

MERCER CAPITAL

Middle Market Transaction Update

Summer 2023

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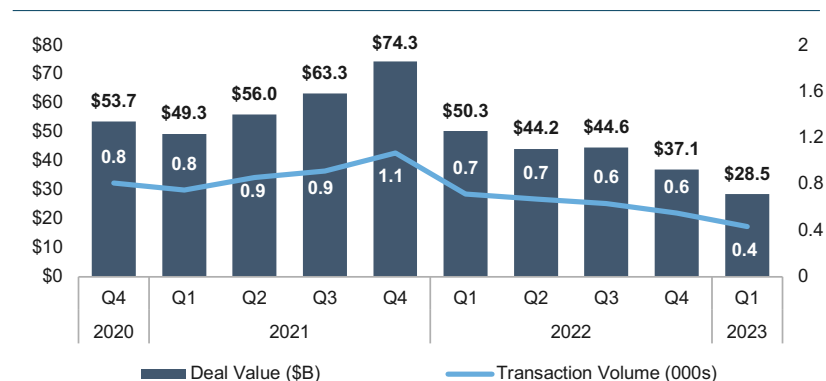
Summer 2023 M&A Update

Middle market transaction activity, as measured by both deal value and deal volume, fell again in the first quarter of 2023. This was to be expected on two fronts. First, we typically observe a decline in transaction activity in the first quarter of any given year from the fourth quarter of the preceding year given the desire of buyers and sellers to get deals done before year end. While this seasonal effect may have contributed to the decline in activity in the first quarter of 2023, tighter financial conditions took a much more exacting toll on transaction activity in the middle market, which should come as no surprise to keen observers. We'll walk through the how and why of these effects and more in this quarter's *Middle Market Transaction Update*.

Deal multiples held steady for much of 2022 before falling across all size tranches in the fourth quarter of 2022. While deal activity as reported by GF Data® was down in the first quarter of 2023 (70 reported PE deals compared to 92 in the first quarter of 2022), multiples rebounded from their fall in the final quarter of 2022. Deals in the \$100-\$250 million total enterprise value tranche realized increased from 7.5x EBITDA in Q4 2022 to 10.0x in Q1 2023. We believe this expansion in multiples, along with the drops in value and volume as seen in the charts on the right, speaks to the quality of deals that are still being closed in spite of tumultuous economic conditions. Strong companies with favorable growth prospects coming to market have continued to command high multiples in the middle market. The data also implies that deals made in the calmer macro conditions of 2021 and early 2022 either are not coming to market or are falling apart before closing. It is also possible that favored industries that are shielded against economic headwinds are showing up in the elevated multiples of the first quarter of 2023 more so than those that have been heavily impacted by the dynamic macroeconomic environment.

