

MERCER CAPITAL

# Middle Market Transaction Update

Winter 2023

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# Winter 2023 M&A Update

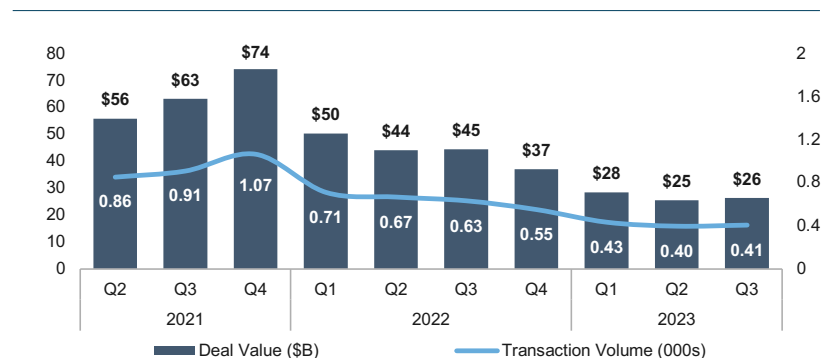
Although middle market transaction activity remained depressed in the third quarter of 2023 compared to 2022 levels, M&A activity and possibly deal multiples could improve in 2024 given the potential for Fed rate cuts, an economy that has remained resilient in spite of 525bps of rate hikes by the Fed, and ample dry powder held by PE firms to deploy.

As shown in the chart in the top right, overall U.S. deal activity, as compiled by *Capital IQ* in the third quarter, was little changed from the depressed levels observed in the first half of 2023. Pitchbook reports that U.S. PE middle-market activity defined as deals with an enterprise value of more than \$1 billion fell to a six year low in the third quarter and was down by 13% from the second quarter and 55% from the year ago quarter.

Lower middle market activity (defined as enterprise values of \$10 million to \$500 million) as compiled by *GF Data*® from ~300 PE firms for ~20 years provides several notable observations about PE-backed transactions:

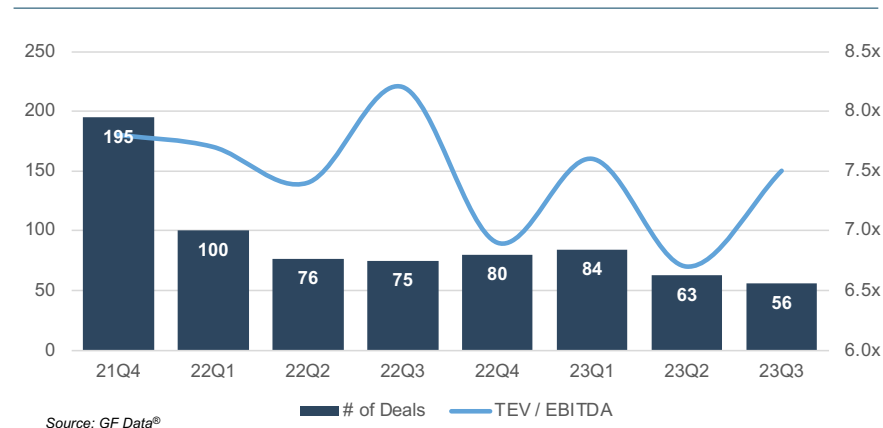
- Similar to the overall U.S. transaction level, lower middle market activity is depressed relative to 2022 and especially 2021 when financing costs were exceptionally low.
- The average EBITDA multiple for all sub-groups improved to 7.5x in the third quarter compared to 6.7x and 8.2x in the prior and year ago quarters.
- The average EBITDA multiple for the trailing 12 months on a rolling quarterly basis declined to 7.2x compared to 7.4x in and 7.7x in the prior and year ago quarters.
- The average EBITDA multiple for the trailing 12 months by sub-group ranged from 5.9x for deals with an enterprise value of \$10-\$25 million to 11.2x for deals in the \$250-\$500 million range.
- The year-to-date average industry multiple ranged from 6.4x for manufacturing to 9.4x for healthcare services.

## U.S. Deal Value & Volume Q2-2021 to Q3-2023



Source: Capital IQ

## Number of Deals and Average EBITDA Multiples Lower Middle Market Financial Buyers | Last 8 Quarters



Source: GF Data®

- Buyer transaction costs that are excluded from the multiples cited above add about 0.3x to all-in costs.

Deal volume for both strategic and financial deals present a similar picture. The chart on page 1 highlights overall deal value and volume, including strategic deals. The third quarter of 2023 represents a slight uptick in deal value and consistent volume across each quarter in 2023. Deal value is down approximately 41% year-over-year and down 59% from third quarter 2021 metrics.

One takeaway from the increase in quarterly multiples in the third quarter for lower middle market PE deals is that quality firms continue to transact whereas firms with less attractive characteristics are not transacting as frequently.

