

MERCER CAPITAL

# Middle Market Transaction Update

Winter 2022

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BUSINESS VALUATION &  
FINANCIAL ADVISORY SERVICES

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# Introduction

Overall deal activity at \$45 billion in the third quarter of 2022 was roughly unchanged from the second quarter but down sharply from \$63 billion in the third quarter of 2021. In aggregate, deal activity through the first three quarters of 2022 was down significantly from deal activity in the first three quarters of 2021 as Fed actions to tighten monetary conditions this year have substantially raised the cost of capital and reduced the ability of firms to access the capital markets

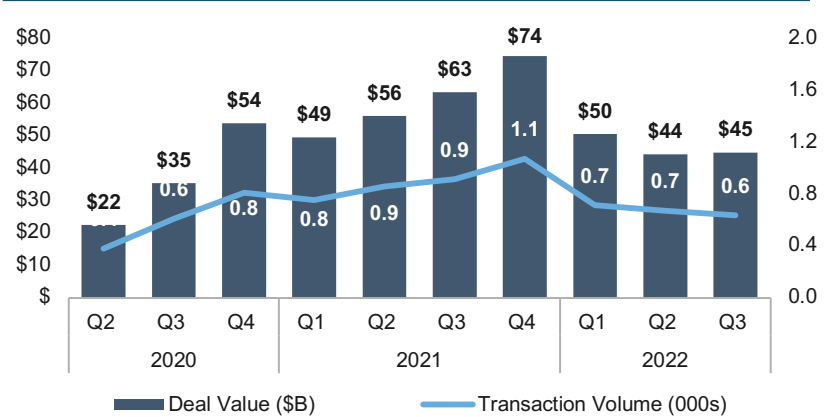
Somewhat surprisingly multiples paid by both strategic and financial buyers held their ground and even increased in some size tranches as tightening financial conditions have not yet produced lower valuations as seen in the public markets. We'll discuss this pricing resiliency and more in this edition of Mercer Capital's *Middle Market Transaction Update*.

Middle market deal activity in the third quarter of 2022 continued against the backdrop of ongoing inflation, rising interest rates, and other deteriorating macroeconomic factors in the U.S. economy. While overall U.S. GDP increased 2.6% in the third quarter, the CPI increased 8.2% year-over-year for the twelve-month period ended September 2022, major equity indices fell approximately 5%-7%, and the Fed raised rates by 0.75% at both its July and September meetings. With the Fed expected to continue raising rates until it deems inflation to be under control, many economists believe the U.S. economy will enter into a recession in 2023 of unknown magnitude and duration.

As a result, deal makers enter 2023 with a greater than normal amount of uncertainty given elevated borrowing costs, less certainty about the ability to access external financing, a slowing economy and weaker acquisition currencies for publicly traded strategic buyers given a 19% reduction in the S&P 500 and a 27% decline in the Russell 2000 during 2022.

