CAPITAL MARKETS UPDATE

Middle Market M&A

Q3 2023

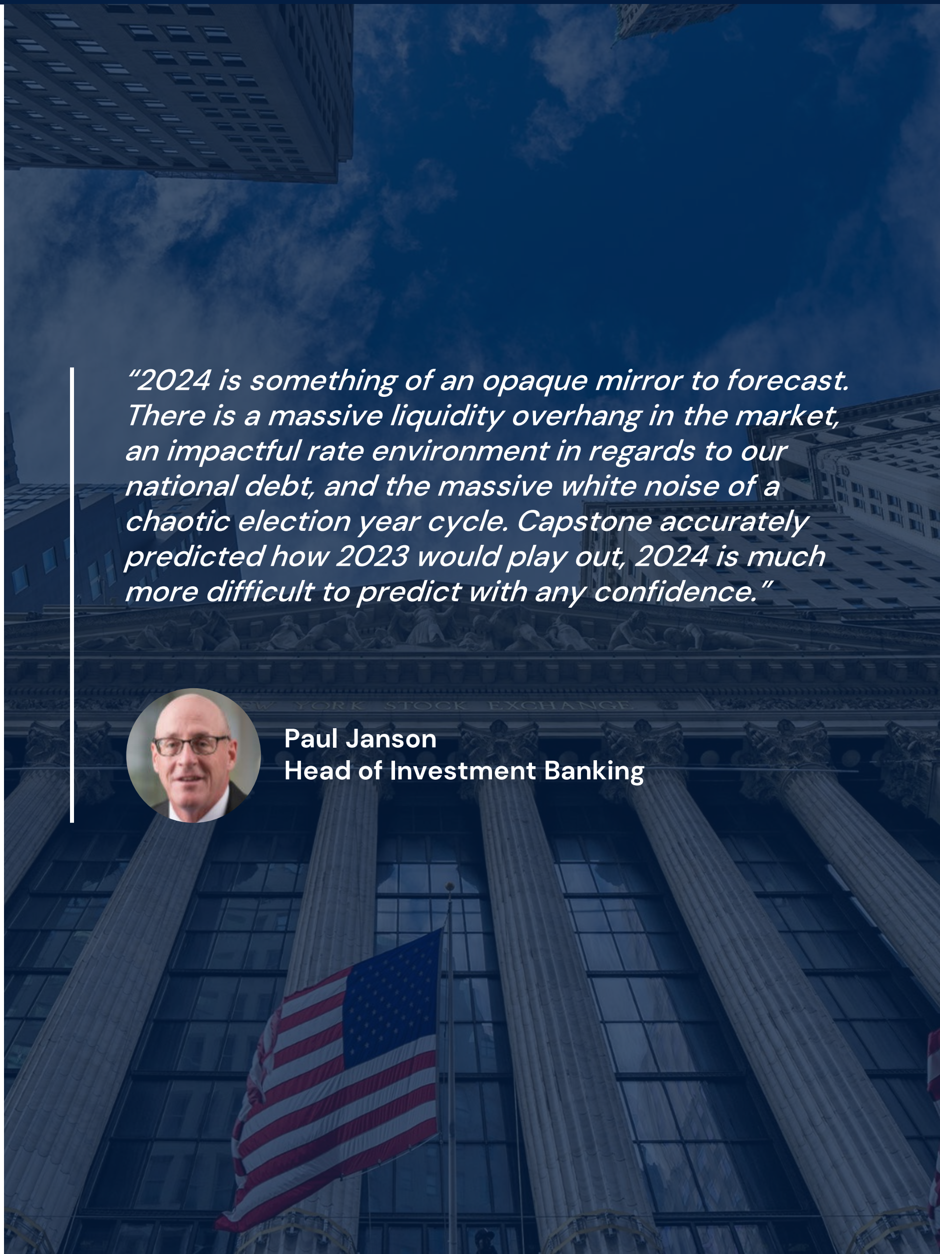
CAPSTONE PARTNERS

MARKET COMMENTARY

Building the Foundation for a Resurgence

Steadily retreating inflation has given credence to the elusive soft-landing scenario that the market has eagerly rallied behind. While 10-year treasury yields briefly flashed at 5% in October, confidence in the disinflation trend has since cooled bond yields and given equity markets breathing room. The Fed's 525 basis points of tightening has coerced a moderation in prices, with the core personal consumption expenditures index rising 3.5% year-over-year (YOY) in October—a continued decline from prior months and the lowest level since April 2021. Federal funds rate futures have even indicated that some market participants are anticipating interest rate cuts as soon as March. While the economy has seemingly avoided a crash landing, persistent progress in disinflation is needed before declaring victory. As noted by Huntington Bank (NASDAQ:HBAN) Commercial Bank Economist Ian Wyatt in a feature on page four, interest rate forecasts have continually missed the mark—who's to say an unexpected interest rate hike is not a possibility?

Merger and acquisition (M&A) markets are waiting for the "all clear" sign. Lending standards have tightened, valuations have contracted, and due diligence requirements have heightened; all against a backdrop of a more stringent regulatory environment. Sell-side participants have been grappling with these headwinds for several quarters and it is largely symptomatic of the business cycle. However, dealmaking remained sluggish through Q3 with total closed transactions falling 13.7% YOY with average deal value declining 24.7%. Dealmakers expect volume to remain tepid to close the year. Meanwhile, optimism in transaction markets is quietly building with business owners increasingly eyeing exit opportunities for the first half of 2024. Middle market business owners are planning to go on the offensive, with over half (50.8%) looking to execute growth strategies over the next 12 months, according to Capstone's Business Owners Survey.



