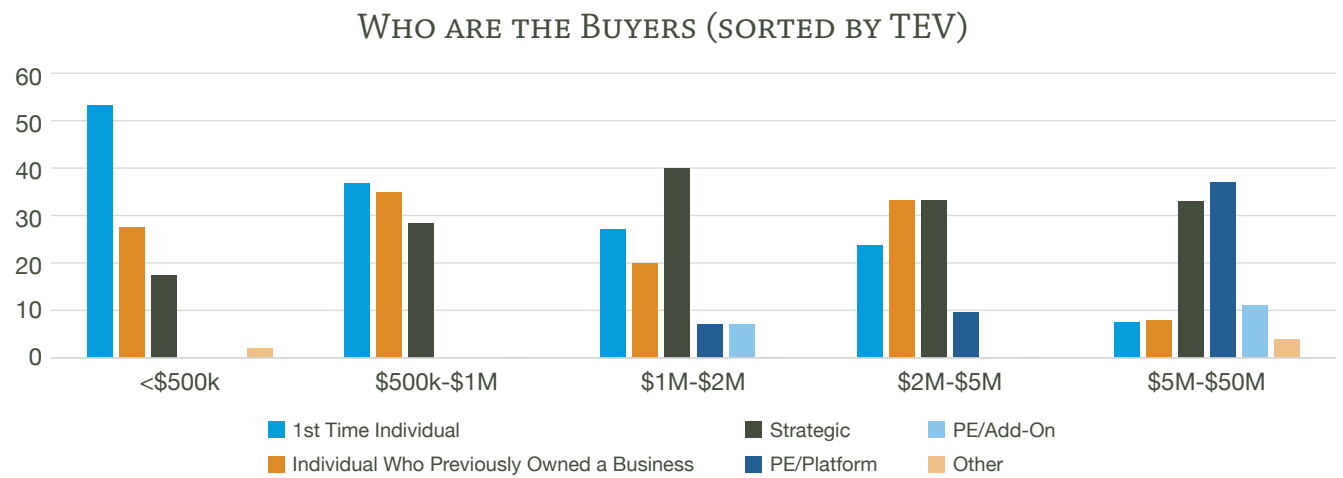
Source: Pepperdine Private Capital Markets Survey

Chart #6 - Size of transaction generally dictates who has the upper hand in deals. Supply and demand plays a major role here. Demand for good, larger-sized businesses exceeds the supply and the opposite holds true for smaller businesses.



Source: Pepperdine Private Capital Markets Survey

Chart #7 - Eager to grow top-line revenue, Strategic buyers appeared all across the deal size spectrum. With higher transaction costs and the need for bigger returns, PE buyers generally don't take interest until purchase prices exceed \$5M. As expected, individual parties are the most prevalent buyer type for small businesses.

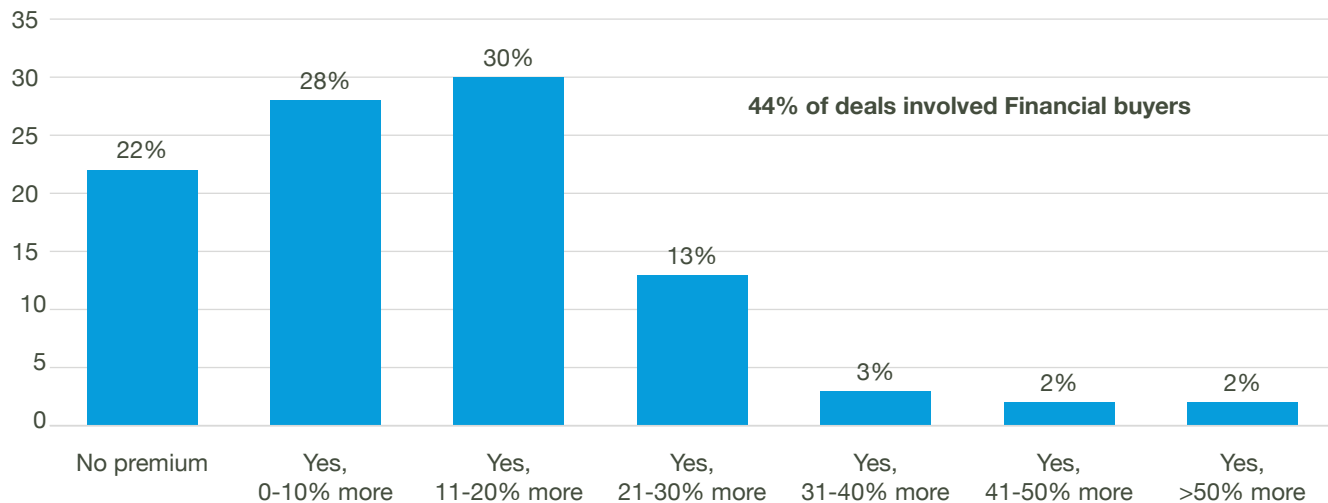


Source: Pepperdine Private Capital Markets Survey



Chart #8 - 78% of the time, Strategic buyers were willing to pay more than Financial buyers. Strategic buyers generally have more synergistic opportunities, industry experience and operational experience to leverage in the valuation model, improving their proforma return.

