MERCER CAPITAL

# Middle Market Transaction Update

## First Quarter 2018

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BUSINESS VALUATION & FINANCIAL ADVISORY SERVICES

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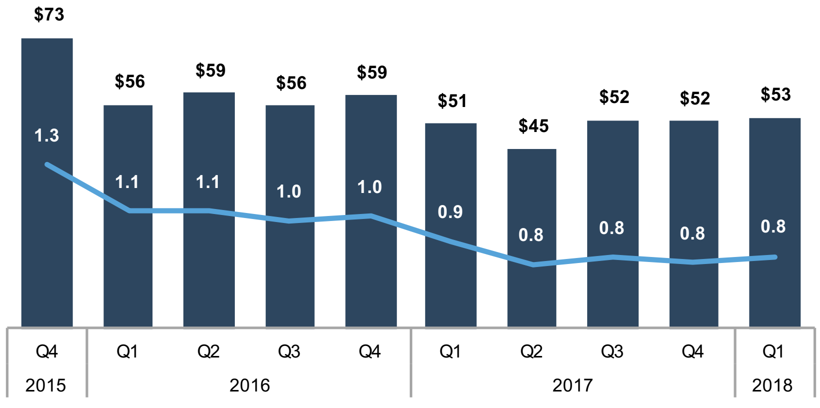
# U.S. Deal Value & Volume 4Q15 to 1Q18

Transaction volume continued at a reduced pace during 2017 – with most market commentators contributing this diminished activity to business owners "waiting" for the impact of the business-friendly tax and regulatory reforms that had been promised by the Trump Administration. Most signs pointed to strong buyer demand during 2017, for both strategic and financial buyers, as pricing multiples remained elevated during the year.

U.S. deal volume and value declined in Q1 of each of the last several years, relative to the prior Q4. This is typical as there is often a push to complete transactions prior to the year-end. Deal volume in 1Q18 remained steady and deal value actually picked up a bit on the heels of the passage of the tax reform legislation, which lowered the corporate tax rate to 21%.

Some business owners likely deferred transactional activity in 2017 (especially Q4), effectively making a bet on tax reform and other legislation being passed by the end of the year. This bet appears to have paid off – at least to date. Companies not only utilized the extra cash savings as a result of tax reform on widely publicized one-time employee compensation bonuses in 1Q18, but also put these savings toward additional investment in the business and various M&A activities. Assuming macro-economic and geo-political factors remain stable, the market should remain strong, in terms of volume and pricing, during 2018.

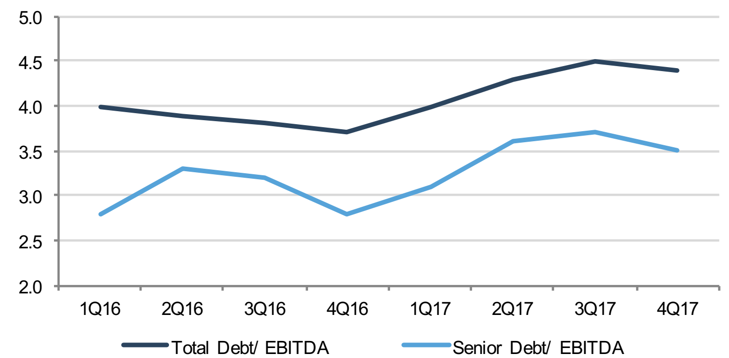



Source: Capital IQ

SPECIAL TOPIC

## Debt Multiples

As the Fed continues to signal moves towards raising interest rates, it will be interesting to watch the corresponding response of the middle market. Logic would suggest that rising interest rates will further reduce debt utilization and could, at some point, also have a negative impact on deal pricing.




Source: GF Data®

# Trends to Watch

## Baby Boomer Owners

There are approximately 76 million members of the Baby Boomers in the U.S. – roughly 25% of the total population. Over of 60% of all businesses are owned by Baby Boomers, totaling nearly 4 million companies. Baby Boomers began turning 65 in 2011, and will do so at a rate of 10,000 people per month for another 12 years or so. Business ownership does not last forever. As business owners move into retirement age, they will eventually need to transition ownership – either through intra-family or intra-company transfers or through the sale of the business to an outside party. While some business owners may hold out in the short-term waiting for the ideal time to sell, the generational shift in business ownership will win out eventually.