"2024 is something of an opaque mirror to forecast. There is a massive liquidity overhang in the market, an impactful rate environment in regards to our national debt, and the massive white noise of a chaotic election year cycle. Capstone accurately predicted how 2023 would play out, 2024 is much more difficult to predict with any confidence."

Paul Janson
Head of Investment Banking

MARKET COMMENTARY

M&A valuations retreated significantly in Q3, falling to 8.1x EV/EBITDA, from 9.2x in the previous quarter. The compression in debt multiples has weighed on pricing, as buyers are not receiving the same degree of turns on EBITDA as prior years. The average debt multiple for private equity middle market transactions amounted to 3.5x Total Debt/EBITDA in Q3, which marked a decline from 3.7x in Q3 2022, according to GF Data®. Private equity buyers have been forced to put forth greater equity contributions to close deals and meet this valuation gap. However, even at an average equity contribution of 57.9%, valuations have remained lower.

Higher transaction financing costs and a challenging exit environment have stifled private equity returns. In 2023, private equity gains have trailed public markets, with one-year rolling internal rates of return amounting to 0.7%, according to PitchBook. As a result, many large private equity firms have placed increased focus on private credit lending and secondaries investing to bolster returns for limited partners. However, capital deployment towards acquisitions continued to slow through year-to-date (YTD) Q3, with total closed private equity transactions falling 26.1% YOY.

Sponsors have increasingly eyed smaller transactions that require less debt utilization, which has benefited select middle market targets. Notably, add-ons accounted for 76.1% of total private equity dealmaking through Q3. Moving through year end and into early 2024, the exit environment remains clouded with sponsors extending holding times. The number of exits in Q3 fell to its lowest level since Q2 2020—pointing to hesitancy among many sponsors to realize investments at potentially discounted valuations. While business owners and financial acquirers will likely need to contend with a higher-for-longer rate environment, this is not entirely new territory. The cost of money becoming meaningful again will likely place a greater premium on high-quality targets with robust cash flows that can quickly service debt. Private equity firms still have the luxury of vast reserves of dry powder, and following lackluster returns in recent quarters, limited partners will want to see this capital put to work.

Strategic buyers have slowed acquisition activity through Q3, with closed deals among private and public buyers falling 19.4% and 26.7% YOY, respectively. An uncertain macro backdrop has pressured dealmaking with many strategics seeking greater economic transparency before deploying significant dollars towards acquisitions. As a result, the average purchase price has retreated through Q3 with the average enterprise value for deals closed by private buyers falling 26.7% YOY. Average enterprise value for transactions closed by public buyers has been more resilient, declining a modest 4.9% YOY.

Many corporate players in highly cyclical industries have refrained from aggressive inorganic growth strategies in recent quarters, choosing to prioritize internal operations. However, others have pursued acquisitions to offset slowing organic sales which may fuel further consolidation across industries facing challenges to top-line growth. As strategics look towards growth strategies for 2024, dealmaking is likely to accelerate in the next several quarters.

M&A markets have seemingly been approaching its trough for the past few quarters. However, many middle market business owners have bolstered their financial profiles and are optimistically looking toward 2024. Notably, 31.2% of middle market business owners plan to engage in M&A either as a buyer or a seller in the new year, according to Capstone's Business Owners Survey. As dealmakers and prospective sellers eagerly move into 2024, confidence is building for a return to the rapid pace of M&A that has characterized prior years.

MIDDLE MARKET OBSERVATIONS

Q3 2023 TAKEAWAYS & THEMES

A sustained higher rate environment, economic uncertainty, and caution in the market has negatively impacted middle market M&A activity.

- The flight to quality continued through Q3 as strategic and financial buyers have been increasingly selective when pursuing acquisition opportunities.
- Quality companies in defensible industries with strong margin profiles have continued to command premium valuations.
- Buyers have increasingly targeted core middle market businesses, rather than chase large-scale acquisitions, to conserve cash while also reducing risk.
- Capital overhang has remained robust, with opportunities available for sponsors to acquire assets at attractive prices.

Early signs point to a recovery in M&A activity towards the first half of 2024, which will likely see a wave of pent-up demand.

- Market participants will need to contend with a higher cost of capital for the foreseeable future and adjust growth strategies accordingly.
- Upon a market recovery, sponsors will likely face LP pressure to actively deploy capital to generate sufficient internal rates of return—creating a frenzy of financial acquirers.
- Demographics are a key catalyst for middle market volume, which has created a healthy pipeline of pent-up demand as aging founders and entrepreneurs seek to monetize their business.
- Macroeconomic clarity will likely prove consequential for transaction activity in the following quarters.

CAPSTONE PARTNERS

TABLE OF CONTENTS

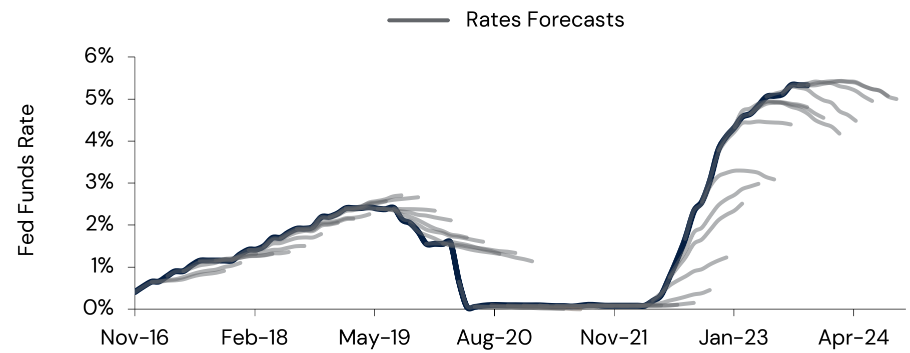
Ian Wyatt
Huntington Bank Commercial Bank Economist
703-785-5827
Ian.Wyatt@huntington.com