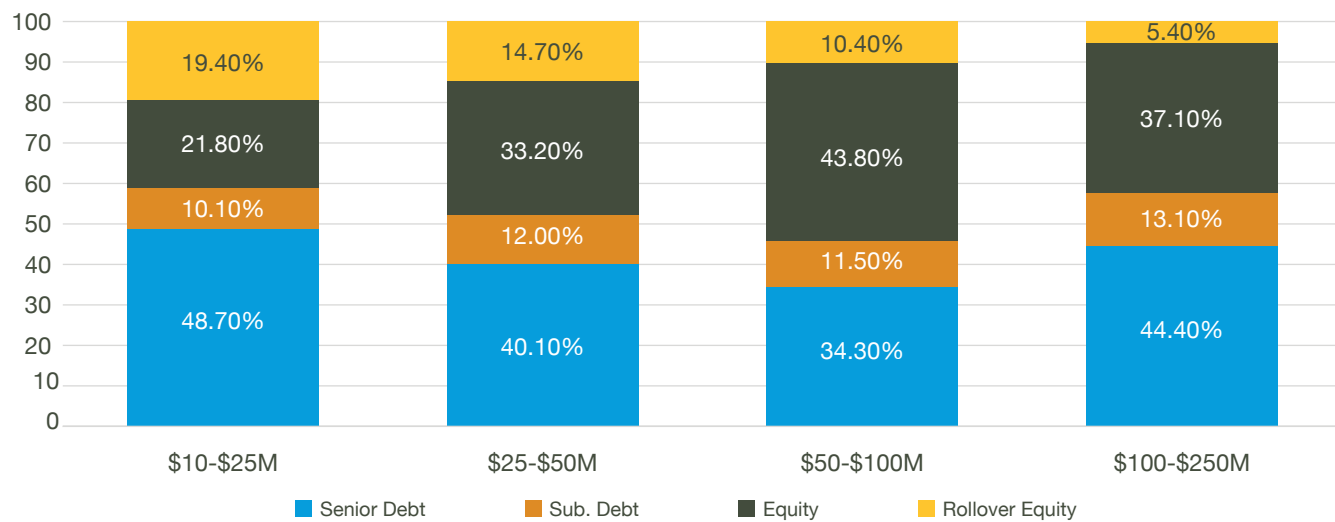
PERCENTAGE OF TIME STRATEGIC BUYERS PAID A PREMIUM VS. FINANCIAL BUYERS



Source: Pepperdine Private Capital Markets Survey

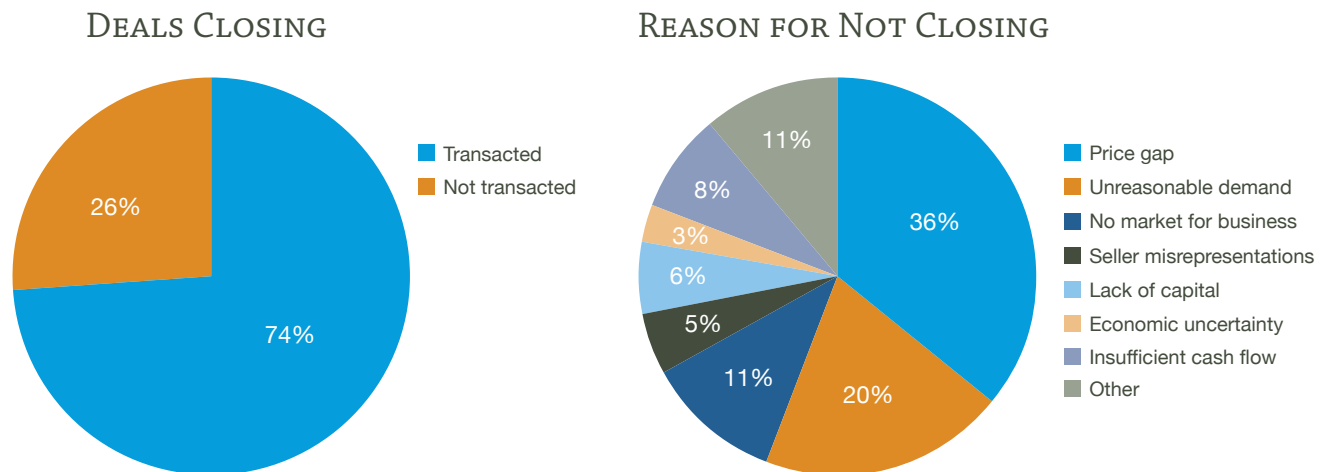
Chart #9 - If you sold your company to a Private Equity (PE) buyer in 2018, the chart below reflects the common breakdown for how PE funded the transaction. We again see the benefits to the low cost of capital. We also see the necessity for buyers being willing to stay invested in their business (rollover equity).

