Pursant
INSPIRED PURSUIT

M&A insider

Continued M&A Strength in 2014

- Volume still up over 20% from 2013
- Some softening in valuations
- Big "Size Premiums" being seen

M&A Lending Continues to Improve

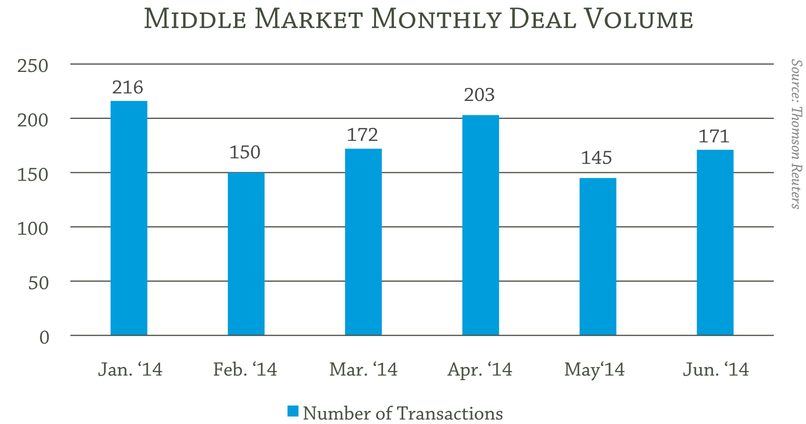
- More attractive M&A financing available
- More loans with fewer covenants
- Loan rates remain low

Pursant's Thoughts on the 2nd Half of 2014

- Forward-looking positive economic indicators, such as the job market, organic revenue growth, inflation, interest rates and cash reserves point to continued strength in M&A activity in 2014.
- "Quality" and "Size" Premiums continue.
- Valuation multiples for smaller businesses may have peaked for the time being, as the growth rate for these multiples has slowed when compared to that of bigger businesses.

2014 Middle Market M&A Summary

Q2 2014 indicators closely followed suit with early 2014 M&A activity. Q2 2014 middle market deal activity continued with total deal volume beating that of 2013 and 2012 and 2014 is still showing its best year since the 2007 financial crisis. Business values remain strong. Q2 2014 saw numerous billion-dollar deals and the middle-market exhibited the same theme with strong volume. This shows that M&A continues to be a popular means for small to medium sized businesses to grow and, in some cases, to survive.



We define Middle Market deals as transactions with less than $1B in transaction value.

The market shows continued signs of strength going into the third quarter. We expect sustained healthy deal flow due to the large amounts of investment capital held by PE groups who have investors that demand that their capital be put to work, despite high valuations. Additionally, our discussions with strategic buyers continues to reveal their hunger for acquisitions. Monthly volume is keeping pace with the first three months of 2014. Quarterly measured volume, which is also on pace with first quarter, provides a more accurate depiction of activity, since monthly data is often skewed by monthly events unrelated to market sentiment.

Aggressive Lending Terms Show Evidence of Continued Market Improvement

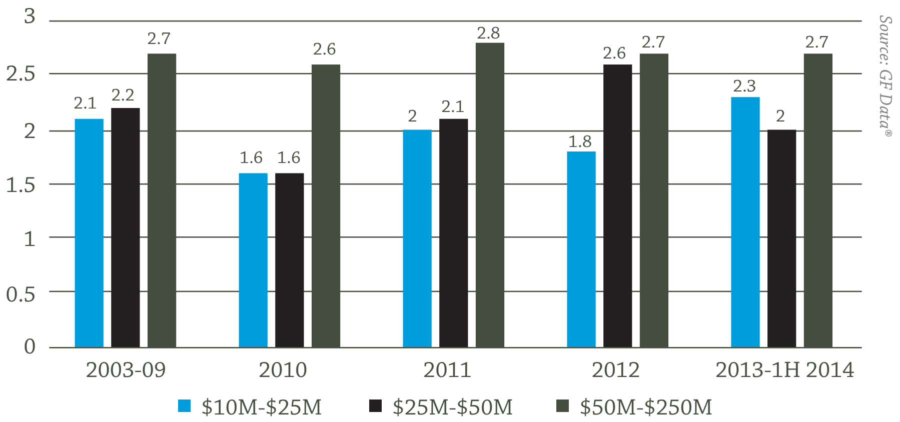
Often buyers will use debt to fund acquisitions, regardless of their cash positions. Debt is currently an attractive way to fuel an acquisition campaign because its cost hovers in the low single digit range and funds are readily available. Depending on the buyer's capital structure and the deal economics, a buyer can generally count on being able to finance anywhere between 25% and 75% of the acquisition cost in the form of senior and/or junior debt.

