STRATEGIC ADVISORS
Middle Market Investment Bankers
Bringing Efficiency to Inefficient Markets

2017

M&A AND CORPORATE FINANCE OVERVIEW

First Quarter

Merger & Acquisition
Corporate Finance Advisory
Strategic Consulting

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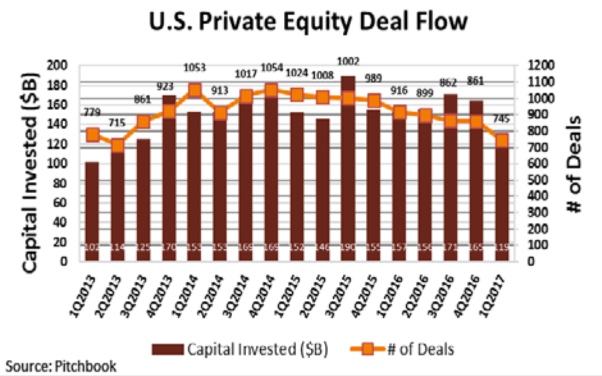
Strategic Advisors is a middle market investment banking firm that helps clients achieve financial and business goals by providing merger and acquisition advisory, corporate finance advisory and strategic consulting services. Along with many years of experience in advising middle market clients, our Managing Directors have experience investing in and managing portfolio companies. As such, Strategic Advisors not only has expertise in advisory services but also firsthand knowledge of what stakeholders, investors and lenders expect and desire.

Merger and Acquisition Overview

- In its *1Q 2017 Private Equity Breakdown*, Pitchbook comments that the beginning of 2017 showed signs of a complex and expensive deal-making

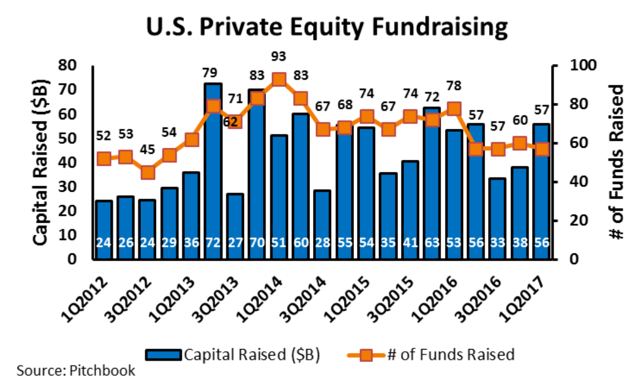


  environment, one characterized by declining activity and high value. Too much capital and not enough investment opportunities are pushing the premiums higher. The first three months of 2017 registered only 745 closed transactions, totaling a value of $118.7 billion, definitely a less robust pace than the 867 deals totaling $138.7 billion that closed in 4Q 2016. Pitchbook acknowledges that quarter-to-quarter activity can be volatile, and it is optimistic regarding future deal flow.

- PE firms are victims of their own success. Price inflation shows no signs of stopping, as the industry's remarkable returns have led to heftier stores of dry powder, which in turn results in more competition for feasible buyout targets. The buying pressures come from the corporate front as well. Per *FactSet*, S&P 500 earnings growth in the first quarter is expected to be 8.9%, the highest since 4Q 2013. This means that strategic acquirers will pay top dollar for a target, further driving up premiums.

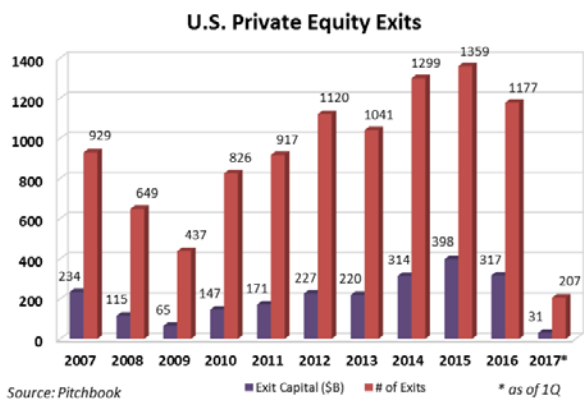
- Continued public market volatility and increasing public company valuations kept limited partners interested in PE funds. Fundraising was widespread, as reflected in the $55.8 billion 1Q 2017 capital commitments, a 15.8% year-over-year increase. Considering the higher valuations and fiercer competition, deploying the newly acquired capital could pose a challenge for PE firms, one that may be overcome by placing special emphasis on sourcing and diligence.