EQUITY & DEBT CONTRIBUTION BY TEV RANGE



Source: GF Data®

Chart #10 - If you embarked on a sale or acquisition process in 2018, odds are that the transaction did not close approximately a quarter of the time. The predominant reasons for deals not closing were buyer/seller misalignment on valuation expectations and deal terms.



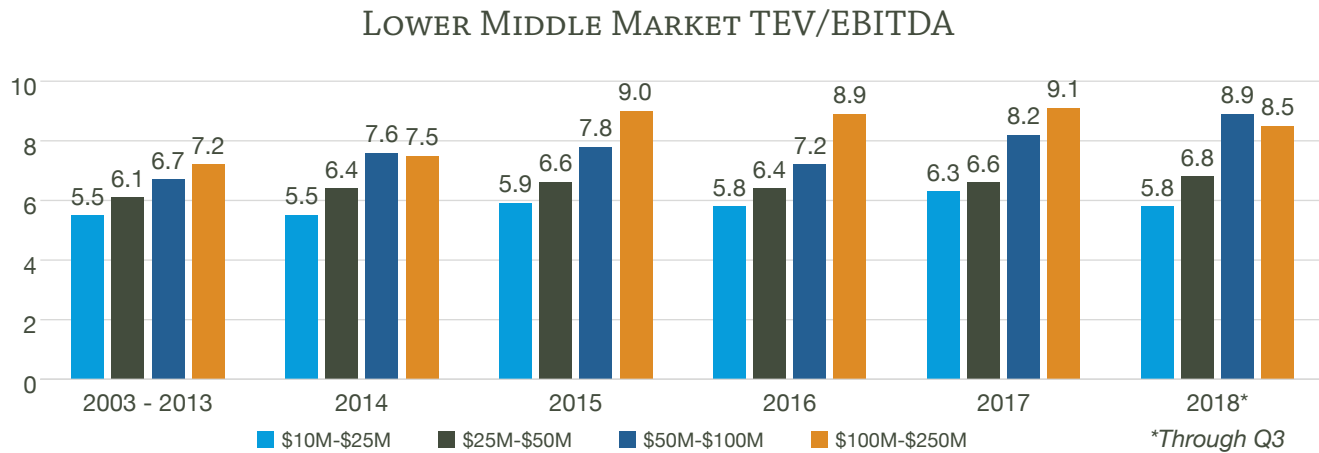
Source: Pepperdine Private Capital Markets Survey

Most lower middle market companies trade at multiples of adjusted earnings (EBITDA). The Multiple is driven by the Risk Profile of the company.

Common Valuation Components

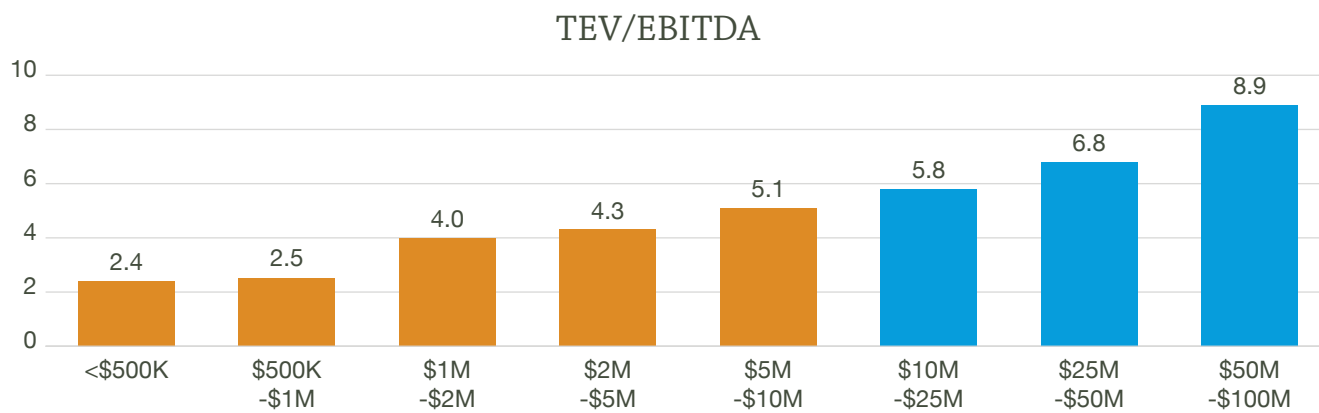
- Multiples of EBITDA (Adjusted, TTM, Run-Rate)
- Risk Profile attributes that drive the Multiple range
 - ✓ Mature, declining or growing sector
 - ✓ Customer type (mature, declining or growing sectors)
 - ✓ Customer retention
 - ✓ Customer concentration
 - ✓ Revenue and Margin trends
 - ✓ Talent concentrations
 - ✓ Quality, completeness and accuracy of books and records
- ✓ Company size (bigger is usually better)
- ✓ Earnings and revenue growth when compared against competitors
- ✓ Recurring, repeat or non-recurring revenue
- ✓ Asset-light or asset-heavy business
- ✓ Proprietary and/or patented technology
- ✓ Growth rate
- ✓ Untapped revenue and margin improvement opportunities

