



STRATEGIC ADVISORS

Middle Market Investment Bankers

Bringing Efficiency to Inefficient Markets

2017

M&A AND CORPORATE FINANCE OVERVIEW

Third Quarter

Merger & Acquisition
Corporate Finance Advisory
Strategic Consulting

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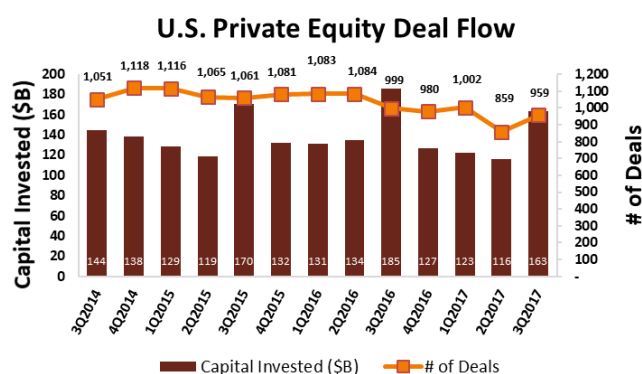
Strategic Advisors is a middle market investment banking firm that helps clients achieve financial and business goals by providing merger and acquisition advisory, corporate finance advisory and strategic consulting services. Along with many years of experience in advising middle market clients, our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

3Q17 Remains a Sellers' Market; Valuations at Post-Recession Highs

Fundraising, Flow & Multiples

Multiples & Fundraising Solid Despite Lower Volume



Source: Pitchbook

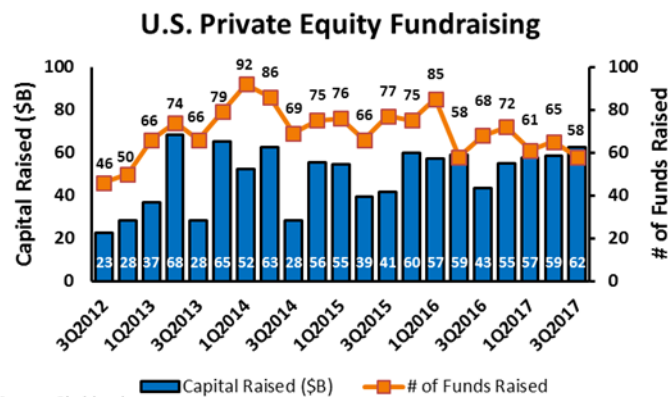
3Q17 remains a sellers' market with unprecedented valuations and aggressive debt availability by lenders extending into the latter half of 2017. According to Pitchbook's 3Q 2017 *Private Equity Breakdown*, 959 deals were announced or completed across the U.S. in 3Q17. This brought the number of year-to-date (YTD) deals to 2,820 (down 11% year-over-year), with an aggregate deal value of \$401.7bn. Despite sitting on nearly \$556bn in dry powder, PE deal flow has likely declined due to concerns surrounding price and quality of targets.

Even though the pace of deal flow decelerated when compared to the past three years, valuations are on track to achieve new heights. They are driven by an influx of capital available for investment and competition for quality acquisitions. EBITDA multiples were 10.5x in 3Q17 (slightly below the pre-recession high of 10.7x).

Investors' higher risk appetite for PE returns continues to translate into a willingness to commit greater amounts of capital to this asset class. Capital raised by PE funds in 3Q17 totaled \$62.4bn committed across 58 funds (\$24.7bn of which was raised by Apollo's ninth flagship fund). On a YTD basis,

\$178.48bn was committed across 184 funds compared to \$214.42bn committed over 283 funds in all of 2016.

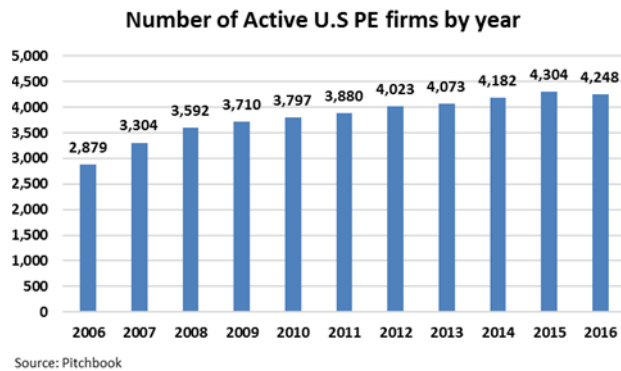
When annualized, fundraising approaches all-time highs and continues to be more concentrated in larger funds. This has led to an 11% increase in the median US PE fund size to \$265m. Much of these investments are concentrated in mega-funds with more than \$5.0bn at closing. These funds accounted for 54% of all YTD 3Q17 capital raising. Should this trajectory continue, they will account for more than 50% of overall capital raised for the first time since 2007.