Notwithstanding the current depressed M&A market, we believe there are multiple reasons to be optimistic about middle market M&A activity in the coming year.

There is an abundance of committed capital ready for deployment, allowing investors and acquirers to become increasingly more motivated to put their money to work. Recent reductions in intermediate and long-term rates when combined prospectively with a potential reduction in SOFR if the Fed follows through with rate cuts portend lower borrowing costs. Also, the ability of issuers to tap the capital markets for equity and debt financing should improve given the strong rally in small cap equities and to a lesser extent high yield credit since late October. Lastly, there are technological advancement needs within the market that could be driving factors in M&A growth activity in 2024.

Mercer Capital has a deep bench of seasoned transaction professionals with experience in all different types of market environments, including this one. If you are 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.

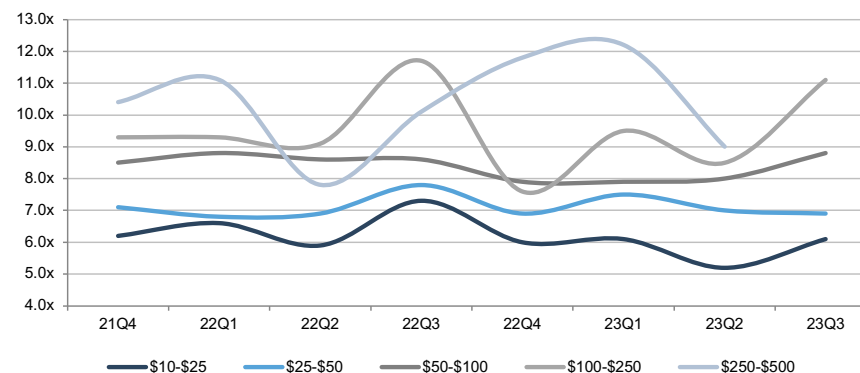
*J. Davis Rolfe*

**J. Davis Rolfe, Jr., CPA**

rolfed@mercercapital.com | 901.322.9712

## TEV/EBITDA Multiples

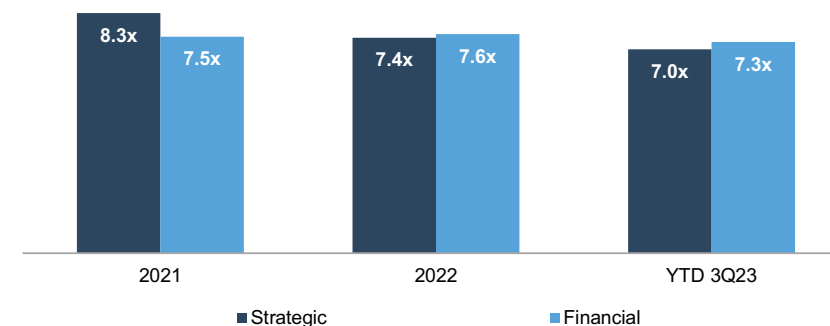