- *Pitchbook's 1Q 2017 US PE Middle Market Report* comments that 2016 saw PE firms focusing on the lower middle market to seek discounted add-ons and buyouts. After two consecutive years of decreases, a surge in dry powder led to an increase in the median deal size. It was $238.5 million in 1Q 2017 compared to $128.3 from 4Q 2016.



- Pitchbook, in its 1Q 2017 Private Equity Breakdown, notes that 94.3% of funds achieved their fundraising targets. In addition, fund sizes increased again, particularly for buyout vehicles. These reached an average size of $275 million, a level not seen since 2008.

- The first quarter was slow for exit markets, with a four-year low of only 207 PE-backed exits completed. These exits totaled $31.2 billion in deal value and represented 28.9% and 58% quarter-over-quarter decreases in deal numbers and value, respectively. Pitchbook notes that it will be awhile until the bulk of PE investments made in the boom years of 2014-2016 will be realized. For now, the ones ready for harvest are the vintages from 2011 and 2012.

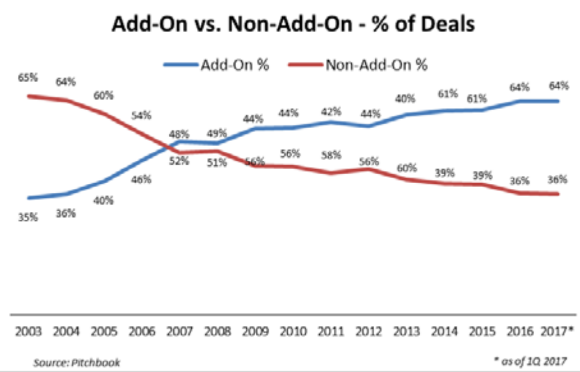


In 1Q 2017, there were 13 PE-backed IPOs, compared to zero from 1Q 2016. Interestingly, the 13 offerings were made by oil and gas companies, whose industry has seen an increase in activity since the stabilization of crude oil prices at the end of 2016. IPOs bounced back in other sectors as well. In addition to PE portfolio companies, there were 28 IPOs that were completed on US Exchanges in the first quarter of 2017.

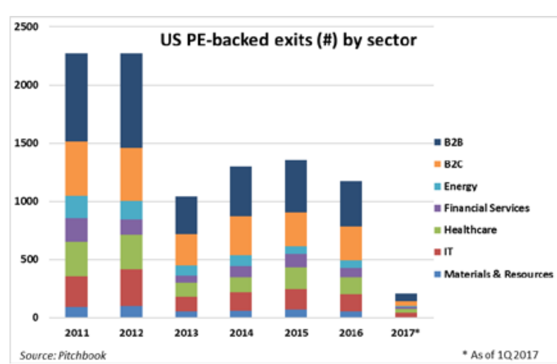
- The theme of substantial add-on transactions as a percentage of all buyout deals continued through 1Q 2017, as 66% of buyouts were comprised of add-ons. This was a 2% increase from last year. Pitchbook states that this trend resulted in a record 13.3% exits via PE firms, the highest level of such exits since 2006. In the tech industry, PE firms not only had the option to make growth equity investments, but also controlling stake buyouts. In addition, due to higher enterprise values, averaging 7.8x according to *GF Data Leverage Report*, and the maturing nature of the tech industry, PE firms have been betting more frequently. 28.4% of all IT M&A in 1Q 2017 were PE acquisitions.

- One example is Altassian's $425 million acquisition of Trello, an online and collaboration business. Not too long ago, Trello, which essentially provides project management and communications functions, would have been categorized as a traditional B2B. Now, due to the digital, yet still enterprising, nature of its tools, it is considered a tech company.