Pulling The Economy Back To Normality

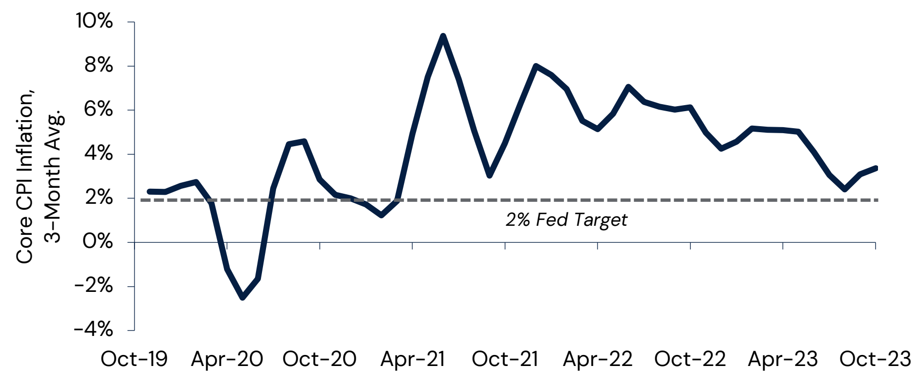
Does the Fed cut rates in Spring as the market expects or does it stick to 'higher for longer'? In 2023, market forecasts for interest rates were consistently too low with the economy outperforming bearish expectations and the Fed hiked rates higher than expected. Now, while additional rate hikes appear unlikely, the Fed has a clear message: it intends to keep rates at or above current levels for an extended period, a policy known as 'higher for longer,' in part, out of fear of repeating historical mistakes. Studying past inflationary shocks tells us inflation tends to be resilient and persistent and central banks often cut rates too soon. Are forecasts going to miss low on rates again this year or does inflation continue to fall towards target levels while the labor market normalizes? Businesses should be careful to hedge their interest rate risks and avoid trusting market forecasts. The Fed may even surprise with another hike.

Labor market normalizes after a volatile three years. The COVID recovery saw the fastest pace of job creation in 20 years and record job turnover, quits, and openings. Companies adapted and sped up hiring processes and lowered requirements. Now, as turnover and job growth have slowed, the balance of power has shifted back to employers with wage increases, hiring time, and turnover reverting to previous levels. Businesses that made changes to the hiring process in 2020-22 might want to revisit which changes are worth keeping as the labor market normalizes.

Market Forecasts of Fed Funds Rate Consistently Too Low



Inflation Nearing Fed's Target



Sources: Bureau of Labor Statistics Core CPI (Consumer Price Index). Rates forecasts from Bloomberg. Implied probabilities of rate cuts sourced from Bloomberg as of 11/27/2023

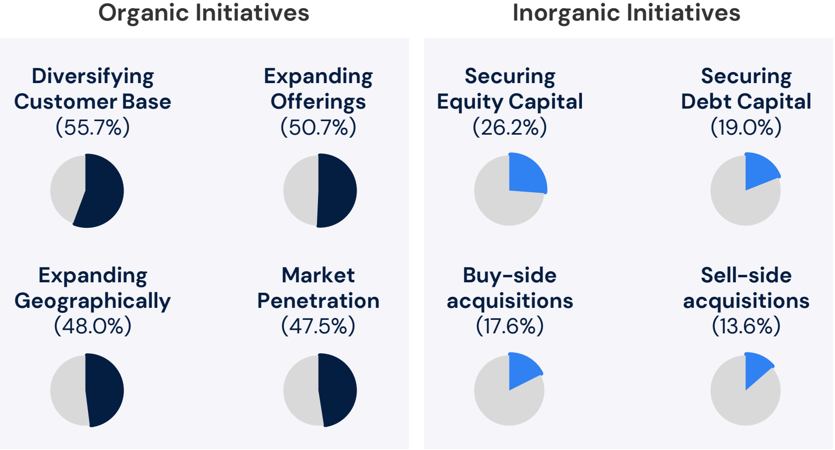
KEY CONSIDERATIONS FOR BUSINESS OWNERS

	Current State	Takeaways for Business Owners
Dry Powder	Abundant	Private equity firms have maintained a consistent level of fundraising through Q3. Sponsors remain armed with vast reserves of dry powder, opting to deploy capital mainly for add-on acquisitions as continued interest rate hikes have increased financing costs for large-scale buyouts.
Buyer Appetite	Selective with a focus on quality	Private strategic buyers have been highly selective in their acquisition targets in Q3. Strategics have continued to eye acquisitions that offer synergies while private equity firms have opportunistically acquired businesses with proven cash flows, often at discounted valuations compared to prior years.
Debt Market	Tightened lending conditions	Debt capital remains available despite a difficult lending environment. Banks have increasingly tightened their lending standards, contributing to the continued rise of private credit and non-bank financing for middle market businesses.
Valuations	Compressed but robust for high-quality companies	M&A valuations fell sharply in Q3 to an average of 8.1x EV/EBITDA as financing costs have impacted pricing. Buyers have prioritized profitability and scale, which has allowed quality businesses to secure strong interest.