Financial Buyers | Last 8 Quarters



Source: GF Data®

## EBITDA Multiples by Buyer Type

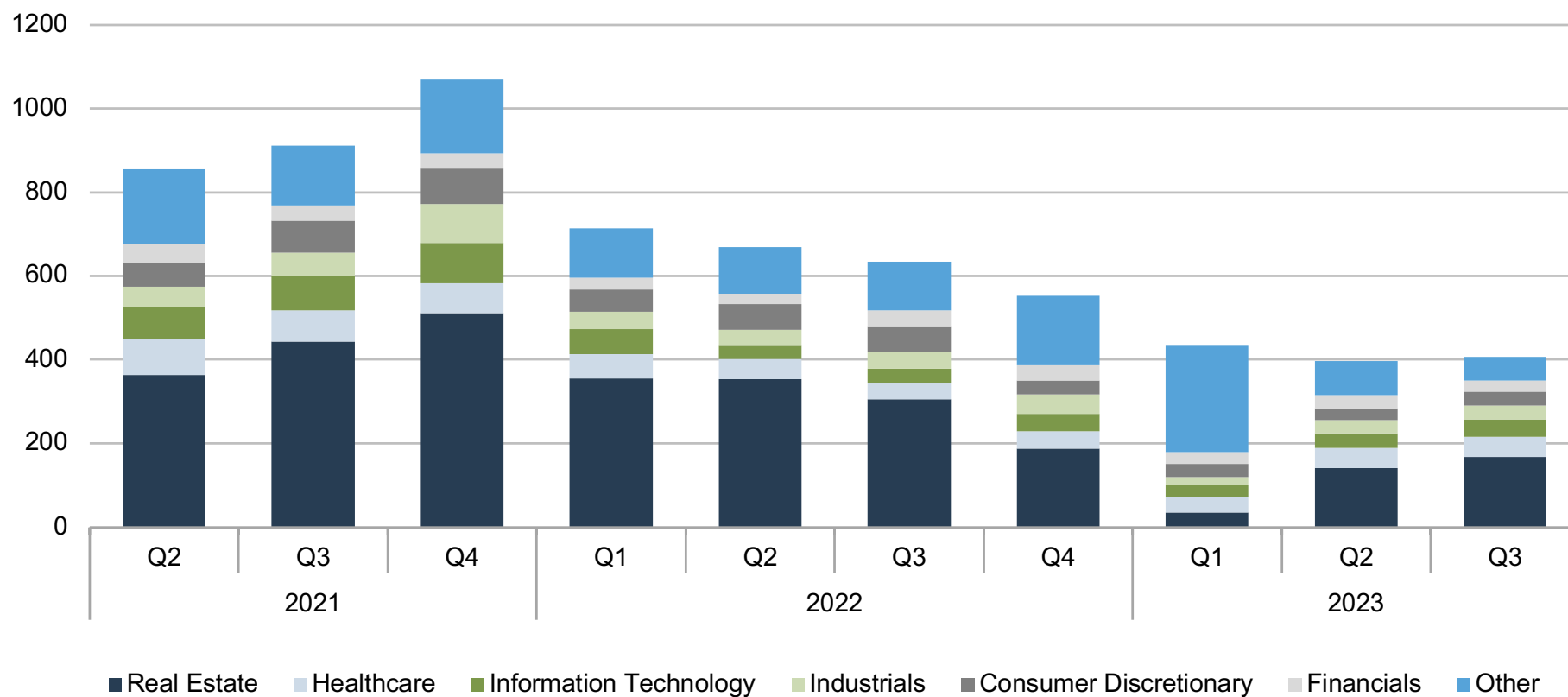
2021 to YTD 2023



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

## U.S. Deal Volume by Industry

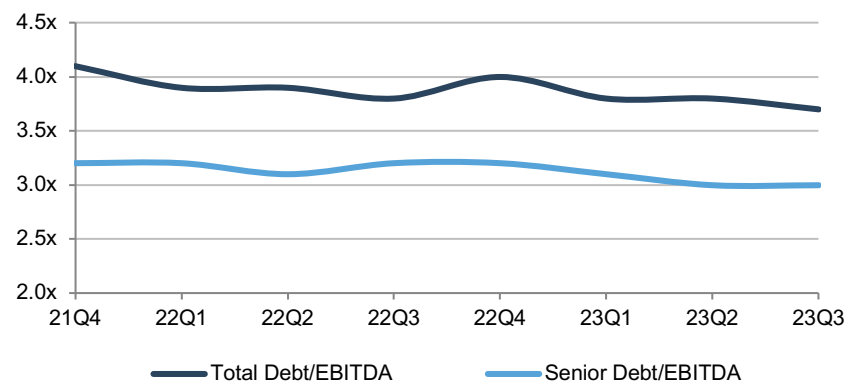
Q2-2021 to Q3-2023



Source: Capital IQ

## Debt Multiples

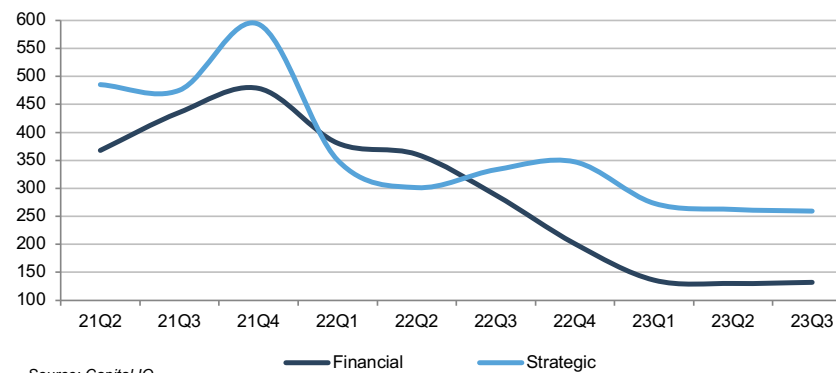
Financial Buyers | Through Q3-2023



Source: GF Data®

## Number of Deals by Buyer Type

Q2-2021 to Q3-2023



Source: Capital IQ

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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,

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**Nicholas J. Heinz, ASA**  
heinzn@mercercapital.com  
901.685.2120



**Timothy R. Lee, ASA**  
leet@mercercapital.com  
901.322.9740



**Jeff K. Davis, CFA**  
jeffdavis@mercercapital.com  
615.345.0350



**J. Davis Rolfe, Jr., CPA**  
rolfed@mercercapital.com  
901.322.9712



**Matthew R. Crow, ASA, CFA**  
crowm@mercercapital.com  
901.685.2120



**John T. (Tripp) Crews, III**  
crewst@mercercapital.com  
901.322.9735



**Jay D. Wilson, Jr., CFA, ASA, CBA**  
wilsonj@mercercapital.com  
469.778.5860

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