MERCER CAPITAL

Middle Market Transaction Update

Second Half 2020

In This Issue

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BUSINESS VALUATION & FINANCIAL ADVISORY SERVICES

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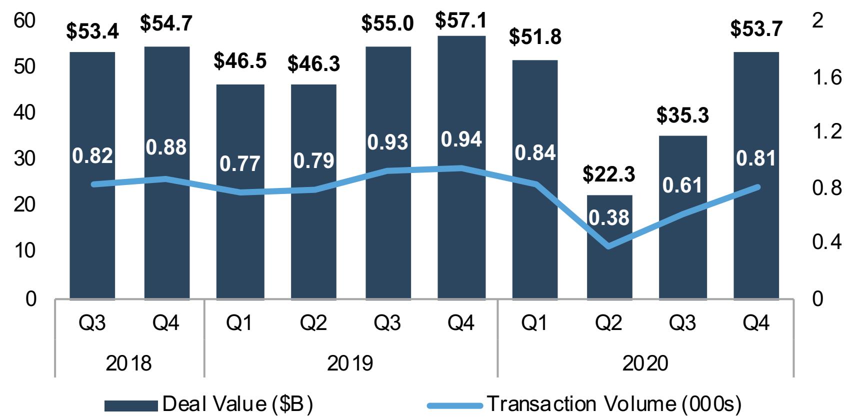
Introduction

As described in the following pages and charts, U.S. M&A activity slowly rebounded in the third quarter of 2020 from the pandemic-shocked levels seen in the second quarter and reached pre-pandemic levels of activity in the fourth quarter. In the second half of 2020, reported TEV/EBITDA multiples on private equity transactions across all tranches of enterprise value remained fairly consistent with observed multiples in the first half of the year. Multiples in the middle two tranches did increase during the fourth quarter, which is likely a result of increased buyer demand towards the end of the year. Overall, multiples for both strategic and private equity deals were down slightly from levels observed in 2019, and overall activity in 2020 was still considerably below levels observed in 2019 given the economic impact of the pandemic on both acquirers and target companies. Levels of activity observed in the second half of 2020 suggest that buyer and seller appetite for transactions is beginning to return.

