STRATEGIC ADVISORS
Middle Market Investment Bankers
Bringing Efficiency to Inefficient Markets

2016

M&A AND CORPORATE FINANCE OVERVIEW

Fourth Quarter

Merger & Acquisition
Corporate Finance Advisory
Strategic Consulting

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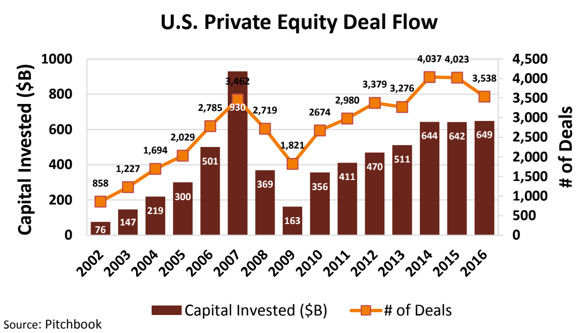
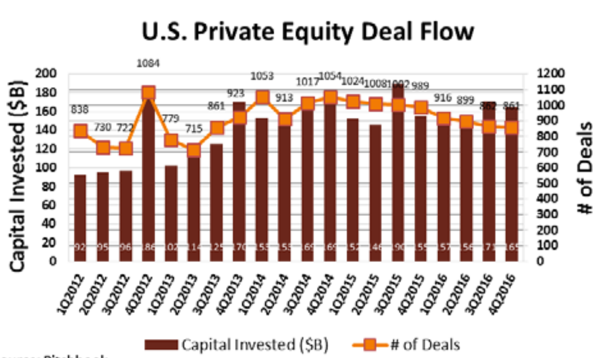
Strategic Advisors is a middle market investment banking firm that helps clients achieve financial and business goals by providing merger and acquisition advisory, corporate finance advisory and strategic consulting services. Along with many years of experience in advising middle market clients, our 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 their 2016 Annual Private Equity Breakdown, Pitchbook comments that 2016 was the first step toward normalcy after two very robust years in 2014 and 2015. They further note that buyout activity receded amidst the growing concerns about global trade, rising populism, and certain central bank policies. In 2016, $649 billion in private equity transactions were completed across 3538 deals, representing 12% and 14% year-over-year decreases, respectively. Pitchbook attributes these declines to an expensive market and a lack of quality acquisition targets. In addition, competition was heightened by aggressive corporate buyers who continue to push up multiples and squeeze the margin for error. As such, managers continue to seek out new pockets of growth and opportunity and recently have centered their attention in the energy and tech sectors, where transaction volume increased 31.6% and 377.8% respectively in 2016.



Source: Pitchbook

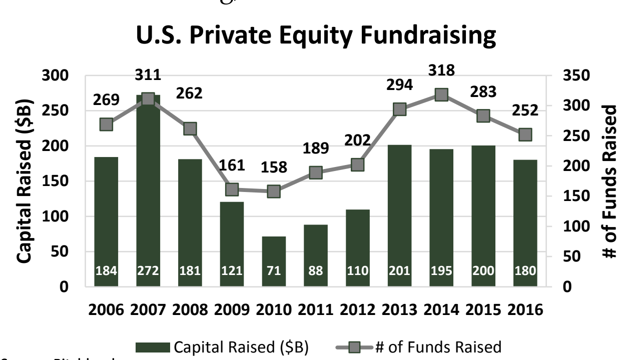


Source: Pitchbook

In the fourth quarter of 2016, $165 billion was invested across 861 transactions. That volume represented a quarterly increase of 6.8% from the fourth quarter of 2015, and a 3.6% decline when compared to the third quarter of 2016.

❖ Dealmakers continue to look down market for value. Transactions under $100 million represent the largest proportion of completed deals since 2009. In 2016, 2,492 transactions were closed with values under $100 million. This amounted to over 70% of all deals completed. Further evidence of this trend is the fact that over 46.5% of all completed transactions were under $25 million.