CEOs PREPARE FOR MARKET REBOUND VIA GROWTH STRATEGIES

- **More than half (50.8%) of business owners polled in Capstone's 2023 Middle Market Business Owners Survey plan to execute growth strategies over the next 12 months** to capture additional market share and gain scale in preparation for a market rebound. Among CEOs planning growth strategies, most have prioritized organic initiatives including diversifying customer bases (55.7%), expanding offerings (50.7%), and penetrating new geographies (48%). While organic measures can support revenue growth, inorganic growth practices have remained a key strategic option to expedite expansion. Of note, 26.2% of owners plan to raise equity capital as the elevated cost of debt capital has persisted. M&A transactions have also remained prevalent, with 17.6% of CEOs surveyed planning a buy-side acquisition to capitalize on compressed M&A valuations. Only 13.6% of owners plan to engage in an acquisition as a seller as many sell-side prospects have opted to delay deal execution in hopes of a more favorable valuation environment.
- **As the majority of CEOs surveyed indicated growth strategies are a priority for 2024, the lion's share (31.5%) of owners anticipate a need for growth strategy support services.** Similarly, 28.5% of owners require accounting and audit support to shore-up cash flows and establish financial stability. In addition, more than one-fourth of CEOs demonstrated an interest in accessing relevant industry research to keep up with emerging industry trends, complete competitor analyses, and track capital markets activity in their space.
- **In 2023, 26.4% of CEOs surveyed indicated they have yet to start planning a business exit, illustrating the need for professional advisory services.** Owners' succession planning has heavily depended on annual revenue generated, as CEOs of smaller companies (less than $10 million in annual revenue) plan to transfer ownership to family and larger company operators (more than $10 million in annual revenue) plan to transfer ownership to business partners.

Priority Growth Strategies Over the Next 12 Months



Top Financial Services Required by Business Owners in 2024

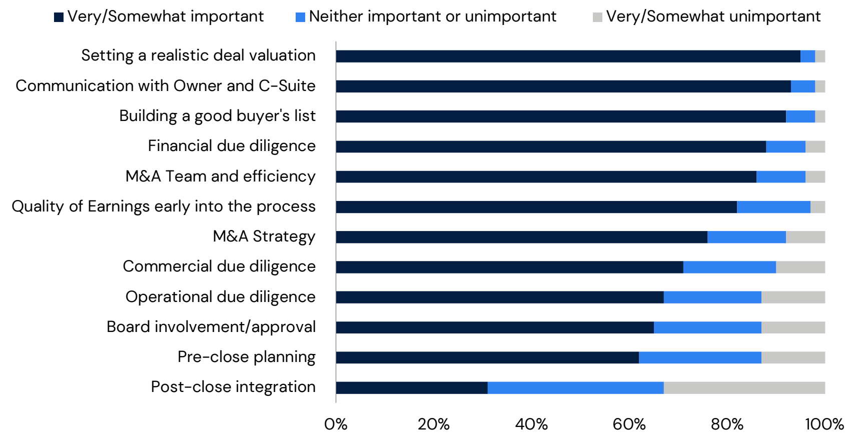
- **31.5%** Instituting a growth strategy
- **28.5%** Accounting & audit support
- **25.7%** Access to industry research
- **20.0%** Raising equity capital
- **17.0%** Corporate restructuring
- **15.6%** Interim management

Source: Capstone Partners' Middle Market Business Owner Survey, Sample Size (N): 435

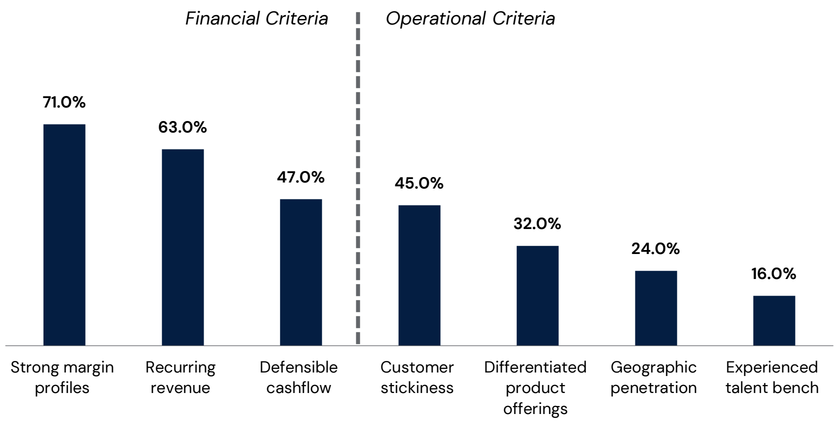
STRONG FINANCIALS & REALISTIC VALUATIONS DRIVE M&A SUCCESS

- The sale of a business is a momentous decision for an owner. **To achieve a successful M&A deal for a seller, nearly all (95%) advisors polled in Capstone Partners & IMAP 2023-2024 Trends in Global M&A Survey pointed to setting a realistic deal valuation as very or somewhat important**, closely followed by communication with the owner and C-Suite (93%), building a good buyer's list (92%), and financial due diligence (88%). These success elements closely align with the deal closing hinderances advisors faced throughout 2023, with the majority (58%) of investment bankers identifying sellers' excessive transaction valuation expectations as a primary hurdle. Strong communication with the selling entity's owner and C-Suite can also rectify a misalignment on valuation expectations.
- **Buyers have become increasingly selective in their acquisition pursuits, prioritizing target companies with strong financial profiles.** This has largely been driven by a difficult transaction financing environment with many acquirers hesitant to employ significant leverage at elevated rates. Financial criteria comprised the top three most important M&A target characteristics for acquirers in 2023, as noted by total advisers surveyed. This includes strong margin profiles (71% of advisors), recurring revenue (63%), and defensible cashflow (47%). However, select operational criteria has remained relevant to acquirers in 2023 such as customer stickiness (45%) and differentiated product offerings (32%).
- **M&A purchase multiples are expected to remain compressed in 2024, with 67% of M&A advisors anticipating little to no change in valuations compared to 2023**, likely driven by market/economic uncertainty and a lack of motivated acquirers. Advisors showcased significant consistency regarding 2024 industry valuation forecasts, with the TMT, Healthcare, and FinTech & Services industries most likely to receive the highest M&A valuations, matching industry valuation rankings from 2023.