U.S. Deal Value & Volume

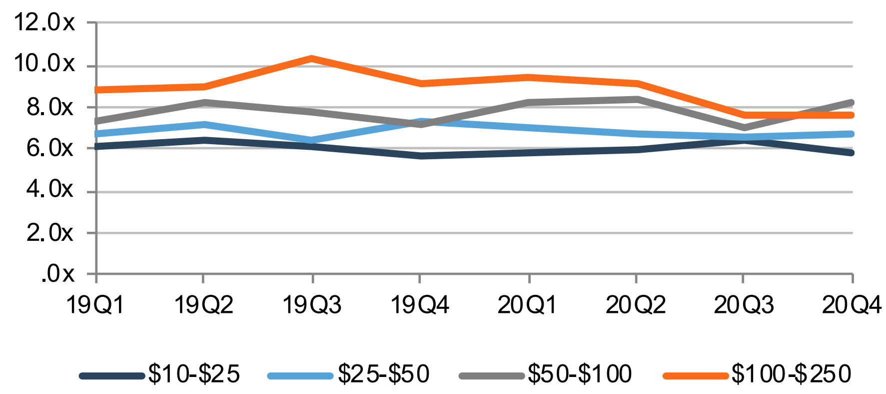
Q3-2018 to Q4-2020



Source: Capital IQ

TEV/EBITDA Multiples

Financial Buyers | Q3-2018 to Q4-2020



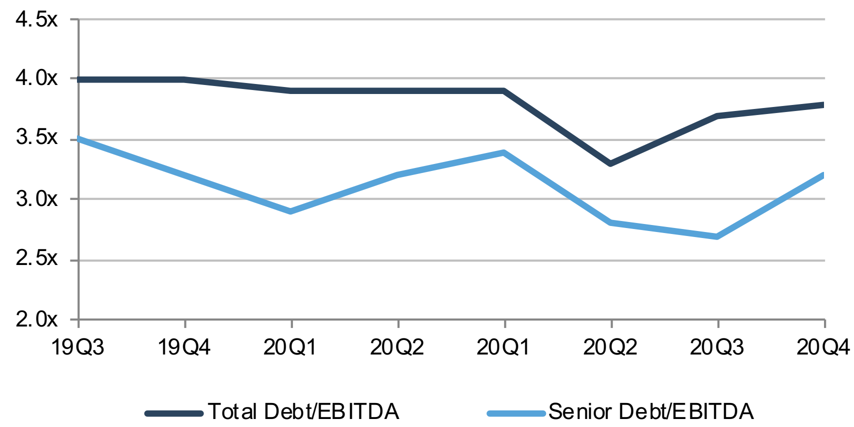
Source: GF Data®

Debt Multiples

Debt multiples among private equity buyers trended upwards in the fourth quarter of 2020, nearing pre-pandemic levels in terms of both total debt and senior debt to EBITDA. Still, deals that reported debt utilization in 2020 dropped to 81% in the fourth quarter of 2020, down from a range of 85% to 90% in 2019 and the first half of 2020. The increase in the senior debt multiples in the fourth quarter can be viewed as a sign that commercial banks are beginning to finance deals again exclusively with senior debt, a trend that came to light in 2019 and was overturned in the early uncertain stages of the pandemic.