The graph on the right shows how much of a transaction a buyer can count on funding in the form of *senior debt* for acquisitions in the business services sector, which typically entails asset-light businesses. Data is broken out by transaction size. Adding junior debt into the equation, one can usually count on an additional multiple of leverage. Considering leverage in both senior and junior forms and in all sectors of the lower middle market, the average multiple is 3.9x. Generally, the larger the business, the more a buyer can leverage.

In the upper end of the middle market—companies with more than $50M in EBITDA— there has been a resurgence in what are called "covenant-lite" loans. Covenant-lite loans are loans that have fewer covenants involved, maybe— 3 or 4 covenants rather than 6 or more. The amount of leeway extended by lenders for missing covenants has increased as well. In the past, there may have been a 15-20 percent cushion; currently the cushion can be as much as 35-40 percent.

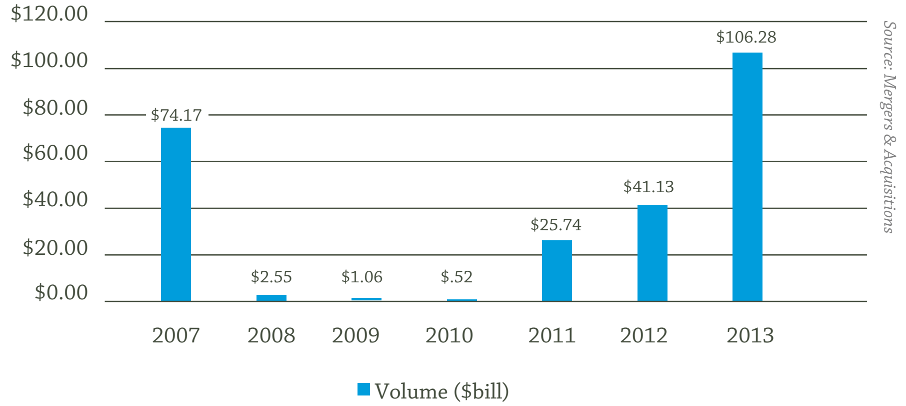
For companies with less than $50M in EBITDA, there is less risk tolerance by lenders because $10M in EBITDA is generally much more fragile than $50M in EBITDA. However, lenders are still doing more aggressive lending with looser restrictions in the lower middle-market. The graph to the right shows how lenders' appetites for covenant-lite loans are improving.

Senior Debt/EBITDA-Business Services



GENERALLY, THE LARGER THE BUSINESS, THE MORE A BUYER CAN LEVERAGE.

U.S. Covenant-Lite M&A Institutional Loan Volume ($bil)



LENDERS ARE DOING MORE AGGRESSIVE LENDING WITH LOOSER RESTRICTIONS IN THE LOWER MIDDLE-MARKET.

A Word About Rates

Senior debt spreads in Q2 2014 were LIBOR plus 4.4 percent—essentially the same as in Q1 2014 and down from the 5.1-5.4 percent range in 2013. Subordinated debt spreads were 12.0 percent for Q2 2014, also down from levels in the same period prior year.

2014 Multiples Continue to Hold Strong, But Bigger is Better

In M&A, bigger can often be better—especially in 2014. Data shows that the "size premium" for a company valued at $100M-$250M is significant. "Size premium" is the premium at which a larger company trades over a smaller one due to the increased perceived risk and reduced marketability associated with a smaller company. We are seeing larger companies hold on to their "size premiums" in 2014. Private equity acquired companies valued at $25M-$50M traded at 6.3x EBITDA in the first half of 2014, down 10% from 2013's 7x. The same 10% drop was seen for companies valued at $10M-$25M where multiples dropped from 5.9X EBITDA in 2013 to 5.3X EBITDA in 2014. Small businesses with less than $10M in transaction value are still exhibiting multiples in the 3x-5x range.