❖ As public markets have been volatile and other alternatives have struggled to produce in the last few years, many limited partners have increasingly leaned on their private equity allocations in hopes of maintaining the returns needed to meet obligations. In 2016, 252 private equity funds closed on $180 billion worth of commitments, representing 11% and 10% year-over-year decreases which seem to mirror the downturn in deal volume this year. This is indicative that limited partner interest in the asset class is still strong, but has receded since 2014.



Source: Pitchbook

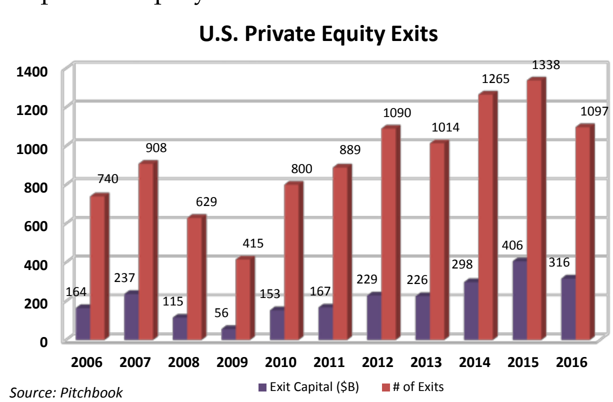
❖ Traditional buyout funds represent 64.9% of the funds closed. It is noted that buyout funds have seen relative growth every year since 2013. The median buyout fund has increased to $250 million, up from

$202 million in 2015 and the highest figure since 2010. Mezzanine and energy funds raised has been subdued with senior lenders extending more aggressive debt facilities and oil and gas prices remaining low for much longer than investors expected.

Pitchbook, in their 2016 Annual Private Equity Breakdown, notes that 89% of funds achieved their targets, which is higher than any other year. In addition, first time managers raised 10.3% of the funds closed this year. That so many managers are hitting their goals is evidence of the continual demand that limited partners have for this asset class.

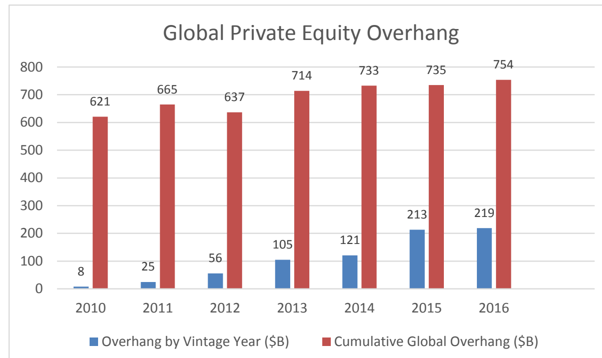
- Overall, 2016 was healthy for private equity sellers in both volume and value. In 2016, PE-backed activity exits fell 22% in value to $316 billion across 1,097 transactions. Pitchbook notes that although this is still high by historical standards, the falling off speaks to some softening of the overall M&A cycle. PE-backed exits peaked in the fourth quarter of 2015. Pitchbook expressed surprise, given the current high multiples being paid, which leads them to believe that the quality of assets in many private equity portfolios may not be able to justify a sale in the present environment.

In 2016, there were only 32 private-equity-backed IPO's, the fewest since 2009. With the IPO market being cold and a greater number of private equity firms in the market, private equity investors became more likely to sell to other financial buyers. 47% of private equity exits in 2016 were secondary buyouts, compared to just 32% in 2009. Strategic acquirers, however, dominated the market, completing 73% of the private-equity-backed exit value in 2016.



Source: Pitchbook

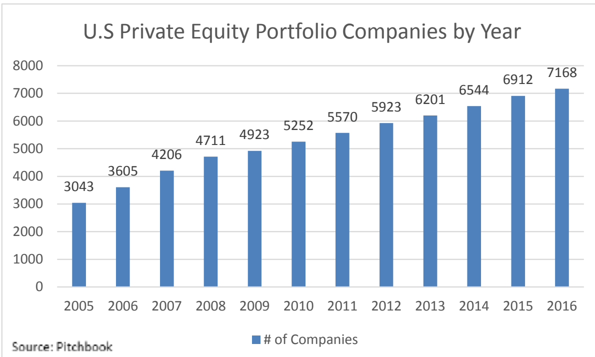
- The global private equity capital overhang reached a new all-time high of $754 billion in 2016. Of that sum, $213.3 billion, or 28.3% of the total, comes from 2015 vintages, with 81% of the capital raised yet to be deployed. These vast reserves of capital should help to fuel private equity deal flow this year and next. Despite the high multiples in the market, private equity firms will be under pressure to deploy capital quickly, which will likely produce lower returns across all asset classes.

