

MERCER CAPITAL

Middle Market Transaction Update

Fall 2022

In This Issue

U.S. Deal Value & Volume

EBITDA Multiples

EBITDA Multiples by Buyer Type

Debt Multiples

U.S. Deal Volume by Industry

Number of Deals by Buyer Type

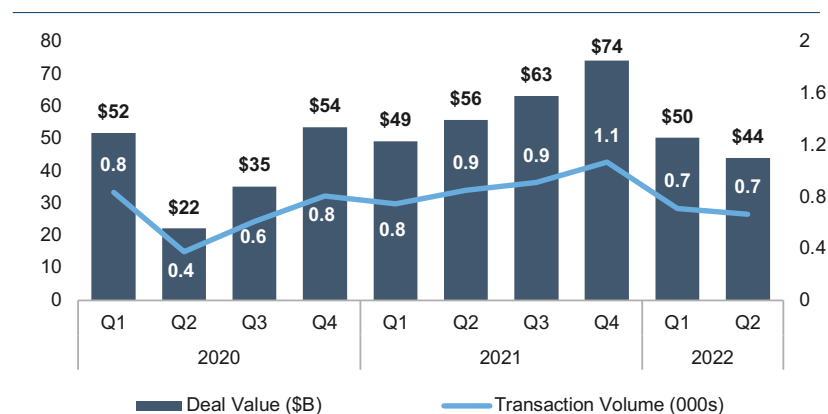
Introduction

As seen in the chart to the right, overall deal activity in the second quarter of 2022 fell from levels seen in the first quarter of the year and the second quarter of 2021. In aggregate, deal activity in the first half of 2022 also fell from aggregate deal activity in the first half of 2021. Despite the decline in U.S. deal value and volume, multiples on deals completed in the first half of the year remained in line with levels observed in 2020 and 2021, suggesting a potential “flight to quality” of sorts in the middle market in the first half of the year. We’ll discuss that and more in this edition of *Mercer Capital’s Middle Market Transaction Update*.

Broader economic conditions in the U.S. negatively influenced deal value and volume in the first half of 2022 but did not totally stifle overall deal activity. In the second quarter of 2022, U.S. GDP declined for the second straight quarter and annual and monthly inflation measures continued to hit record levels. In response to the rampant inflation in the U.S. economy, the Fed executed two sizable rate increases in the second quarter, including enacting the largest rate increase since 1994 at its June meeting. While the U.S. economy has not yet officially fallen into a recession (despite the two straight quarters of decline in GDP), most Fed watchers agree that Jay Powell and the FOMC won’t relent in their fight to bring down inflation even if it does cause a recession. In short, the Fed appears to be willing to take a cool down in inflation in exchange for a weaker short-term outlook in terms of GDP and overall economic growth.