## U.S. Deal Value & Volume

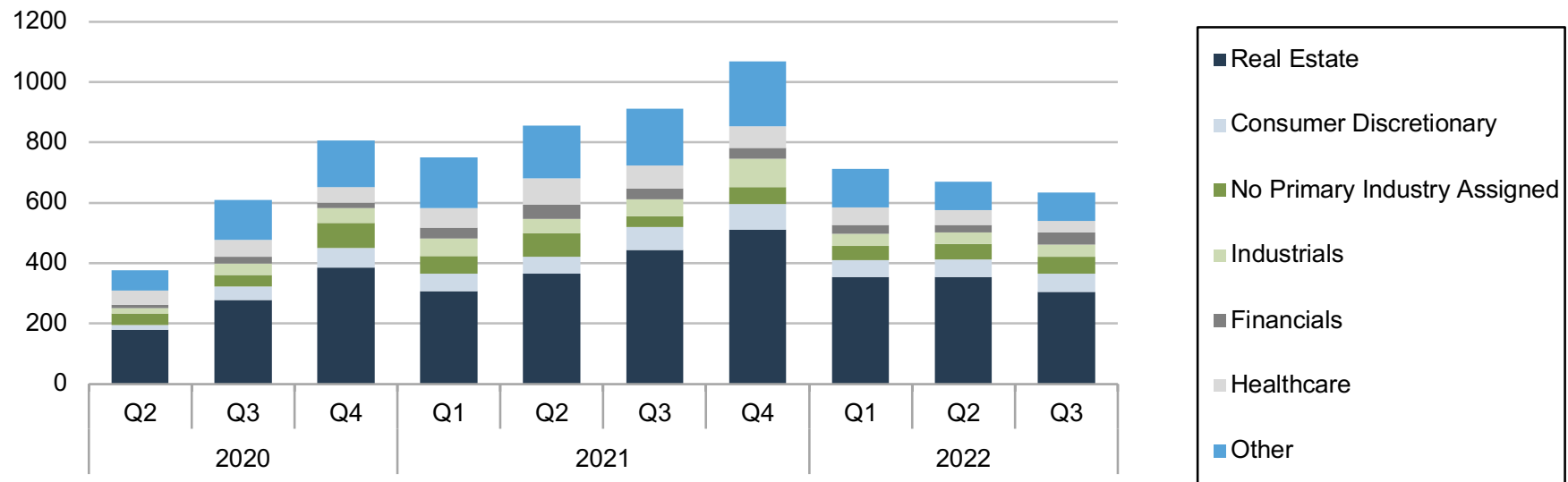
Q2-2020 to Q3-2022



Source: Capital IQ

## U.S. Deal Volume by Industry

Q2-2020 to Q3-2022



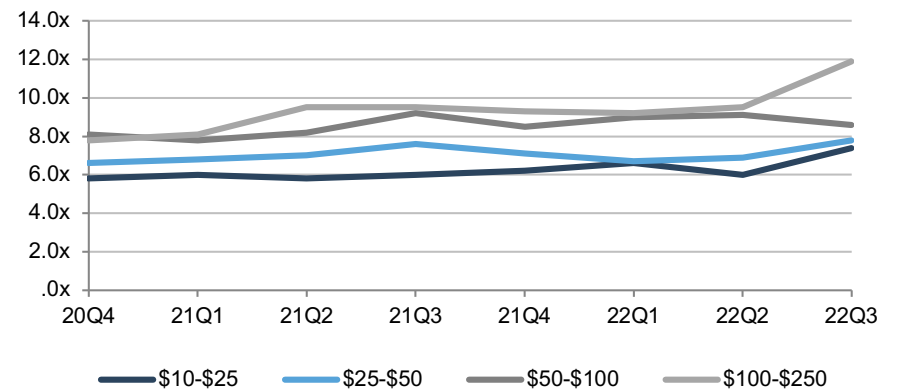
Source: Capital IQ

## TEV/EBITDA Multiples

While the overall economic picture was darkening during the third quarter, deal activity has carried on, albeit at lower levels relative to 2021's record-breaking middle market deal activity. Persistence in deal activity in the middle market demonstrates that despite turbulent economic conditions, there are still quality businesses coming to market and buyers are willing to pay reasonable values for these businesses. The chart on the right is further evidence of this continued persistence, as multiples in PE deals across all size tranches ticked up from 7.4x in the second quarter of 2022 to 8.1x in the third quarter. Segmented by size, multiples rose in every tranche besides the \$50 - \$100 million range, which only fell slightly.

## TEV/EBITDA Multiples

Financial Buyers | Last 8 Quarters



Source: GF Data®

# Debt Multiples

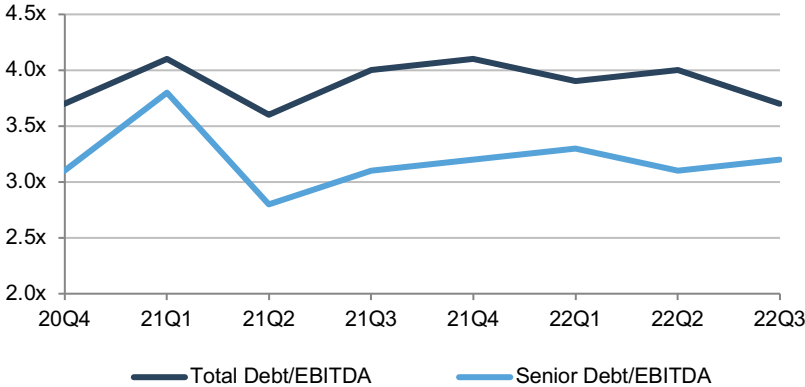
Total debt multiples on PE deals fell again in the third quarter of 2022. The drop in debt utilization in deal activity is likely a sign that rising interest rates are continuing to weigh on deal activity and financing terms. Rising interest rates equate to an increased cost of borrowing and overall 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 lower valuations (i.e., multiple contraction as seen in the public markets), heavy competition for quality companies combined with plentiful liquidity embedded within corporate balance sheets and PE firms has supported deal valuations and multiples to this point in 2022.