- Pitchbook states that if the market stays overheated, add-ons will remain popular amongst PE firms. Since smaller companies demand a lower multiple, add-on transactions not only proved to be an effective way to lower the fund's aggregate multiple, but also a way to increase the platform's EV and subsequent exit multiple. With prices as high as they are, it has become imperative for firms to use buy-and-



build strategies in order to blend multiples and create lower aggregate pricing for their portfolio acquisitions. In addition, managers can utilize this strategy to ensure a higher exit price as they build a more comprehensive business. Most private equity firms are now espousing a "buy-and- build" strategy, so it is not surprising to find that the proportion of add-on deals has increased steadily in recent years.

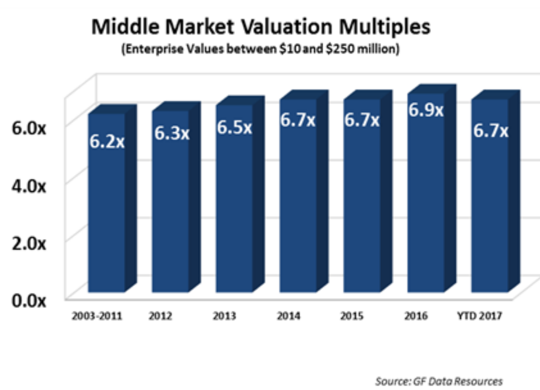


- The tech industry sparked PE firms' interest in 1Q 2017, as one-fifth of all PE deals involved companies in the IT sector, making it the second most common industry behind B2B. IT companies comprise a substantial portion of the world economy as more and more business and consumer-facing strategies are embracing the digitalization era.

- The trend of venture-backed tech companies exiting via IPO is slowing, with just 5.0% of such exits in 2016. The pressure of quarterly earnings expectations seem to divert the tech companies' focus from long-term growth, making exits via PE firms more attractive.

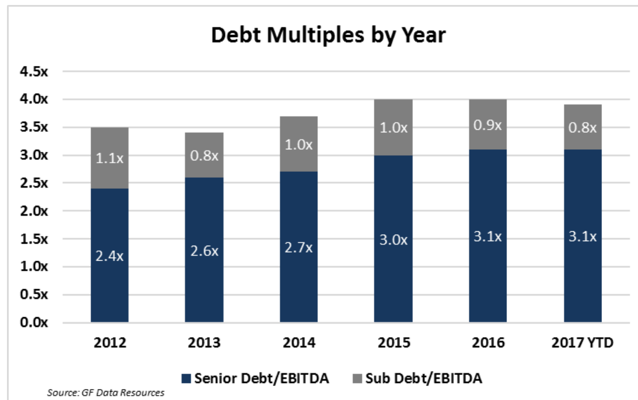
- GF Data M&A Report illustrates that in 1Q 2017, 53 transactions involved the U.S. middle market, right on par with the last quarter's number and up from 1Q 2016's 49 transactions. The multiples for businesses sold to private equity groups averaged approximately 6.7x EBITDA, a decrease from 6.9x in 2016. GF Data states that a business owner initiating the sale of his or her company in early 2016 expected dormant capital markets, low growth, and rather familiar federal governmental policies. This changed in November, with the outcome of the U.S Presidential election. Anticipation of the incoming administration changing tax structure and regulations caused a "wait and see" approach, dampening transaction activity.

Leverage multiples decreased to 3.9x for total debt and increased to 3.1x TTM Adjusted EBITDA for senior debt, falling exactly in line with the averages of 2016. The senior debt spread over LIBOR in 1Q 2017 averaged 4.2%, while the spread on sub debt remained about 10%, reflecting a 100 basis-point decrease from spreads in 2013-15.