U.S. Deal Value & Volume

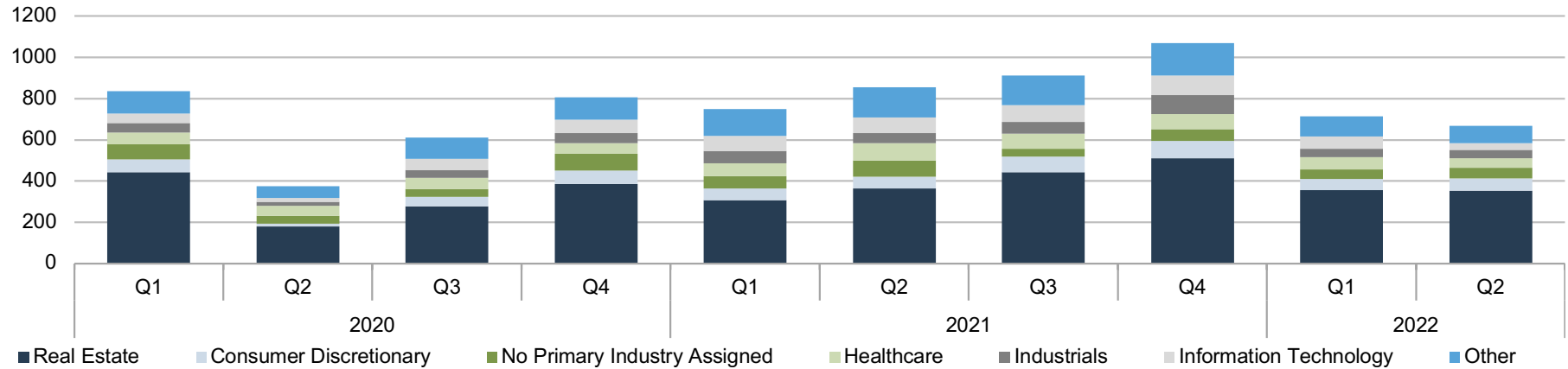
Q1-2020 to Q2-2022



Source: Capital IQ

U.S. Deal Volume by Industry

Q1-2020 to Q2-2022



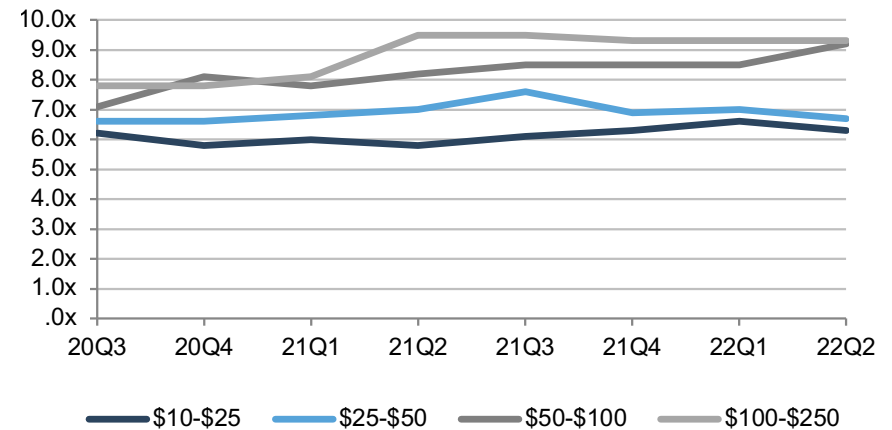
Source: Capital IQ

TEV/EBITDA Multiples

Despite these challenging macroeconomic conditions, deal activity did not come to the screeching halt in the first half of 2022 that was seen in the middle of 2020. We believe this is a good sign for the overall health of the middle market, particularly when coupled with the fact that multiples on PE deals were relatively unchanged in the second quarter as seen in the chart on the right. The prolonged “sellers’ market” of the past several years appears to be holding up to this point in 2022, as buyers continue to be willing to pay elevated multiples for well-positioned businesses. Deals in the \$50-\$100 million tranche of the middle market actually realized multiple expansion in the second quarter, growing from an average multiple of 8.5x to 9.2x. Multiples in other tranches were either unchanged or slightly down.

TEV/EBITDA Multiples

Financial Buyers | Last 8 Quarters



Source: GF Data®

Debt Multiples

Debt multiples on PE deals fell in the second quarter of 2022. The drop in debt utilization in deal activity is likely a sign that rising interest rates are beginning to weigh on deal activity and financing terms. Rising interest rates equate to an increased cost of borrowing and overall cost of capital for businesses, which in turn increases the discount rates used in buyers' valuations of potential targets. While elevated discount rates in theory should lead to valuations (and hence multiples) coming down from levels seen over the past several years, corporate balance sheets and PE firms still appear to be flush with cash. We believe that there is still a great deal of readily deployable capital on the sidelines that should continue to support elevated multiples and valuations in the middle market for the foreseeable future.

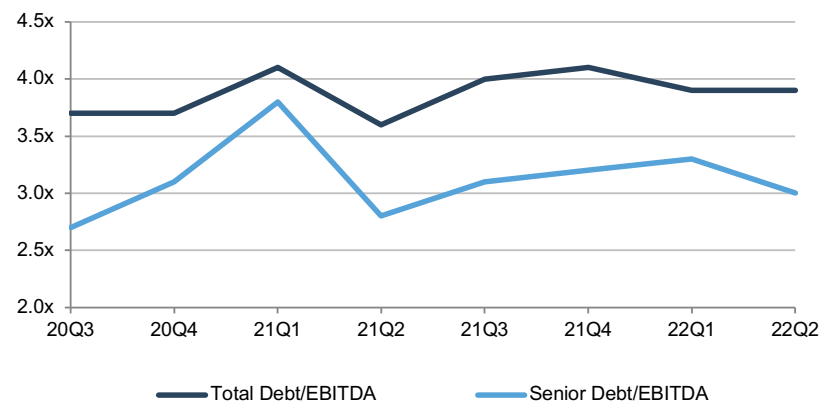
Check Out This Video!



What do you do if your business is approached by a potential acquirer? In this video, Nick Heinz presents four broad steps you should undertake to determine if the potential acquisition makes sense.