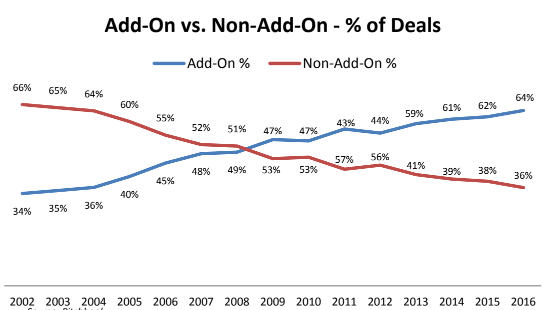


Outside of traditional buyout funds, the energy sector raised the most capital. Deal flow in this sector continues to be limited as GP's wait for the opportune moment and for potential bankruptcies. Pitchbook believes that given the capital nature of these transactions, the capital overhang will decline over the next 12 to 18 months as more opportunities arise. With the opportunities being sparse, the larger funds continue to look down market and seek out niche markets for opportunities. In any given sector or geography, there are a finite number of companies that can reasonably service the debt loads necessary for producing the returns that buyout producers expect.

- Several factors conducive to deal making remain in place. First, there remains a large amount of dry powder that needs to be invested. The investment window is now closing on those funds raised during the financial crisis between 2007 and 2011. Second, investors seek to access debt while rates remain low with ready availability. Finally, the deal sourcing seems to be improving with the deep inventory of aged PE-backed portfolios and the development of the secondary buyout market.

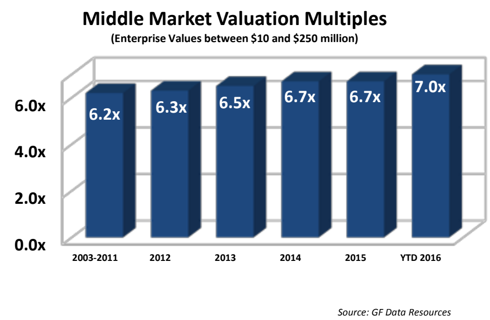
PEG's have a significant inventory of PE-backed companies sitting in their portfolios for three years or longer. The median holding period for a portfolio company remains in excess of five years. Prolonged holding periods are now part of an ongoing sea of change in private equity, as the emphasis has shifted from financial engineering and multiple arbitrages to revenue growth and operational improvements. Add-ons accounted for 64% of all buyout activity during 2016. Add-on deals are being used as a means of increasing the operational capacity of portfolio companies, but PE firms are increasingly viewing add-ons as a viable way to put capital to work as well. 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 a lower aggregate pricing for their portfolio acquisition. 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.



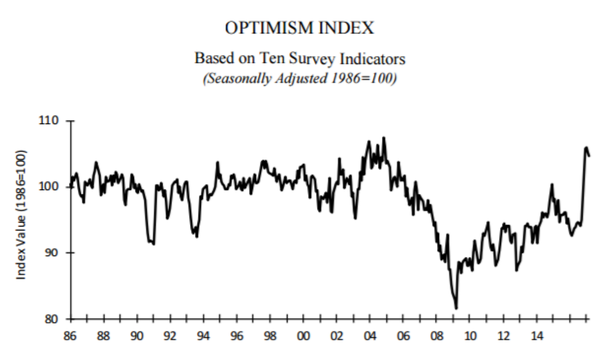


U.S. middle market transaction multiples for businesses sold to private equity groups averaged approximately 7.0x EBITDA in 2016 through the first nine months of 2016, increasing from 6.7x in 2015. GF Data Resources suggests that we should not be misled by the current YTD valuation, as the second quarter valuations were aggressive. Managers continued their focus on larger platform investments and were looking to complete transactions prior to the election.