Most Important Elements in a Sell-Side Transaction



Foremost Target Company Characteristics for Acquirers



Source: Capstone Partners & IMAP 2023-2024 Trends in Global M&A Survey, Sample Size (N): 100

Q3 2023 BY THE NUMBERS

13.7% ⇩
DECREASE IN DEAL VOLUME

M&A volume has continued to decline, falling 13.7% YOY through Q3 amid persistent caution in transaction markets.

$53.6M ⇧
AVERAGE DEAL VALUE

Average deal value increased by 6.2% QoQ in Q3 as buyers exhibited a continued flight to quality in their acquisition strategies.

8.1x ⇩
AVERAGE EBITDA MULTIPLE

The average EBITDA multiple in Q3 fell substantially to 8.1x EV/EBITDA from 11.0x EV/EBITDA in the prior year.

26.1% ⇩
DECREASE IN PE TRANSACTIONS

Private equity transaction volume fell 26.1% YOY as higher borrowing costs have begun to severely impact volume.

12.5% ⇩
DECREASE IN PE FUNDRAISING

Private equity fundraising fell YOY to $134 billion. Sponsor returns have been challenged through the first three quarters.

12.3x ⇨
$100-$250MM EBITDA MULTIPLE

Pricing in the core middle market nearly mirrored prior year levels and outpaced the broader middle market average.

3.5x ⇨
AVERAGE DEBT MULTIPLE

Average debt multiples declined YOY to 3.5x, however, debt coverage improved on a QoQ basis.

3.6% ⇧
PRIVATE BUYER AVERAGE VALUE

Average deal value for transactions closed by private strategics increased modestly in Q3 from Q2 to $51.1 million.

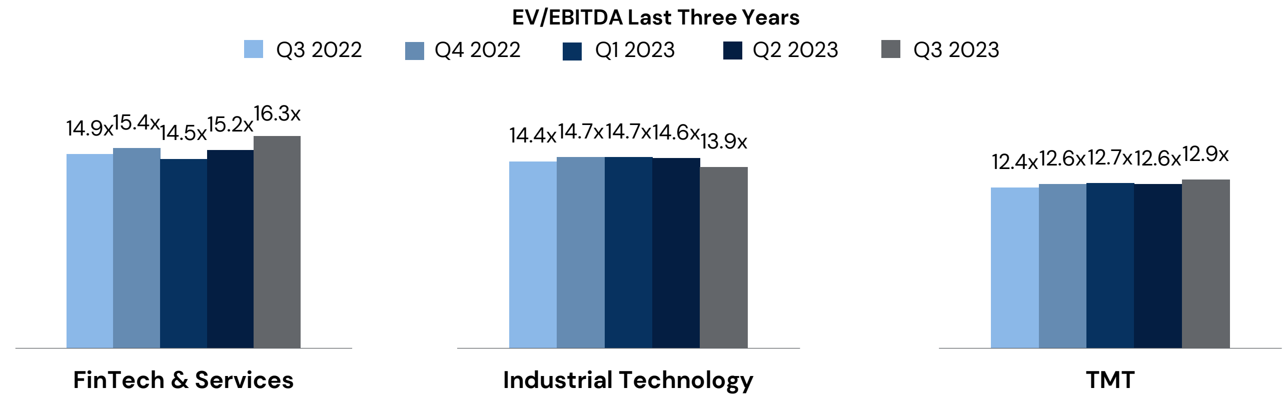
$1.5T ⇧
GLOBAL PE DRY POWDER

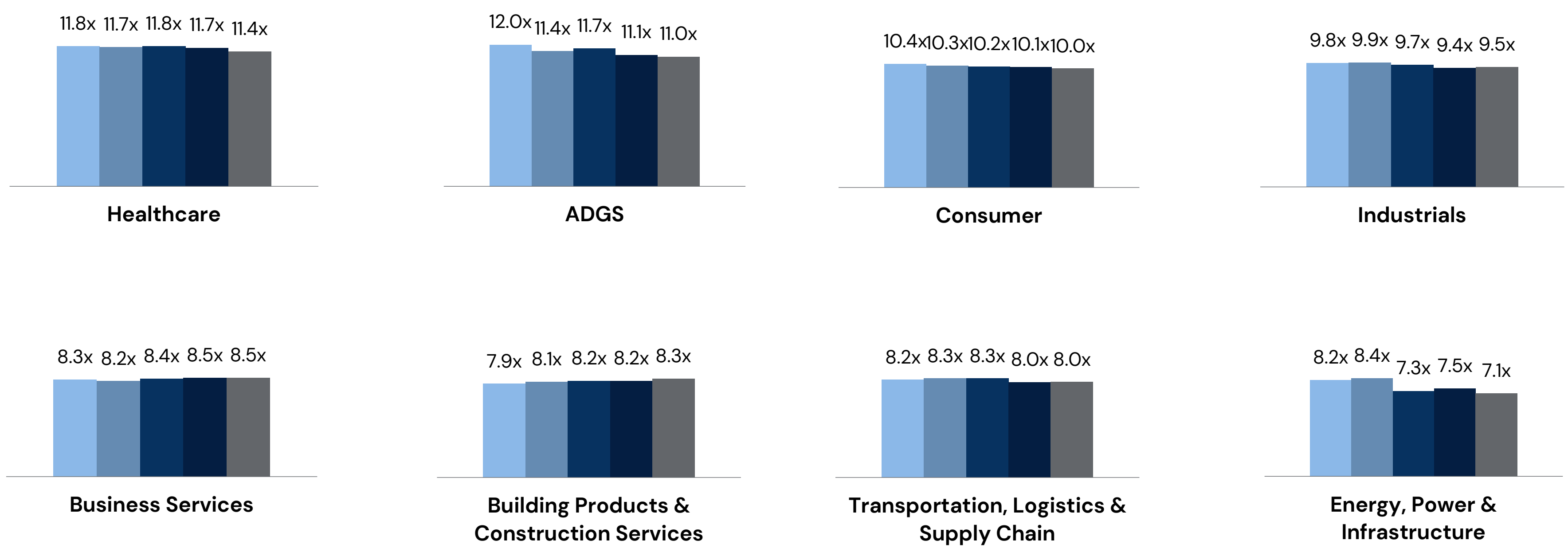
Capital overhang has remained at elevated levels, with an overwhelming majority concentrated in U.S funds.