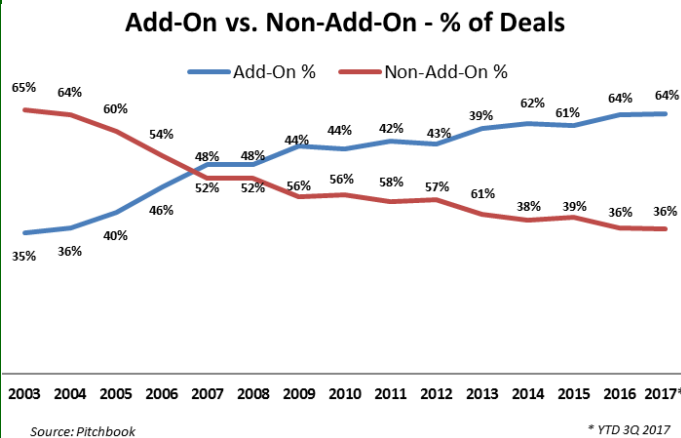
Source: Pitchbook

The Financial Services Industry, which includes PE funds, is experiencing continued consolidation, especially among the biggest players. Competition continues to drive firms to consolidate as a way to improve economies of scale and product offerings (including hedge funds, credit funds and other strategies) for clients. This allows the acquirer not only to grow AUM, but also to diversify their fee pool as well. One example of this strategy is Softbank Group's acquisition of NYC-based private equity firm Fortress Investment Group for \$3.3bn in cash. SoftBank acquired Fortress in February 2017 to leverage the firm's investment experience in order to create follow-on offerings to its Vision Fund.

Continued consolidation will mostly benefit larger industry players and its effects are already making a mark. The overall number of PE firms decreased by 1.3% in 2015 to 4,248 firms at year-end (YE) 2016.



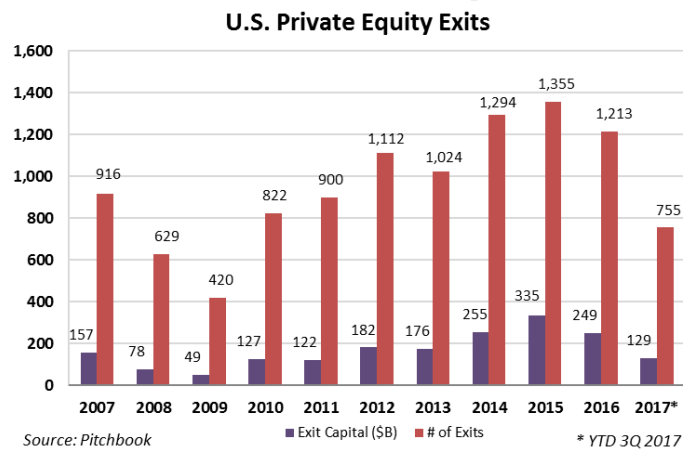
Pitchbook notes that bolt-on acquisitions continue to represent the majority of buy-out activity (64%) in 2017. Each platform reaches an average size of three portfolio companies (1 platform plus 2 add-ons) over an average holding period (5 to 7 years). This disproves the notion that sponsors have a limited period to make these acquisitions before liquidating the fund and returning capital to investors. The grab for bolt-on acquisitions will likely diminish the investible universe of these assets and will continue to drive up multiples across lower tier EBITDA thresholds.



Deal exit volume also slowed into the third quarter of 2017, dropping 20% from 2Q17 to 224 transactions comprising \$40.8bn in exited capital. This decline was largely due to the continued decline in corporate acquisitions, which were down 24% YTD at 350 deals worth \$65.05bn in exited capital. Secondary Buyouts (SBOs) accounted for 50% of exit deal-flow at 375 deals with a value of \$55.7bn through YTD 3Q17.

Corporate acquisitions and SBO's stand at their lowest and highest deal-flow percentages (as recorded by *Pitchbook*) respectively. This trend is likely to continue given that PE funds are maturing (38% of portfolios are more than five years old) in an environment where their counterparts are flush with dry powder, thereby making other PE firms the most likely buyers in an exit.