Debt Multiples

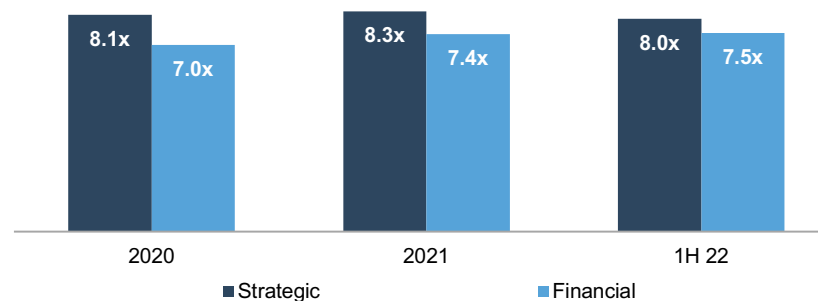
Financial Buyers | Through Q2-2022



Source: GF Data®

EBITDA Multiples by Buyer Type

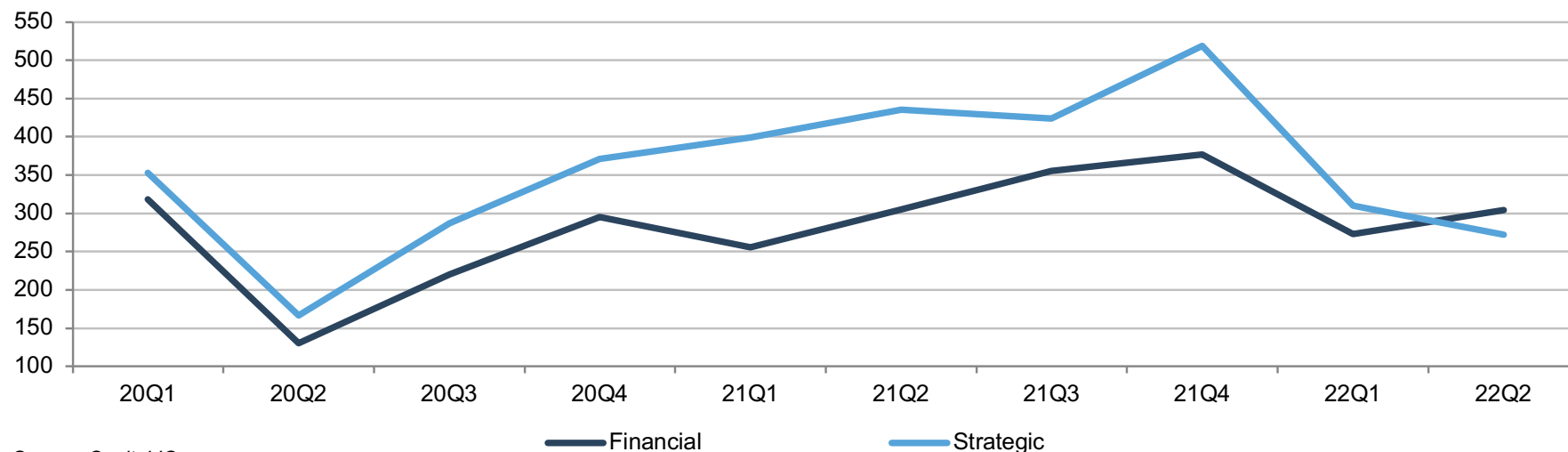
2020 to 1H 2022



Source: Capital IQ (strategic) and GF Data (financial)
Strategic multiples exclude outliers (defined as EBITDA multiple > 18x)

Number of Deals by Buyer Type

Q1-2020 to Q2-2022



Conclusion

While deal volume was down in the second quarter of 2022 (and in the first half of the year in general), activity did not stop despite a challenging economic environment in the U.S. and geopolitical strife abroad. In our opinion, there has been a “flight to quality” of sorts in the middle market, which has supported valuations and multiples in spite of reduced deal volume. This has created heavy competition among strategic and financial buyers for well-positioned businesses coming to market and, in the process, has helped maintain the elevated multiples and deal values seen in the middle market over the past year or so.

While observed multiples remain elevated, owners looking to transact their business would be advised to begin the process sooner rather than later given the prospects of further interest rate hikes, continued volatility in the public markets, ongoing geopolitical tensions, and the upcoming midterm elections. While the state of the middle market remained relatively placid in the first half of 2022, these and other factors could hamper deal activity in the coming quarters and years.

Thinking About Acquiring?

Before you do, check out our recent series on
Buy-Side Considerations

- 1 Identifying Acquisition Targets and Assessing Strategic Fit
- 2 How to Approach a Target and Perform Initial Due Diligence
- 3 Strategic Premiums: Can 2+2 Equal 5?
- 4 Considerations in Merger Transactions
- 5 The Importance of a Quality of Earnings Study
- 6 Negotiating Working Capital Targets in a Transaction
- 7 Considering Contingent Consideration
- 8 Buy-Side Fairness Opinions: Fair Today, Foul Tomorrow?
- 9 Buy-Side Solvency Opinions
- 10 The Importance of Purchase Price Allocations to Acquirers

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Advantages We Offer

- Maximize Net Proceeds
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- Help Ensure Confidentiality
- Minimize Burden on the Ownership



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