## Impact of Tax Cuts and Jobs Act

With the passage of the Tax Cuts and Jobs Act in December 2017 (and the apparent positive reaction to this legislation in the public markets), the stage should be set for increased M&A activity throughout 2018.

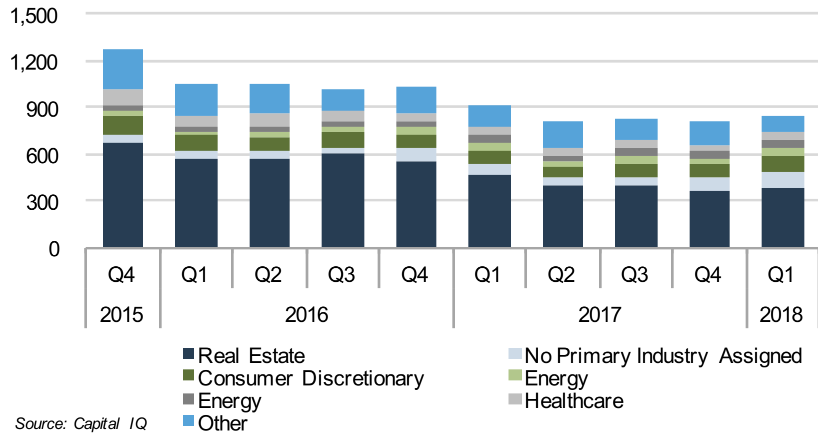
Several provisions in the tax reform legislation should impact deal activity in 2018. Among the most favorable of these is the accelerated tax benefits that can be realized under the Section 179 Deduction. Under the previous tax regime, a bonus depreciation deduction was limited to 50% of eligible, new "qualified property". Per the new tax law, "qualified property" includes tangible property with a depreciable recovery period of 20 years or less.

Under the new tax regime, the bonus depreciation deduction is extended to 100% of eligible property placed in service between September 2017 and January 1, 2023. In short, the new tax law paves the way for an immediate bonus deduction for 100% of the cost of any qualifying assets through 2022. The language of the Act is such that it allows for this deduction to apply not only to new property, but also to property acquired through acquisition, which will drive businesses to look to the middle market in efforts to reduce their tax burden and enhance cash flow through acquisitive activities. Clearly, this provision most greatly benefits asset intensive sectors, and it will be interesting to see its effects on M&A activity in these industries in the coming quarters. This part of the tax law creates an incentive for buyers to allocate as much purchase price as possible to "qualified property", which could be beneficial to sellers depending on the basis the seller has in its tangible assets.

2017 was largely marked by high valuations across all transactions sizes and a slightly higher use of debt to finance such transactions (relative to 2016). Historically low interest rates and a loosened regulatory environment continued to induce a heavy use of debt financing in 2017, though overall debt utilization has declined from the peaks of 2012-2014.

