Strategic Advisors
Middle Market Investment Bankers
Bringing Efficiency to Inefficient Markets

2016

M&A AND CORPORATE FINANCE OVERVIEW

Third Quarter

Merger & Acquisition
Corporate Finance Advisory
Strategic Consulting

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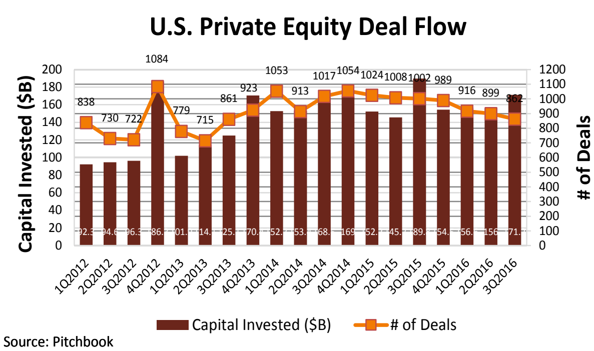
Strategic Advisors is a middle market investment banking firm that helps clients achieve financial and business goals by providing merger and acquisition advisory, corporate finance advisory and strategic consulting services. Along with many years of experience in advising middle market clients, our 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

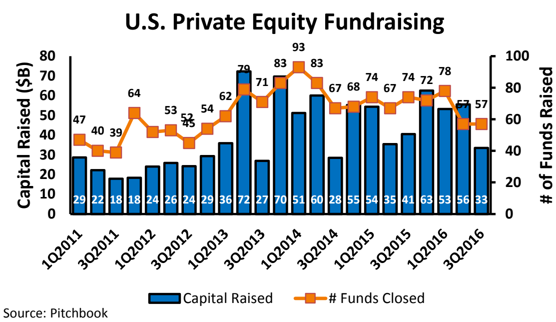
- In their 3Q 2016 Private Equity Breakdown, Pitchbook comments that deal volume has plateaued. Through the third quarter nothing has changed in terms of the downward trend in private equity deal flow. Activity has consistently fallen quarter over quarter. Through the first nine months ending September 30, 2016, the capital invested totaled $484 billion across 2,477 transactions. While deal value appears to be relatively flat, it is likely that volume will decline by approximately 20% year over year.

  In the third quarter of 2016, $171 billion was invested across 662 transactions. That volume represented a quarterly drop of more than 26% from the second quarter of 2015, and a 44% decline when compared to the third quarter of 2015. The volume was up 10% from the second quarter of 2016; however, one transaction, the Silver Lake-backed Dell-EMC combination, totaled $60 billion. If this transaction is eliminated, the third quarter volume fell 29%.

  Dealmakers continue to look down market for value. Transactions under $100 million represent the largest proportion of completed deals since 2009. Through the first nine months of 2016, 1750 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% of all completed transactions were under $25 million.



- Although the number of PE funds raised this quarter was the same as the number raised last quarter, the value of those funds dropped rather sharply by approximately 40%. Despite a strong start in 2016, capital raised is now poised to be about equal with the last few years.

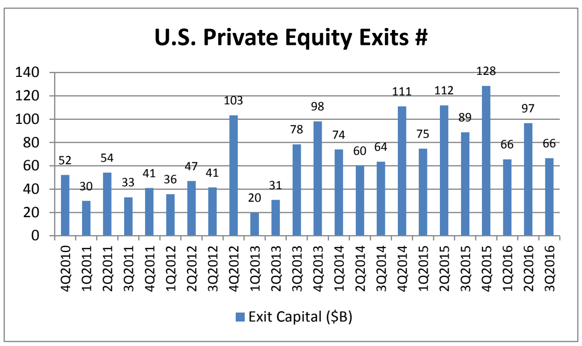


- Through the first nine months of 2016, traditional buyout funds represented 81% percent of the capital raised and 66% of the funds closed. Both figures are the highest since 2006. It is noted that buyout funds have seen relative growth every year since 2013. The median buyout fund has increased to $225 million, up from $165 million in 2015. Mezzanine funds are on track for their slowest year with just $2.8 billion being raised through the first nine months of 2016. Energy fundraising has been subdued with just $11 billion raised across 15 funds as oil and gas prices remained low for much longer than investors expected. However, Pitchbook anticipates increased activity as oil and gas prices begin to stabilize.

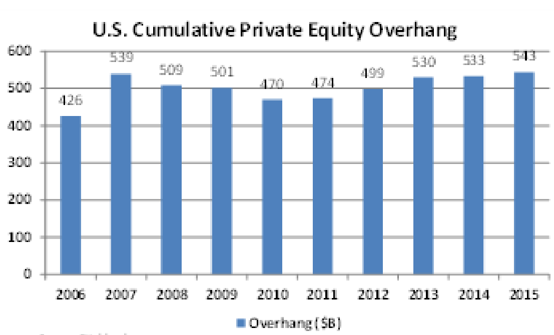
  Pitchbook, in their third quarter Private Equity Breakdown, notes that 90% of funds achieved their targets, which is higher than any other year. This is somewhat contradictory to recent news that many limited partners are looking to slash their alternative asset allocations.