U.S. Deal Value & Volume

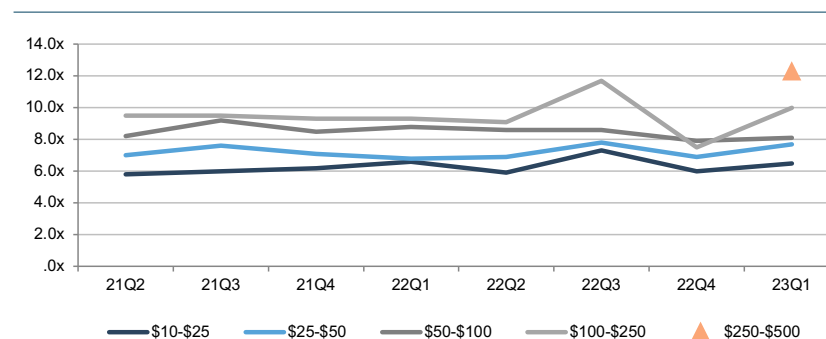
Q4-2020 to Q1-2023



Source: Capital IQ

TEV/EBITDA Multiples

Financial Buyers | Last 8 Quarters

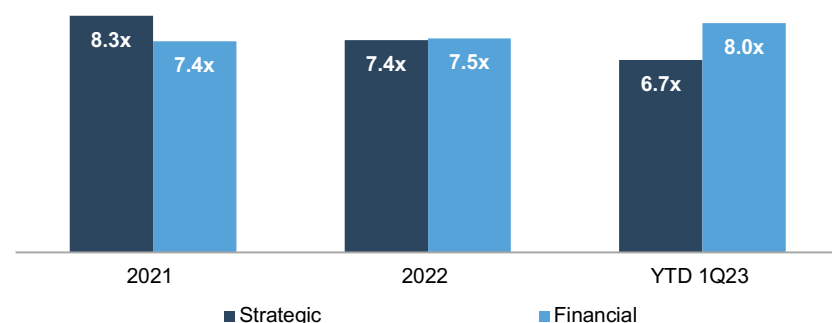


Source: GF Data®

Macroeconomic headwinds continued to stifle deal activity throughout the middle market in the first quarter. High inflation remained persistent throughout all sectors of the economy, causing the Federal Reserve to continue to fight inflation with interest rate increases. At this writing, the Fed Funds Rate was in a range of 5.00% to 5.25%, up from a range of 0.75% to 1.00% a year ago. Higher interest rates have certainly weighed on deal activity, as traditional financing has become more expensive and difficult to obtain relative to the pre-2022 zero-interest rate environment. As credit standards become more stringent, companies coming to market that could be considered lower quality assets than companies with stronger cash flows, growth prospects, and balance sheets are likely to come under stricter scrutiny from lenders, possibly stopping deals dead in their tracks. Therefore, it is crucial that all borrowers in the current market should document business contingency plans that detail to lenders how the company will respond to higher interest rates, lower margins, and other consequences of the tumultuous macroeconomic environment.

EBITDA Multiples by Buyer Type

2020 to 1Q 2023



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

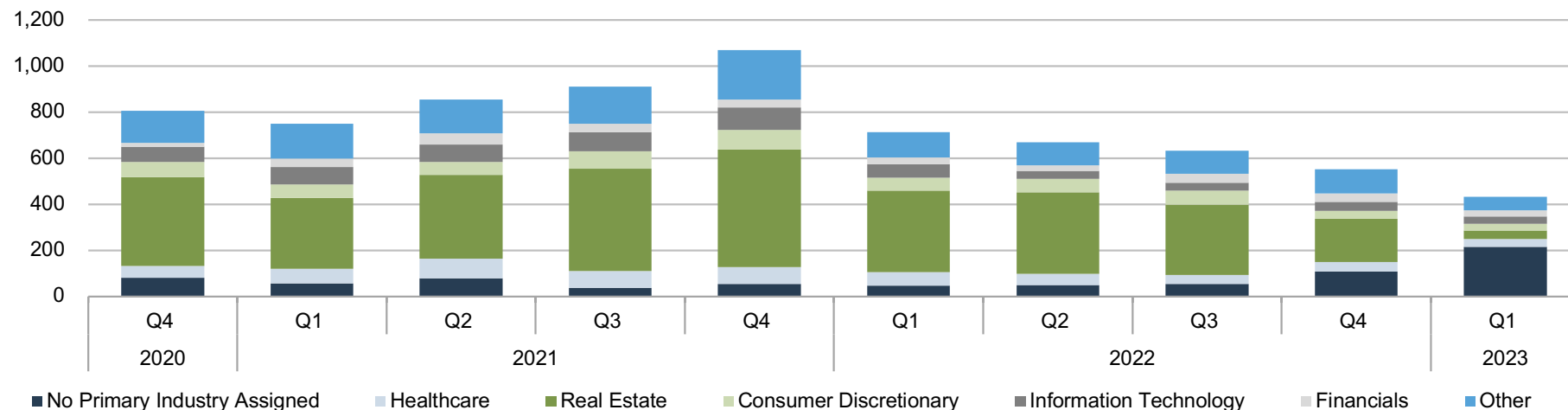
An unintended consequence of the Fed's interest rate hikes, that materialized in the first quarter of 2023, were the failures of Silicon Valley Bank and Signature Bank of New York. While both of these banks did not properly manage their exposures to rapidly increasing rates, the perceived greater risk of the banking system at large caused a shift in deposits from small and mid-size regional banks to larger banks. This shift has reduced the base against which regional banks can make loans, further exacerbating the difficulties that may arise in financing a deal. Lending practices among smaller regional financial institutions have become even more conservative, which could possibly lead to further downturns in deal activity through the balance of 2023.

Despite these adverse market forces, there's still reason for optimism if you're looking to sell your business in the current environment. While the "seller's market" that we've written about for much of the past several years has run its course, we believe that strong, well-prepared companies coming to market can benefit from a flight to quality of sorts in the middle market. This bears itself out in the expansion in PE-backed deal multiples seen in the first quarter. We expect the scarcity of quality prospects in the middle market to continue to support multiples through the balance of 2023.