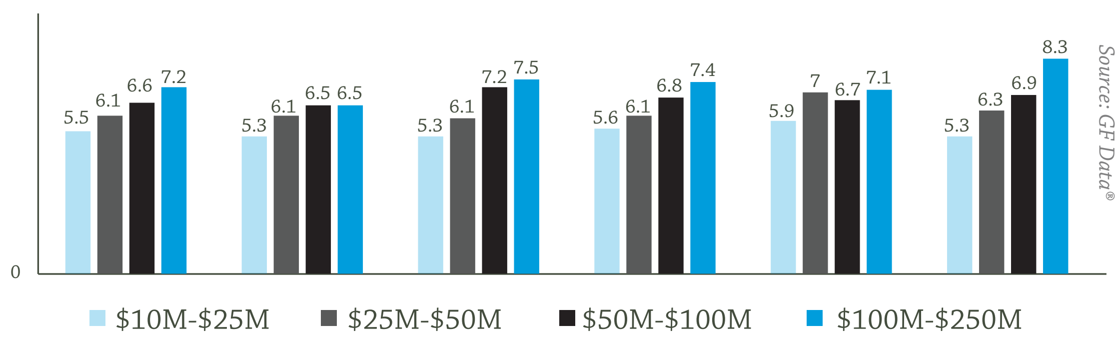
Transactions above $100M have been closing at 8.3x, on average, in 2014—significantly higher than the 7.1x multiple of 2013 and transactions in the $50M-$100m remain virtually unchanged from 2013.

This size premium can be seen in two Q2 2014 transactions in the same industry for which Pursant served as advisor and facilitator. One company was valued at $5M (4.2x EBITDA) and the other was valued at $60M (6x). While the $60M company was valued below the average market valuation range due to a variety of issues, the valuation still reflects the size premium associated with bigger companies.

Acquiring a smaller business may not make a significant impact on the financial profiles of large strategic or financial buyers. However, such acquisitions remain very attractive to the marketplace right now since deal flow for large company acquisitions is light and the multiple arbitrage of the large player makes good investment sense.

Business owners in the middle market considering a sale can still take advantage of continued favorable market conditions. Businesses that are properly prepared for sale months or years in advance can expect to capture "quality premiums" and better market values than those business that are not adequately prepped. A "quality premium" is the premium a business trades at above the typical range for that given sized business. Abundant buyers, excellent liquidity and inexpensive financing remain, while the economy continues to improve. The sun, moon and stars are aligned.

Lower Middle Market Acquisition Multiples Enterprise Value/EBITDA



For most businesses, valuation is typically expressed in the form of a multiple of EBITDA (earnings before interest, taxes, depreciation and amortization), a measurement of a company's ability to generate cash flow. EBITDA figures also serve as a barometer of the company's health and performance. Multiples of EBITDA vary greatly depending on a company's risk profile, the markets in which they operate and the likelihood of continued returns.

Pursant's Updated Perspective for 2014

GDP growth in the second quarter of 2014 realized the predicted rebound from the abysmal first quarter of 2014. After further review, the Bureau of Economic Analysis revised first quarter GDP from a 0.1 percent increase to a 2.1 percent decline, mostly due to a brutal winter and reduced asset purchases by the Fed. Q2 2014 GDP increased by 4 percent. This increase in real GDP was largely due to growing personal consumption expenditures, private inventory investments, exports, nonresidential fixed investments, state and local government spending and residential fixed investment. It is projected that GDP will finish the year with an increase of approximately 2.4%--barely ahead of the average pace of 2.2 percent growth since the recession ended.

To determine our outlook for upcoming periods, we look at forward-looking indicators, such as the economy, the job market, organic revenue growth of companies, inflation, interest rates, cash reserves and alternative opportunities for companies to get yield on their cash. All of these indicators point to continued strength in M&A activity in 2014. Strategic buyers need to continue augmenting top line growth with acquisitions, since organic growth is generally moderate. Financial buyers continue to have large amounts of available investment capital and new funds are appearing weekly. This results in both types of buyers scrambling to identify the right candidates for acquisition.

Pursant's discussions with buyers continue to reveal a strong desire for acquisitive growth. We feel that acquisitions will continue to emphasize strategic fit, synergies and the desire to acquire good people in the process. Creative deal structures will address these criteria accordingly. Buyers are demanding increasingly thorough and professionally prepared information and earlier in their review of each acquisition opportunity, including deep transactional and financial analysis.

Our clients that have been better prepared well in advance of the sale process have been rewarded with higher valuations, smoother and less intrusive pre-closing due diligence, and a quicker deal cycle to close the transaction.

Pursant helps business owners grow the value of their companies and maximize that value when they exit.

Our Investment Banking, Strategic Advisory and Executive Search business units use a deep immersion process, vast industry network and experience as owner/operators to successfully manage M&A transactions, raise capital, pursue business optimization strategies and recruit talent — vital, integrative initiatives for which our clients may not have the time, manpower or competencies.

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.

Pursant

INSPIRED PURSUIT