CAPSTONE'S PROPRIETARY MIDDLE MARKET VALUATIONS INDEX

Middle Market M&A Valuation Takeaways

- Capstone Partners actively monitors the purchase multiples of middle market transactions through its proprietary database to provide insight and transparency into the pricing environment.
- The FinTech & Services industry has continued to lead middle market pricing, followed by the Industrial Technology space.





CAPITAL MARKET DASHBOARD

YTD EQUITIES

S&P 500
+17.3%

Last	1Y %	P/E LTM
4,502.9	*+12.8%*	*22.0*

Dow Jones Industrial
+5.6%

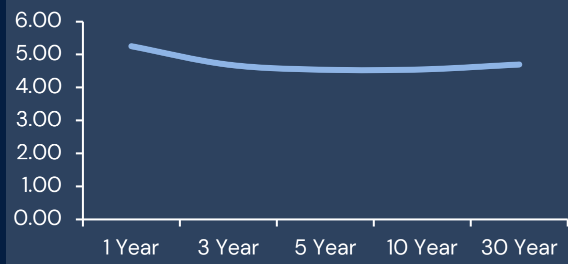
Last	1Y %	P/E LTM
34,991.2	*+4.2%*	*19.4*

NASDAQ
+34.8%

Last	1Y %	P/E LTM
14,103.8	*+24.2%*	*30.9*

FIXED INCOME

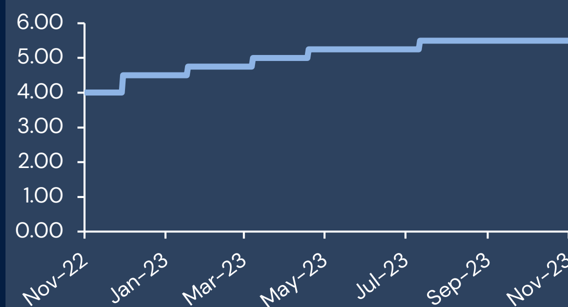
U.S. Yield Curve



1Y	3Y	5Y	10Y	30Y
5.257	*4.690*	*4.533*	*4.544*	*4.695*

POLICY RATE

Federal Funds Target Rate



ECONOMIC INDICATORS

GDP, LABOR MARKET, & INFLATION

	Last	YOY
GDP	*4.9%*	*+2.2%*
Consumer Confidence	*102.6*	*+0.4%*
Unemployment	*3.9%*	*+0.2%*
Consumer Price Index	*307.6*	*+3.2%*

HOUSING MARKET

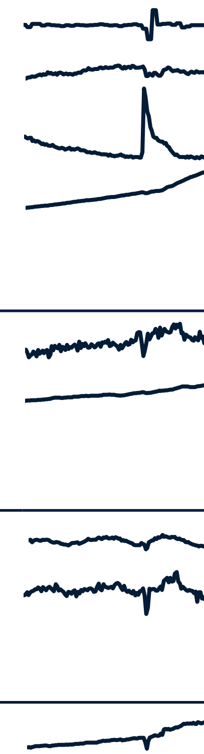
	Last	YOY
Housing Starts	*1,358.0*	*-7.2%*
Total Construction	*$1,996.5*	*+8.7%*

PMI & NMI

	Last	YOY
Purchasing Managers	*46.7%*	*-6.6%*
Non-Manufacturing	*51.8%*	*-4.9%*

RETAIL

	Last	YOY
Retail Sales	*$705.0*	*+2.5%*



Source: FactSet as of 11/16/23

CAPSTONE PARTNERS

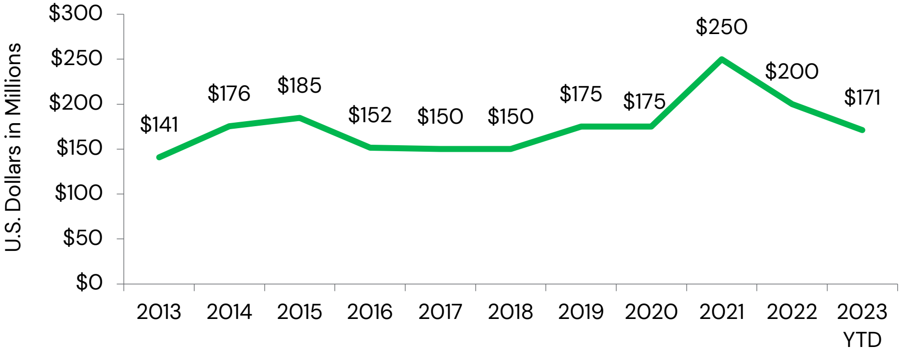
EQUITY PRIVATE CAPITAL MARKETS CONDITIONS

Chris Hastings
Managing Director, Head of Equity Capital Markets
917-339-3528
chastings@capstonepartners.com