- ❖ Larger transactions ($50-250 million) and those involving higher quality companies with above-average financial metrics (TTM EBITDA and Revenue Growth > 10%) continue to demand a premium. The current year's premium has averaged 2.3 turns while the quality premium has averaged 14%.

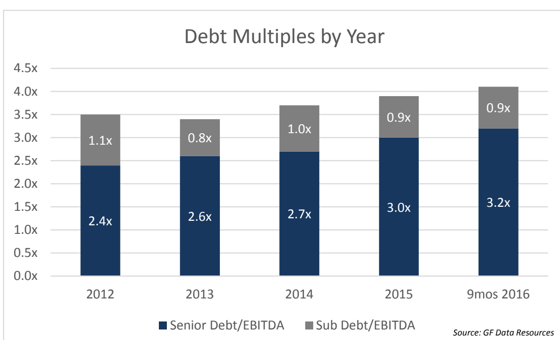


- ❖ According to NFIB's President and CEO Juanita Duggan, small business owners remain optimistic about the future of the economy and the direction of consumer confidence. Furthermore, she strongly believes and is encouraged by signs that optimism is translating into economic activity, such as capital investment and job creation. Although the NFIB Index slipped 0.6 points in March to 104.7, it is still a very strong reading by historical standards. The increases in capital expenditure plans and actual earnings are clear signs of a healthier economy. The NFIB's Chief Economist Dunkelberg noted that while the overall Index remained strong in March, a significant increase in the Uncertainty Index, a subset of data on how small business owners see the near-term future, could indicate trouble on the horizon. The Uncertainty Index hit 93 in March, which is the second highest reading in the survey's history. "More small business owners are having a difficult time anticipating the factors that affect their businesses, especially government policy."

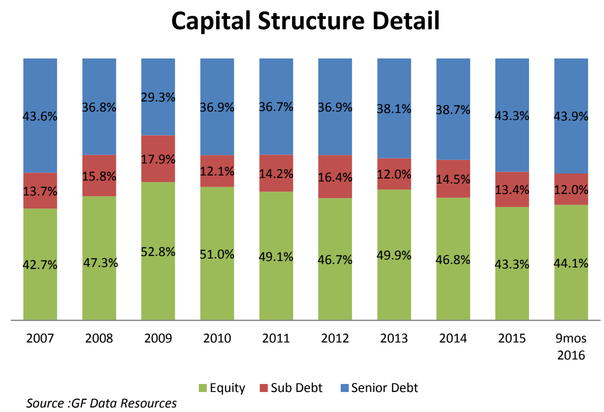


- Bank financing is plentiful and aggressively structured and priced. Banks continue to push the outer limits on overall debt. The average capitalization now accounts for more than half an average buyout transaction's capital structure.

- Leverage multiples increased to 4.1x for total debt and 3.2x EBITDA for senior debt. More liberal debt structures continue to be available for larger deals. The senior debt spread over LIBOR averaged 5.5% in the third quarter of 2016. However, the greatest debt utilization occurred where the transaction was based on the strength of the financial sponsor's current portfolio companies making add-on acquisitions. Total debt on these transactions averaged 4.5x EBITDA. When business owners were looking to capitalize on attractive market conditions while retaining control, debt levels were even higher, averaging 4.7x EBITDA.



- The growing presence of the one-stop financing approach, as well as a plentiful base of mezzanine investors, continue to be a significant part of capital structures and stand ready to fill any void in the market. Mezzanine investors are more aggressively pricing transactions (current interest) with the average spread over LIBOR of 14.6% in the third quarter of 2016.



- The equity contribution to a capital structure during the first nine months of 2016 averaged 44.1% of a transaction's capitalization.

- In forecasting M&A activity glimmers of hope are beginning to emerge, creating 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 a more robust M&A market in 2017.

For more information, please contact any of the professionals listed below or visit our website at www.strategicad.com

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Author: Andy Bianco, Managing Director and Founder

Sources: Pitchbook - The Private Equity 2016 Third Quarter Private Equity Breakdown; GF Data Resources November 2016 Report; NFIB Small Business Economic Trends, October 2016

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