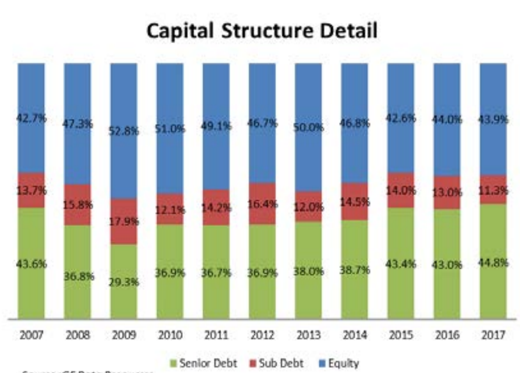
- Average equity contribution for 1Q 2017 was 43.9% of a transaction's capitalization. Equity share bounced back around the 42-44% range. It peaked at 50% in 2013 and then dropped to 47% in 2014.

In addition, total debt declined on transactions financed based on the strength of the sponsor or an acquiring platform. On such transactions, the debt level decreased by .5x to 3.6x in 1Q 2017. Perhaps this manifested a diminishing enthusiasm for price and leverage add-on acquisitions at high multiples, with the intent to "average down" even the more extravagant multiples applied to platform holdings.

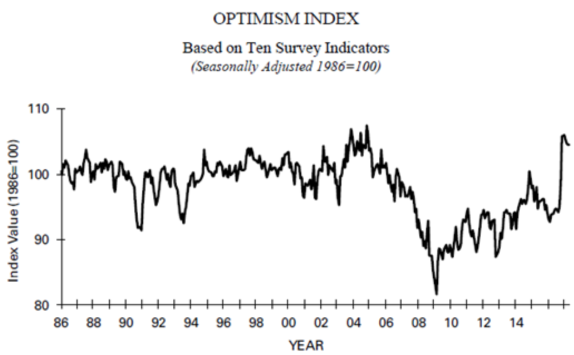


Larger transactions ($50-250 million) and those involving higher quality companies with above-average financial metrics (TTM EBITDA and Revenue Growth > 10%) continued to demand a premium. The 1Q 2017 size premium averaged 1.2 turns while the quality premium averaged 30%. GF Data defines "quality premium" as the reward in valuation for above-average financial performance. The premium had cooled off in 2016 to 20% from a record high 24% in 2015, but the figures are still well above the historical average of 8%.

- Bank financing was plentiful and aggressively structured and priced. Banks continued to push the outer limits on overall debt. The average capitalization accounted for more than half a buyout transaction's capital structure.



- Per the National Federation of Independent Business (NFIB), small business confidence shot up to near record levels after the US presidential election and is still at high levels, falling only 0.2 points to 104.5 in April. NFIB president and CEO, Juanita Duggan, claims that "Small business owners are highly encouraged by the President's regulatory reform agenda, and they remain optimistic there will be tax reform and health-care reform. This is a policy-driven phenomenon." According to the NFIB May



report, five of the Index components posted a gain, four declined, and one was unchanged. Labor market indicators remained strong, capital spending remained high, and reports of improved sales trends also increased in frequency. The results show that small business owners have held on to their optimism, ultimately signaling more growth in the real economy. If Congress continues with a pro-small-business agenda, small firms will be more optimistic about the future and hire more workers.

- The growing presence of the one-stop financing approach, as well as a plentiful base of mezzanine investors, continue to be significant parts of capital structures and stand ready to fill any void in the market. Mezzanine investors are pricing transactions more aggressively with the average spread over LIBOR of 14.6% thus far in 2017.

- Even after a gargantuan 2016, and despite a slow start to 2017, there is some optimism for increased deal flow. The aging dry powder and large inventory of private-equity-backed companies, as well as the availability of liberal, low-interest debt, should provide the stimulus for the remainder of the M&A market in 2017. In addition, consolidation opportunities in the IT and energy sectors generate activity as well.

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When considering a sale of your business, the acquisition of a business, or the restructuring or recapitalization of your balance sheet, the best pathway for achieving your expectations is a well-run process that addresses all your business and personal goals. Strategic Advisors is accustomed to working with business owners to determine the best pathway to achieve their goals and objectives. Give us a call to discuss your possibilities.

Author: Domenick Cristino, MBA Summer Intern

Sources: Pitchbook: M&A report, US PE Breakdown, US PE Middle Market Report; GF Data Resources: May 2017 Leverage Report, Key Deal Terms, M&A Report; NFIB Small Business Economic Trends, May 2017.