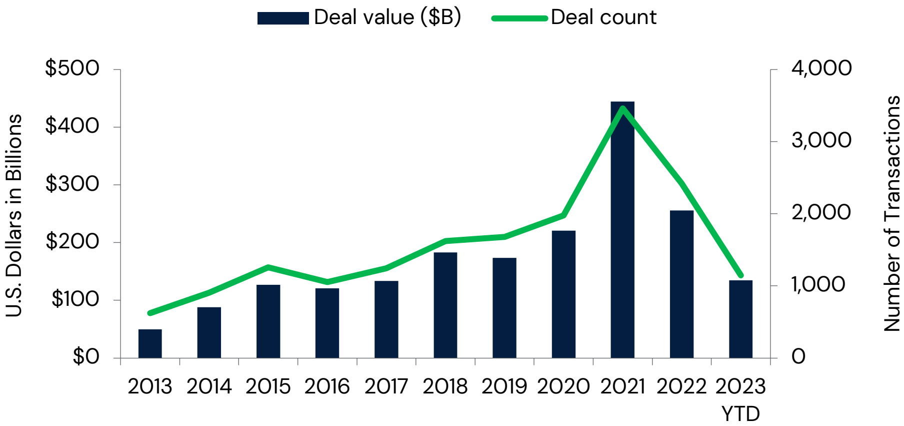
Growth capital volumes continue to lag the bull market years of 2020-2022, but private markets are tracking 2019 levels. Despite the turbulence in public equities and M&A so far this year, growth equity investments into late-stage private companies have tracked with levels seen in 2019, as growth investments through Q3 have totaled $134 billion—77% of 2019's full-year total. Furthermore, while deal activity in 2023 has trailed annual levels seen in recent years (with an average of $307 billion annually from 2020-2022), 1,148 transactions have closed through Q3 2023. There were three transactions ~$1 billion or higher including Anthropic's $4 billion transaction with Amazon (Nasdaq:AMZN), BrandSafway's $1.1 billion raise ($3.8 billion when including debt), and Redwood Materials' $997 million investment from Capricorn and Goldman Sachs (NYSE:GS).

Valuations continue to come under pressure as the market resets from 2021 levels. Lingering (but improving) concerns surrounding the U.S. macroeconomic picture, uncertainty in the medium-term interest rate environment, and depressed public comparables continue to moderate valuations for growth-stage companies. However, valuations followed similar trends as the deal value figures discussed previously. While moderated from the bull market years, valuations have largely tracked pre-pandemic levels. Through the third quarter, median pre-money valuations have been consistent with those in 2019 and 2020, at $171 million. Furthermore, when looking at the median pre-money valuation by quarter, Q3 2023 saw a step-up from Q2 2023 as median valuations increased from $204 million to $230 million.

Median Pre-Money Valuations for Growth Companies



Growth Capital Raised by Year



Source: Capital IQ, PitchBook
Note: Year-to-date (YTD) ended September 30;
Includes all VC stages and Growth Equity transactions excluding deals < $25 million

EQUITY PRIVATE CAPITAL MARKETS CONDITIONS (CONTINUED)

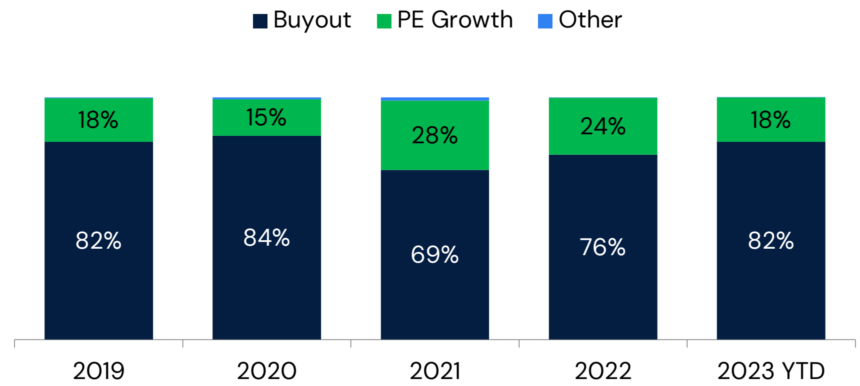
The initial public offering (IPO) market saw a narrow reopening in September for a select group of mature, profitable companies. The value of Arm (Nasdaq:ARM), Instacart (Nasdaq:CART), and Klaviyo's (NYSE:KVYO) IPOs totaled $6.5 billion, which equates to 38% of total U.S. IPO volume ($16.9 billion) this year. As of September 30th, Arm and Klaviyo were trading 5% and 15% above offer price, respectively. Meanwhile, Instacart closed the quarter down 1% from offer price. Investors across public and private markets will continue to watch recent IPO performance to estimate future market appetite and valuation stability.

North American QoQ M&A deal count across all enterprise value ranges declined by 6% while deal value dropped a more severe 25%, according to Pitchbook, as deal makers continued to turn toward smaller deals in the face of higher financing costs, reduced lending, and lingering valuation disconnect. Because of this, many founders are considering postponing a full sale until M&A valuations stabilize. One solution is for founders to sell a minority stake today to pave the way for a full sale in the future. Founders doing so could 1) use some portion of the raise for secondary liquidity and 2) provide growth capital to accelerate their business plan as they grow EBITDA.

Fundraising remains challenged for private equity and growth equity funds. Following record levels of fundraising in 2022, the environment for new growth and private equity funds is limited to larger general partners (GPs) who have a differentiated investment thesis and track record. During the first three quarters of 2023, $313 billion in growth and private equity has been raised across 309 funds. This marks a 13% decline in dollar amount and a 37% fall in fund count YOY, according to PitchBook.