❖ The value of PE-backed activity exits fell by 31% in the third quarter of 2016, to $66 billion across 218 transactions. Through three quarters of 2016, the exit value is on pace to be approximately 25% behind 2015. Pitchbook notes that although this is still high by historical standards, the falling off speaks to some softening of the overall M&A cycle where PE-backed exits peaked in the fourth quarter of 2015.

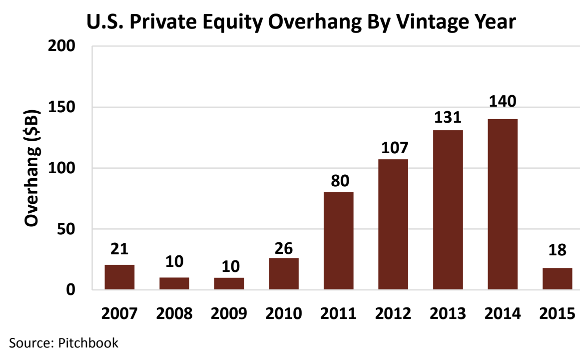
Through the first nine months of 2016, secondary buyouts represented 37% of PE-backed exits. Corporate buyers continue to be aggressive representing 60% of the same activity. IPO's remained subdued.



❖ The private equity capital overhang remains an issue in the industry as the cumulative dry powder grew approximately 2% in 2015 to $543.4 billion. Pitchbook notes that while the PE asset class remains highly sought, and that GP's will continue to come to market to insure they can access capital, newer PE strategies can take a considerable amount of time before the opportunities are ripe for capital deployment. This slightly inflates the amount of dry powder remaining in the coffers.

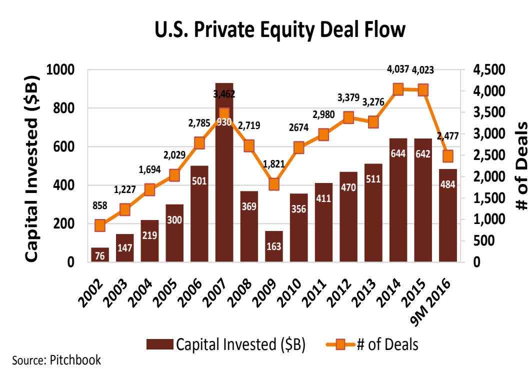


❖ At the end of 2015, approximately 59% of the dry powder was held in the 2012 to 2014 vintage funds. There is still more than $66 billion held in funds dating from 2007-2010, which are now beyond their five-year investment period and run the risk of having to be returned to their limited partners.

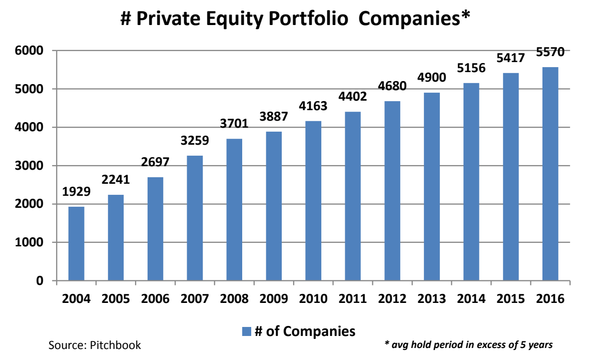


❖ Outside of traditional buyout funds, the energy sector raised the most capital in 2015. Deal flow in this sector continues to be limited as GP's wait for the opportune moment and for potential bankruptcies. Pitchbook believes that given the capital nature of these transactions, the capital overhang will decline over the next 12 to 18 months as more opportunities arise. Buyout funds centered in the energy sector that raised between $1 billion and $5 billion are a large proportion of the dry powder. With the opportunities being sparse, the larger funds continue to look down market for opportunities.

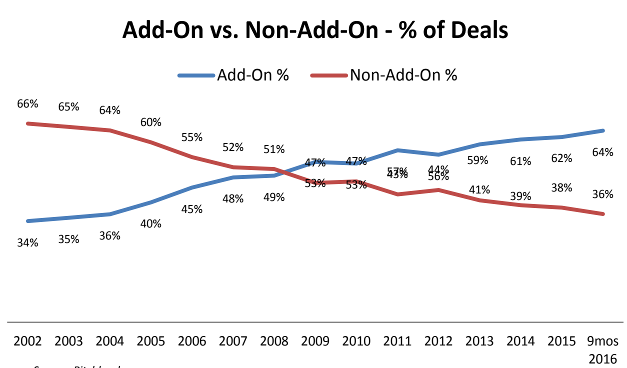
❖ Several factors conducive to deal making remain in place. First, there remains a large amount of dry powder that needs to be invested. The investment window is now closing on those funds raised during the financial crisis between 2007 and 2010. Second, investors seek to access debt while rates remain 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.