## U.S. Deal Volume by Industry

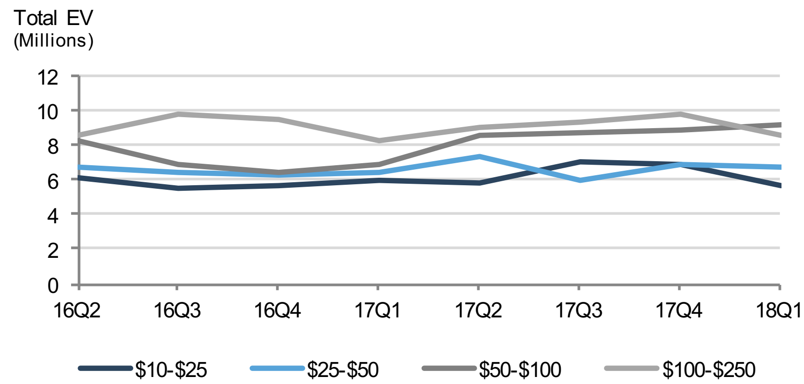
4Q15 to 1Q18




Source: Capital IQ

## TEV/EBITDA Multiples

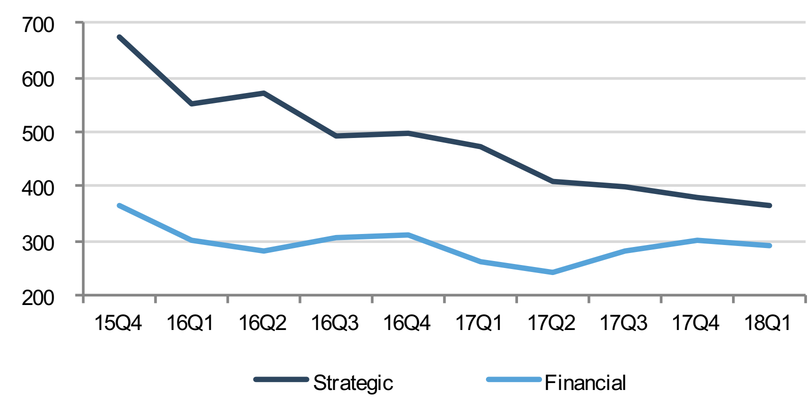
Financial Buyers | 2Q16 to 1Q18




Source: GF Data®

## Number of Deals by Buyer Type

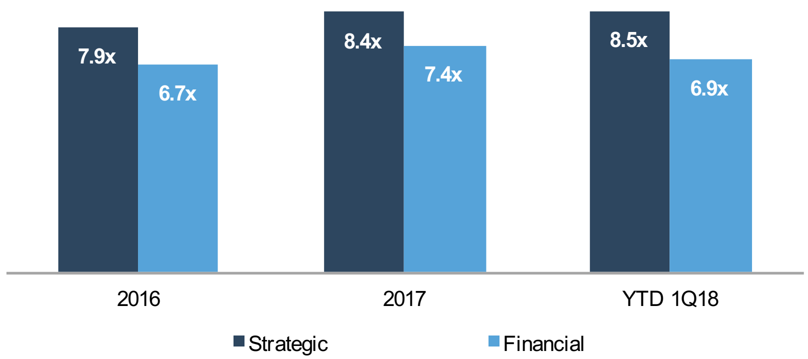
4Q15 to 1Q18




Source: Capital IQ

## EBITDA Multiples by Buyer Type

1Q16 to 1Q18




Source: Capital IQ (strategic) and GF Data (financial)
Strategic multiples exclude outliers (defined as EBITDA multiple > 15x)

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# Transaction Advisory Services

**In addition to our corporate valuation services, Mercer Capital provides investment banking and transaction advisory services to a broad range of public and private companies and financial institutions.**

Mercer Capital has been successfully executing mergers & acquisitions for a broad spectrum of middle-market companies since the mid-1980s.

We specialize in providing merger & acquisition services to sellers or buyers of private businesses or public companies divesting divisions and subsidiaries. In addition, Mercer Capital assists clients in industry consolidations, roll-ups, and refinancings.

Mercer Capital leverages its historical valuation and investment banking experience to help clients navigate a critical transaction, providing timely, accurate and reliable results. We have significant experience advising boards of directors, management, trustees, and other fiduciaries of middle-market public and private companies in a wide range of industries. Our independent advice withstands scrutiny from shareholders, bondholders, the SEC, IRS, and other interested parties to a transaction, and we are well-versed in the new industry standards.

The professionals of Mercer Capital guide you through the uncharted waters of selling your business, acquiring another business or division, mergers, valuations, fairness opinions, and other transaction advisory needs. Rely on the experience, independence, and analytical and transaction know-how of Mercer Capital.

## Transaction Advisory Services

- M&A Representation
- ESOP Installation, Termination, and Transactions
- Squeeze-Out Transactions
- Fairness Opinions
- Minority Shareholder Stock Repurchases
- Corporate or Partnership Recapitalizations

## Advantages We Offer

- Maximize Net Proceeds
- Negotiate the Best Possible Terms
- Speed Up the Deal Process
- Ensure Transaction Closure
- Help Ensure Confidentiality
- Minimize Burden on the Ownership


**Nicholas J. Heinz, ASA**
heinzn@mercercapital.com

**Timothy R. Lee, ASA**
leet@mercercapital.com

**Jeff K. Davis, CFA**
jeffdavis@mercercapital.com

**Matthew R. Crow, ASA, CFA**
crowm@mercercapital.com

**Travis W. Harms, CFA, CPA/ABV**
harmst@mercercapital.com

**Bryce Erickson, ASA, MRICS**
ericksonb@mercercapital.com