That may change in 2023 as the impact of rising rates and presumably declining levels of liquidity (or LP liquidity for PE buyers) should be fully reflected in current deal negotiations compared to those that were negotiated in the first half of 2022 and closed during the third quarter.

# Debt Multiples

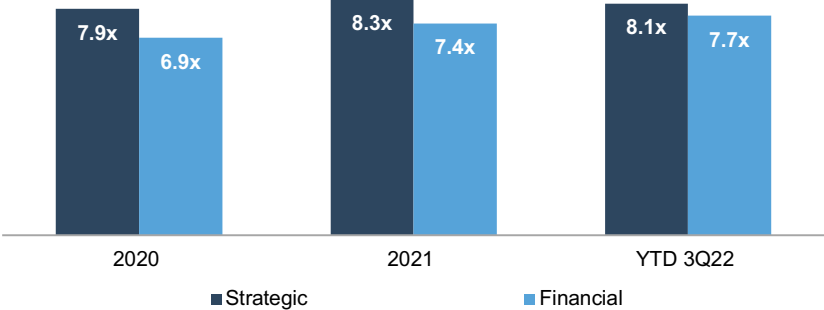
Financial Buyers | Through Q3-2022



Source: GF Data®

# EBITDA Multiples by Buyer Type

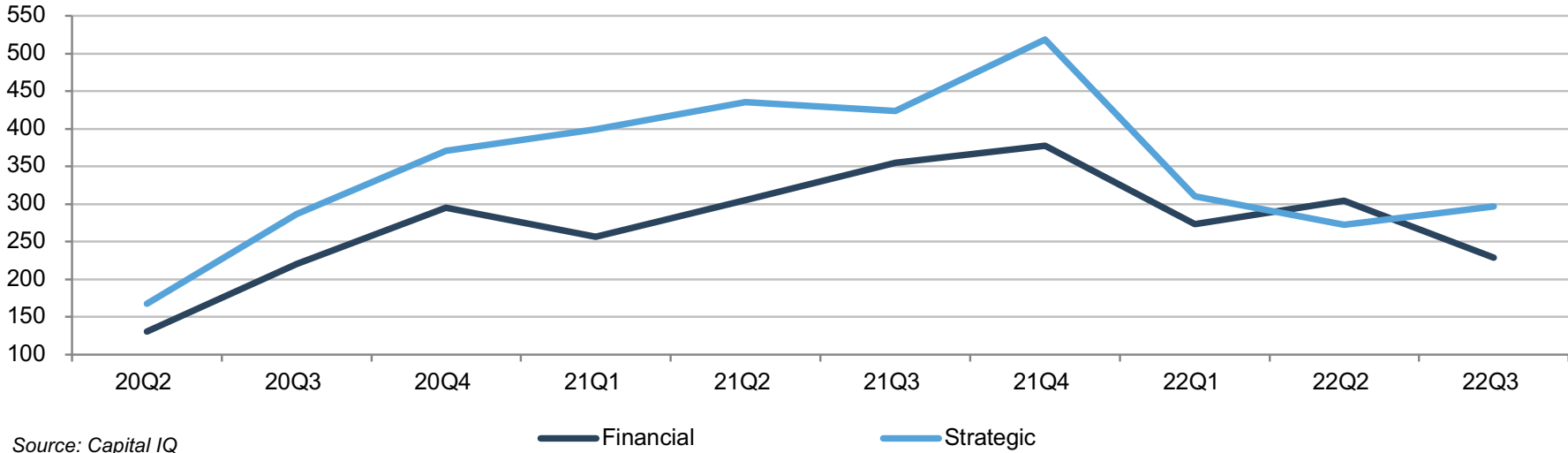
2020 to 2Q 2022



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

### Number of Deals by Buyer Type

Q2-2020 to Q3-2022



Source: Capital IQ

## Conclusion

While deal value and volume were stagnant in the third quarter, valuation multiples generally expanded in the middle market, which could be the result of a late-cycle “flight to quality.” As the prospect of a recession looms over the U.S. economy, prospective buyers and sellers looking for a transaction would be well-advised to act sooner rather than later to avoid any recession-induced complications in the deal process.

## 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.

# 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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# 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 can 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



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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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