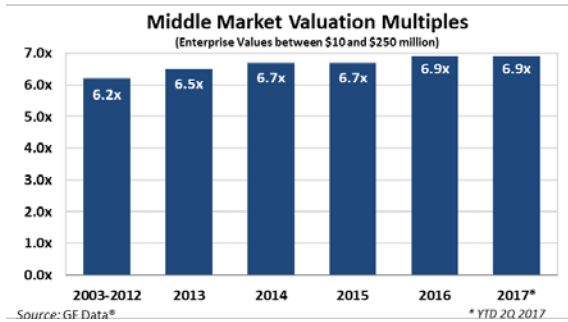
Median deal exit size continued to increase in 3Q17 to \$215m (up 13.2% over FY 2016) due to the aforementioned increase in deal multiples.



From a sector standpoint, the healthcare and consumer space exits are not as prominent as they were last year, but considering the heavy investments made in such sectors from 2010 to 2013 and the increased median hold time, greater activity is expected in the short term. In the first nine months of 2017, the IT sector showed the greatest amount of exit capital at \$25.71bn, which reflects strong PE interest in cloud, SaaS (software as a service), and other PE-friendly IT trends.

According to data reported from 201 PE funds and deal sponsors to GF Data®, 49 transactions were completed during the third quarter with an average valuation of 7.5x. This compares to a lower middle-market adjusted EBITDA multiple of 6.9x reported by GF Data for deals completed over the last six quarters. GF Data CEO Andrew Greenberg believes that this continued appreciation allows for frothy market conditions extending to businesses that are more pedestrian and may signal a peak in market valuations. In addition, GF Data co-founder Graeme Frazier notes that many transactions which were once acquired as stand-alone companies are now

being acquired as bolt-ons, which is another reason multiples may be creeping up.



There is a continued re-assertion of the *quality premium*, which GF Data refers to as the valuation reward offered for above-average financial performance. As of August, this premium was at a record high 33%, an incredible figure when considering that the range for the past two years was approximately 20%.

Furthermore, GF Data defines above-average financial performance as businesses with both EBITDA margins and revenue growth rates at or above 10%, or with one factor above 12% and the other metric at 8% or above. Deals with such characteristics have been more prevalent in larger transactions (\$100m-250m in Total Enterprise Value or "TEV"), as the quality premium is reflected in a 10.3x multiple through 2Q. Companies in the same group (ex-premium) generated an average multiple of 8.8x. On the other hand, smaller transactions of \$10-25m averaged a 6.4x multiple for above-average performers and 5.6x for their counterparts.

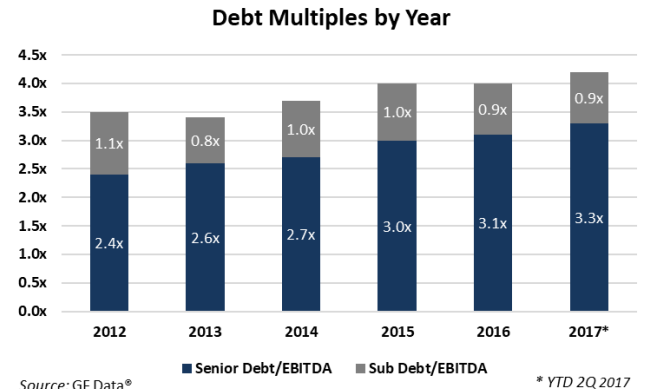
Deal Structure & Terms

Debt Dominates in a Low-Rate Environment

Average debt on deals in the \$100-\$250m TEV range completed through YTD 2Q17 was 4.3x for total debt (comprised of 3.3x senior debt). This compares to leverage reported in a recent GF Data survey of 4.6x for 49 transactions completed in 3Q17. Leverage has been increasing, driven in part by the competitive financing environment. Historically, average debt multiples have been on the rise since 2011-2013, when they averaged 3.4-3.5x.

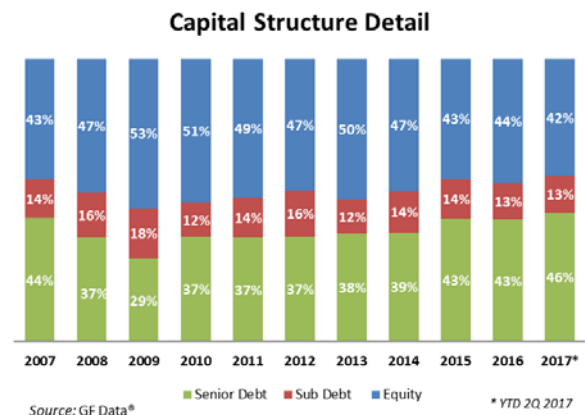
Bank financing remains plentiful and aggressively structured and priced. This is due to banks continuing to push underwriting standards to put abundant capital to work in a low-rate but competitive

environment. As a result, debt continues to increase as a component of the capital structure in the majority of deals.



This view is echoed by Graeme Frazier, GF Data co-founder, who has stated that the three main contributors of increased leverage multiples are the need of debt providers to deploy capital, fear of losing market share, and flight to quality.