Debt Multiples

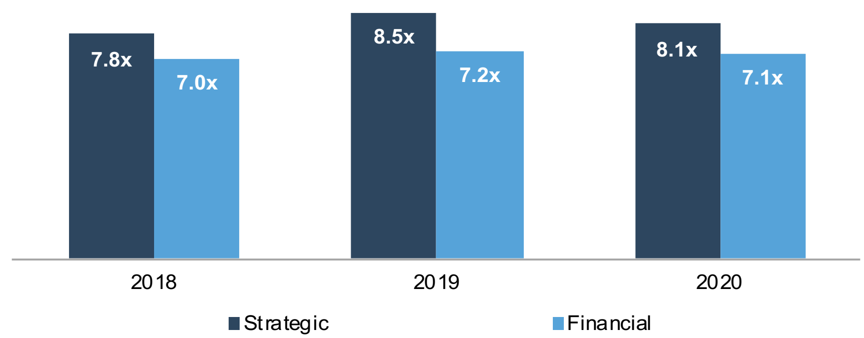
Financial Buyers | Through 4Q-2020



Source: GF Data®

EBITDA Multiples by Buyer Type

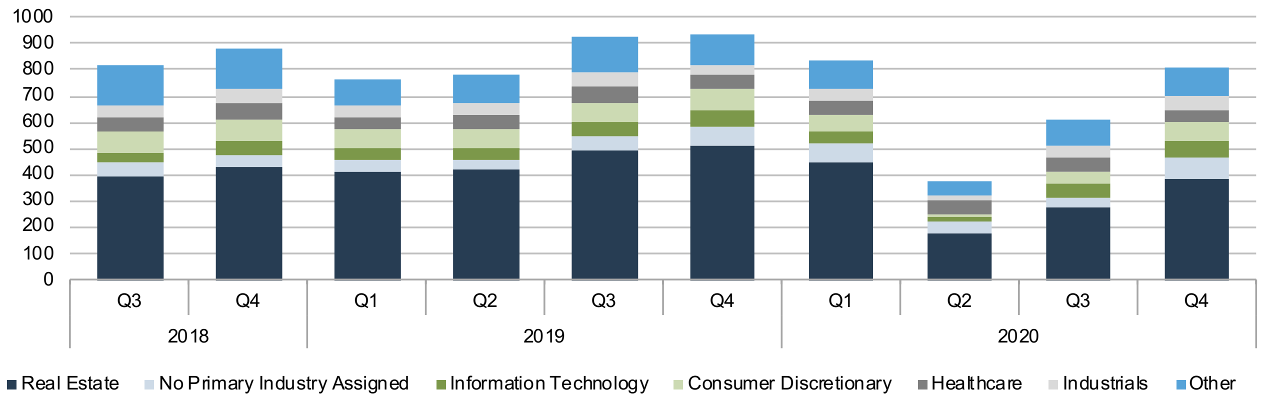
2018 to 2020



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

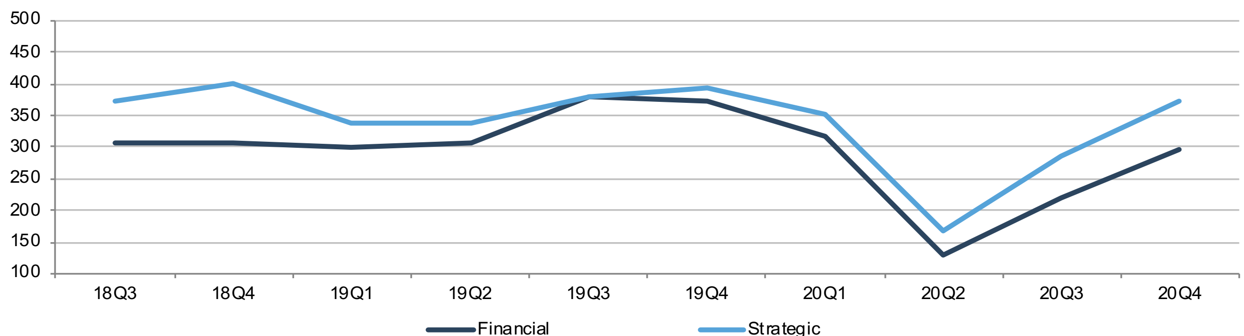
U.S. Deal Volume by Industry

Q3-2018 to Q4-2020



Number of Deals by Buyer Type

Q3-2018 to Q4-2020



Source: Capital IQ

Bankruptcy and Restructuring Advisory Services

Mercer Capital has performed in-depth financial analyses for clients pursuing bankruptcy reorganization in order to explore strategic alternatives and to inform negotiations with various stakeholders. We have considerable experience in providing clients with reliable, relevant and reasonable valuations of businesses and intangible assets, including within the context of financial statements reporting requirements.

- Financial advisory & consulting
- Business valuation
- Fresh-start accounting
- Fairness opinions
- Solvency Opinions

MORE INFORMATION

Summary

The flurry of activity in the second half of the year, particularly the fourth quarter, can be attributed to several factors. First, several COVID-19 vaccines received emergency-use approval in the U.S. in the fourth quarter, which investors and other market participants viewed as a light at the end of the tunnel as it pertains to the economic and societal effects of the pandemic. This positive development eased economic uncertainty in the U.S., and middle markets were the beneficiaries of pent-up demand from acquirers and sellers looking to commence transactions. Political uncertainty in the U.S. was also resolved in the fourth quarter of 2020 with the election of President Biden. Investors reacted favorably to a relatively smooth election process, and this positive sentiment trickled into the middle market, as buyers and sellers could now look to 2021 and beyond with clearer prospects in terms of upcoming fiscal and monetary policy and legislation. Also aiding the increase in transaction activity in the fourth quarter was the fact that many business models were validated as being structurally sound during the tumultuous second and third quarters of the year. Potential sellers that continued to demonstrate favorable revenue and profitability trends in the second and third quarters were rewarded in the fourth quarter by a return in demand by potential buyers. This trend, and those previously discussed, bears itself out in the upticks in deal value and volume seen in the chart on page 3.

In November of 2020, Joe Biden was elected President of the United States. The tax plan Mr. Biden proposed during his campaign has consequences for both potential buyers and potential sellers in the middle market. Mr. Biden has proposed increases to corporate and individual capital gains tax rates from their current levels and an elimination of the step-up in basis for estates, which currently allows for the minimization of future capital gains through adjusting the tax basis to the fair market value at the date of death. Both of these proposals will affect would-be sellers in the middle market. Further, a proposed reversal of the Tax Cut and Jobs Act of 2017 would eliminate companies' ability to immediately expense capital expenditures, potentially affecting would-be buyers in asset deals. According to a survey of U.S. executives conducted by EY, 79% of respondents expected an increase in M&A activity in the U.S. in response to the proposed tax code changes. This anticipated increase in transaction activity will certainly impact the middle market, as buyers and sellers look to beat the clock and take advantage of transacting in a lower tax environment. If passed, the increased capital gains tax rate in particular will heavily incentivize would-be sellers to accelerate transactions to a close before the changes take effect. At the writing of this update, the Biden administration is targeting late 2021 as a time frame to send a bill for passage to Congress. Any proposed tax legislation would certainly be met by fierce opposition from Republicans, but with Democrats in control of both chambers of Congress, passage is nearly guaranteed. We anticipate an increase in transactional activity in the middle market in anticipation of these changes, but the timing of this increase will likely depend on the passage of the bill and the schedule of when any proposed changes take effect. Sellers looking to pre-emptively take advantage of the current lower tax environment would be advised to begin investigating transaction opportunities sooner rather than later in order to avoid any potential adverse tax outcomes resulting from a delayed transaction.

In conclusion, we expect transaction activity in the middle market to continue to build on its strong end to 2020, as the factors noted that led to the rebound in activity will continue to proliferate into 2021 and business earnings continue to "normalize" following the shock of the pandemic. With the consequences of the proposed Biden tax plan in mind, transactional activity in 2021 and 2022 in terms of deal value and volume should continue to increase, as buyers and sellers look to take advantage of the current tax environment before it is altered.

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 transaction know-how of Mercer Capital.

Transaction Advisory Services

- M&A Representation
- ESOP Installation, Termination, and Transactions
- Squeeze-Out Transactions
- Fairness and Solvency 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

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