To gain the attention of financial and strategic buyers in the current market, preparation for the transaction process will become even more important than usual for potential sellers. Well-crafted offering materials, clean historical financial statements, and a deep understanding of key value drivers will take on an even greater importance in the current market. Sellers should also be prepared for more strenuous and lengthier diligence processes. That to say, now is not the time for business owners to attempt to go it alone in a transaction process. Mercer Capital has a deep bench of seasoned transaction professionals with experience in all different types of market environments. If you're a business owner contemplating a transaction on the buy side or on the sell side, feel free to reach out to discuss your needs in confidence.

U.S. Deal Volume by Industry

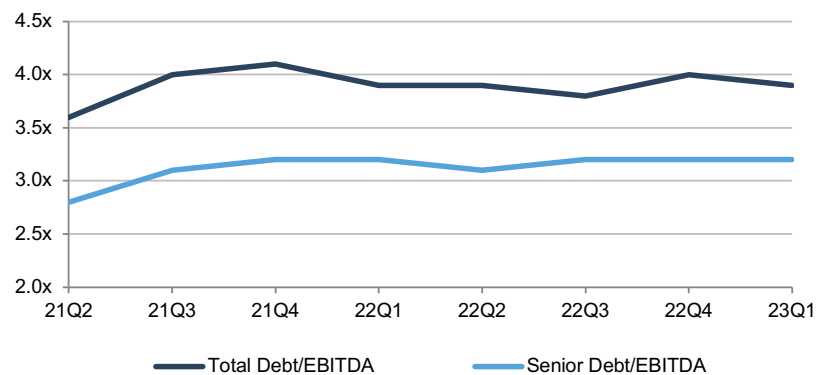
Q4-2020 to Q1-2023



Source: Capital IQ

Debt Multiples

Financial Buyers | Through Q1-2023



Source: GF Data®

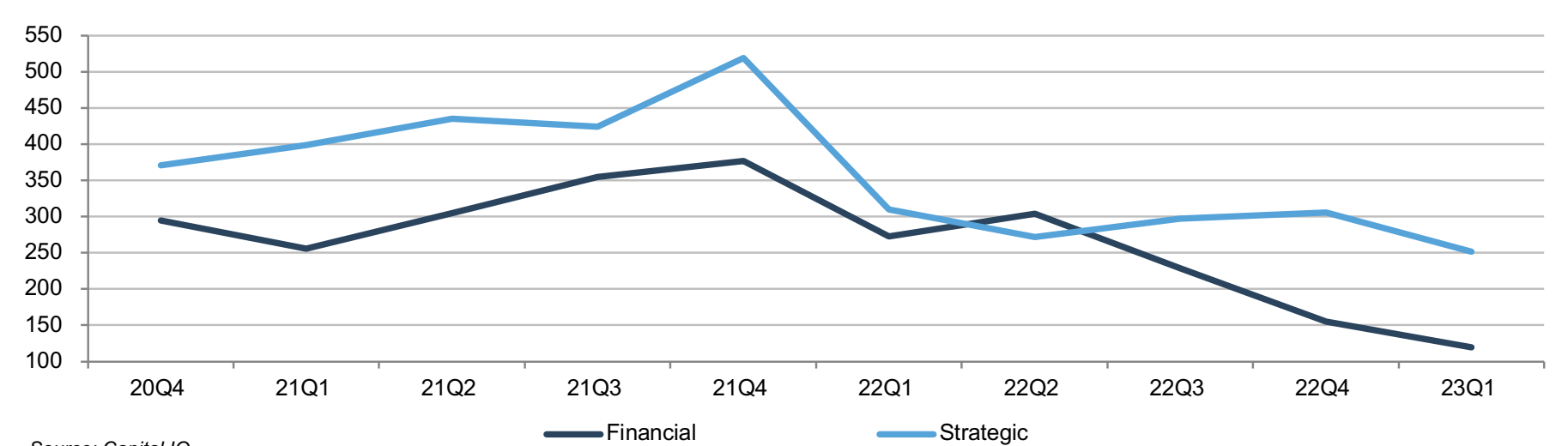
Check Out This Video!



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.

Number of Deals by Buyer Type

Q4-2020 to Q1-2023



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

For more information, visit www.mercercapital.com

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
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- Squeeze-Out Transactions
- Fairness and Solvency Opinions
- Minority Shareholder Stock Repurchases
- Corporate or Partnership Recapitalizations



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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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