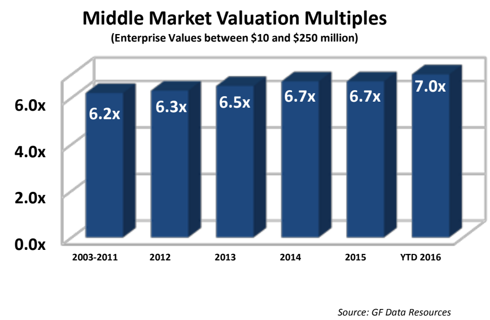
PEG's have a significant inventory of PE-backed companies sitting in their portfolios for three years or longer. The median holding period for a portfolio company remains in excess of five years.



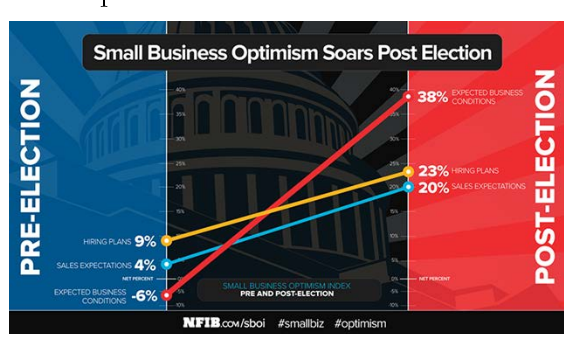
- Prolonged holding periods are now part of an ongoing sea of change in private equity, as the emphasis shifts from financial engineering and multiple arbitrages to revenue growth and operational improvements. Add-ons accounted for 64% of all buyout activity during the first nine months of 2016. Add-on 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. Most PE firms are 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 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 as managers continue 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%.

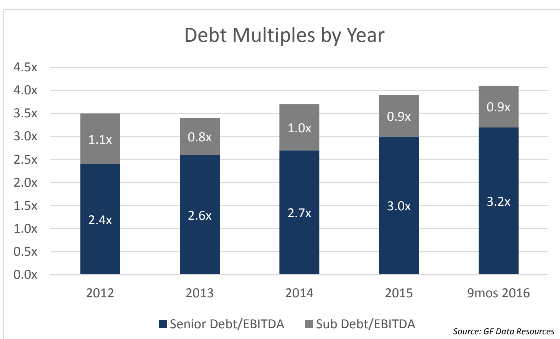


- The Small Business Optimism Index as reported by National Federation of Small Businesses (NFIB) rose 3.5 points to 98.4, a substantial gain to just above the 42-year average of 98. Small business optimism remained flat up to Election Day and then rocketed higher as business owners expect much better conditions under new leadership in Washington. Eight of the ten Index components posted a gain, one declined, and one was unchanged. Expectations for real sales gains and outlook for business conditions accounted for 69% of the gain. The employment components added 20% of the gain. Juanita Duggan, president and CEO of the NFIB states "Whether small businesses remain optimistic and lift the U.S. economy depends on whether the incoming Trump administration and congressional leaders follow through on their plans to reform the tax code, repeal regulations, and fix the broken health insurance system." She notes that Federal taxes, regulations, and Obamacare are the three biggest impediments to running a small business in America. Small businesses have high expectations that those problems will be addressed.

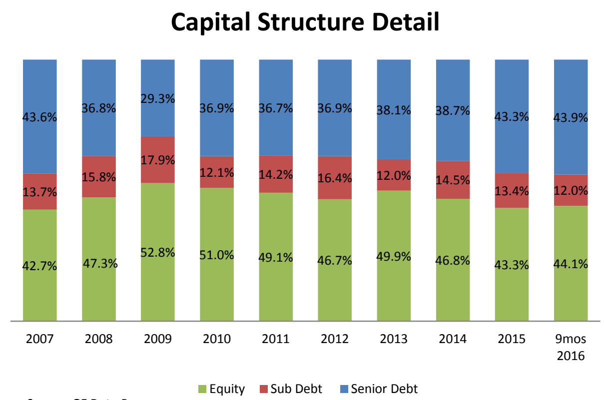


- Bank financing is plentiful and aggressively priced. Banks continue to push the outer limits on overall debt. Overall, debt now accounts for more than half an average buyout transaction's capital structure.

- 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.



Source :GF Data Resources

- 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 the remainder of 2016. The aging dry powder and PE portfolios as well as the availability of liberal, low-interest debt should provide the stimulus for a more robust M&A market.

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

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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: 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

Important Information