Chart #11 - Lower Middle Market multiples remained at healthy levels in 2018.



Source: GF Data®

Chart #12 - The chart below shows how average valuation multiples increase relative to earnings (EBITDA) growth when moving from *small businesses* (<\$10M) to the *lower middle market* (>\$10M).



Source: Pepperdine Private Capital Markets Survey & GF Data

Chart #13 - With more lofty valuations in 2018 came more thorough due diligence. It was common for deals to take 6-12 months to close from the time a company went to market.

HOW LONG TO CLOSE A DEAL?

Deal Size	Months To Close	LOI To Close
<\$500k	6	2
\$500k-\$1M	7	3
\$1M - \$2M	9	3
\$2M - \$5M	10	4
\$5M - \$50M	11.5	5.5

Source: Pepperdine Private Capital Markets Survey

What to Expect in 2019

Below is our list of five deal-related expectations for 2019. The general sentiment is that M&A activity in the middle market will surpass 2018 levels.

1. M&A activity to continue growing driven by:
 - Overall positive business environment
 - Baby Boomers continue selling
 - Favorable legislative and tax environment
 - Financial buyers still have a lot of capital to deploy
 - Strategic buyers still active - 80% of recent Deloitte CEO survey respondents plan to increase M&A in 2019
2. Buyers doing M&A to expand product/service offerings and footprint
3. Macroeconomic M&A drivers mostly positive
4. Potential drags on M&A
 - Global economic issues
 - Rising interest rates
5. Softening multiples driven by rate increases and growing debt loads

Upcoming Speaking Events

April 30, 2019 – Maryland Robert H. Smith School of Business, Washington, D.C.

Alliance of Merger and Acquisition Advisors (AM&AA) Certification Course

Topic: Deal Success: Strategic Buyer Process from Deal Thesis to Integration

Presented by: Brian Steffens, Managing Director, Pursant, LLC

The Certified M&A Advisor (CM&AA) is the most advanced credential illustrating the highest recognized standards of professional excellence for middle market corporate finance, advisory, and transaction service professionals in a collaborative, peer-driven learning environment.

Brian Steffens is conducting a session highlighting the M&A process both sell side and buy side, Corporate M&A, Financing: Growth and Acquisition, Traditional Business Valuation, Cash Debt Free Balance Sheet, Transaction Valuation, Value Growth and Market Readiness, M&A Tax Issues and M&A Legal Topics.

May 15-17, 2019 – Chicago, IL

Young President's Organization (YPO) Merger, Acquisition, Strategic Transaction Seminar (MAST)

Presented by: Mark Herbick, CEO, Pursant, LLC

Mark Herbick will be co-chairing and a featured expert M&A resource at a private seminar hosted by YPO. The seminar is designed for middle market business owners who:

- Are business leaders beginning to think about pursuing liquidity through a sale, financing growth, or growing their business through acquisitions.
- Want to understand how strategic and financial buyers value businesses, and learn how to increase the value of their businesses in the eyes of buyers.
- Seek to understand the normal process steps and best practices in selling or buying a company.
- Would like knowledge on how to use private capital markets to finance certain types of deals, and how to determine when debt or equity is the better option.

Pursant helps companies grow and realize enterprise value by managing their M&A related initiatives.

Our Investment Banking, Strategic Transaction Support and Business Value Enhancement business units use a deep immersion process, our expansive networks and experience as owner/operators and dealmakers to optimize businesses, manage strategic transactions and orchestrate liquidity events — vital, integrative initiatives for which our clients may not have the time, manpower or expertise.

To learn more about how Pursant can help you, contact Mark Herbick at mherbick@pursant.com, call 847.229.7000 or visit www.Pursant.com.

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