Another factor influencing high debt utilization is the current low rate environment. High-yield credit spreads remain at a three-year low, thus making debt financing even more attractive as a way to boost returns. According to *Pitchbook*, in the first half of 2017 the median debt percentage increased to 56.3% of enterprise value, and the median debt-to-EBITDA ratio increased to 5.9x. Although sustainable in the current environment, should a recession occur or interest rates rise too quickly, companies purchased in highly leveraged deals will unlikely be able to service their debt.



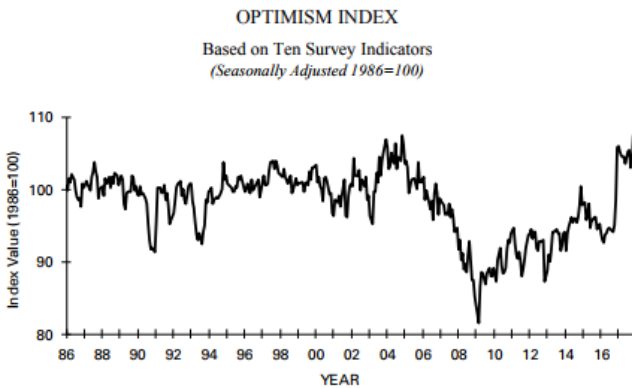
The prevalence of cheap debt financing has further eroded the average equity contribution as a percentage of a transactions capital structure. Through YTD 2Q17 this figure averaged 41.5%, which is down from the 2009 high of 52.8%.

According to the *August 2017 GF Data® Key Deal Terms*, in response to the continued erosion of equity in the capital structure, there has been a substantial increase in the utilization of rep and warranty insurance (7.5% of reported deals in 2016 compared to 34% in the first half of 2017). Deals containing reps and warranties have also closed at half a turn of leverage higher than deals without such terms (7.2x versus 6.7x).

In addition, indemnification cap levels, the maximum liability for a seller as a percentage of the purchase price, declined to 11% in 2017 from 16% in 2015-2016.

What Is Next?

Optimism & Tax Reform to Sustain Markets



OPTIMISM INDEX
Based on Ten Survey Indicators
(Seasonally Adjusted 1986=100)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2012	93.7	94.5	93.1	94.2	94.0	91.9	91.5	92.7	92.7	93.0	87.2	88.0
2013	88.8	90.9	90.0	91.7	94.0	94.0	94.4	94.0	93.8	91.5	92.2	93.8
2014	94.0	91.6	94.0	94.8	96.2	95.4	96.0	95.9	95.3	96.0	97.8	100.3
2015	97.7	98.1	95.7	96.5	97.9	94.6	95.7	95.7	96.0	96.0	94.5	95.2
2016	93.9	92.9	92.6	93.6	93.8	94.5	94.6	94.4	94.1	94.9	98.4	105.8
2017	105.9	105.3	104.7	104.5	104.5	103.6	105.2	105.3	103.0	103.8	107.5	

According to NFIB's Small Business Economic Trends, the Index of Small Business Optimism rose 3.7 points to near Reagan-era highs at 107.5 in November, signaling continued owner optimism. Given the removal of uncertainty from the passage of recent tax legislation and the current deregulatory environment, this index will likely continue to improve in the short-term. Nonetheless, remaining uncertainty on healthcare reform and the stalled pace of deregulation to date will likely cap the upper bounds of this index for the time being.

Capital spending further signals additional owner optimism, with 59% of respondents making capital expenditures (capex). Of capex, the majority of funds were disbursed for new equipment and vehicles.

TYPE OF CAPITAL EXPENDITURES MADE
Percent Purchasing or Leasing During Last Six Months

Type	Current	One Year Ago	Two Years Ago
Vehicles	29	25	25
Equipment	40	36	44
Furniture or Fixtures	13	13	10
Add. Bldgs. or Land	6	4	7
Improved Bldgs. or La	16	15	16

Looking forward, there are several factors conducive to deal making and sustaining high valuations in the short to intermediate term. First, a large amount of dry powder remains that needs to be invested and PE firms have a glut of aged inventory that they will need to liquidate in the near term. Second, investors will continue to seek debt financing while rates remain low and creditors are willing to lend. Lastly, lower corporate taxes will likely boost portfolio returns and corporate spending, which could also mean an uptick in corporate acquisitions.

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: Richard Wilusz, Investment Banking MBA Intern

Sources: Pitchbook - The Private Equity 2017 Third Quarter Private Equity Breakdown; GF Data® November 2017 Report; NFIB Small Business Economic Trends, November 2017

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