Compared to recent years, U.S. Private Equity growth funds make up a smaller share of YTD 2023 PE fundraising. Currently, 18% of PE capital raised YTD is for growth strategies, down from 24% in 2022 and 28% in 2021. While growth fund capital formation has been muted, growth capital deployment has continued its resilience. PE growth deals accounted for 15% of all private equity deals in Q3 by value. This represents a new quarterly high and well above its historical 10-year average of 9%. On a deal count basis, growth equity accounted for one out of every five private equity deals YTD.

U.S. Private Equity Capital Raised by Type



Source: Capital IQ, PitchBook
Note: Year-to-date (YTD) ended September 30; IPO Volume excludes SPACs

EQUITY CAPITAL MARKETS GROUP

The Equity Capital Markets Group focuses on raising equity capital financing for growth-oriented companies and structured equity for more mature middle market enterprises. Our team works closely with companies to secure equity capital to fund growth initiatives, recapitalize the balance sheet (often including shareholder liquidity), and to finance M&A transactions.

FINANCIAL ADVISORY SERVICES

Adam Brissette
Director, Financial Advisory Services
774-239-2525
abrissette@capstonepartners.com

Fairness Opinions: Increasingly Relevant for Private Deals

For decades, fairness opinions were most commonly associated with M&A transactions involving public companies. This was due, in part, to legal precedent and disclosure requirements. In the early 1980s the Chancery Court of Delaware established that, in carrying out their basic fiduciary responsibilities (including oversight and disclosure), public company boards of directors were obligated to perform their own diligence on material M&A transactions. While not explicitly required by law, obtaining a fairness opinion has been firmly established as best practice for public company boards seeking to gain shareholder approval of a transaction.

Private company boards share the same fiduciary responsibilities as their public counterparts but are not burdened with the same level of disclosure requirements and oversight from the SEC. Fairness opinions, while valuable to private company boards and stakeholders, have not historically been a standard operating procedure in deals involving private companies. In private capital market transactions involving private equity funds—especially those in which conflicts of interest are perceived—fairness opinions are increasingly relevant and expected by investors.

What is a Fairness Opinion?
A fairness opinion is a third-party expert analysis that assesses whether a proposed purchase price is fair. It is usually completed when an M&A transaction is imminent but has not yet closed. Companies, boards of directors, and key stakeholders rely on these independent value assessments to affirm they are upholding their fiduciary responsibilities in approving the transaction. Unlike other valuation analyses or opinions, a fairness opinion does not establish a transaction price or conclude a specific value, nor does it tell a seller whether they are maximizing transaction value.

A fairness opinion involves rigorous valuation analysis that provides clients with an independent assessment to mitigate risk, enhance transparency with stakeholders, and enable informed decision-making when assessing transactions that can have a material impact on shareholder value.

When conflicts of interest, perceived or otherwise, are present in an M&A transaction, a fairness opinion can serve as the first line of defense against claims that the conflicts in question negatively impacted shareholders and led to something other than a fair deal. Common conflicts include:

1. Related or Affiliated Parties: Was the transaction in question negotiated in good faith at an arms length?

2. Minority Shareholder Dispute: Did the controlling shareholder/owner/CEO strike a deal that negatively impacted the minority shareholders for their own benefit?

3. Shareholder Lawsuit: Deals involving companies where shareholder lawsuits have already been threatened or initiated.

Litigation Considerations
CEOs and boards of directors often view fairness opinions as an insurance policy to safeguard themselves from personal liability in the

case of shareholder lawsuits. Ninety percent of public company M&A transactions are met with shareholder litigation challenging some aspect of the deal, according to Hogan Lovells.

The private equity community is not immune to this litigious environment, as evidenced by a high-profile case involving The Carlyle Group (Nasdaq:CG). In June 2022, the Delaware Court of Chancery, in *Manti Holdings, LLC v. Carlyle Group Inc*. held that a minority shareholder could proceed with a claim against Carlyle and its directors which alleged that they breached fiduciary responsibilities in approving the sale of a portfolio company in a transaction that did not maximize shareholder value.

The deal in question was Carlyle's sale of Authentix to Blue Water Energy for $77.5 million in upfront consideration and $27.5 million in contingent earnout consideration. Under the transaction, Carlyle maximized value on its $70 million preferred holdings, but common shareholders received nominal consideration. A dissenting board member, who represented minority shareholder Manti Holdings, on multiple occasions urged the board to end negotiations and reenter the market at a later date when conditions were more favorable and Authentix's financial performance was improved. Manti also argued that the transaction sacrificed value to shareholders in exchange for a timely sale that would enable Carlyle to shut down a legacy fund. The board ultimately obtained majority approval and went through with the transaction but now faces significant legal battles.

The Authentix case provides critical takeaways for boards of private equity firms as they endeavor to uphold their fiduciary responsibilities.

Investment Horizon
Speed and certainty to close is always a consideration when contemplating an M&A transaction. Private equity funds at or near the end of their investment horizons often feature dynamics where quickness to closing holds greater weight than maximizing price. However, the recent Authentix ruling made clear that speed to close cannot be the only consideration, especially when a board's fiduciary duties of loyalty and care are compromised or reasonably questioned throughout the transaction.

Conflict of Interest Amongst Shareholder Classes
There are a variety of stakeholders impacted by an M&A transaction. Even within the capital stack there are often competing priorities amongst share classes. In the Carlyle case, the court ruled that the directors—who were fiduciaries of both Carlyle and Authentix—were likely conflicted by the transaction and potentially acted disloyally given the differing levels of consideration received by preferred shareholders (Carlyle) and Authentix stockholders. The expedited sale enabled Carlyle to maximize its return on its preferred stock investment while Authentix's common shareholders stood to benefit only if the company sold for a higher price (which the minority shareholder argued would have occurred with better market timing).

The litigation arising from the Authentix case highlights the complexity and depth of issues that business owners, boards, and shareholders need to take into consideration when assessing an M&A transaction. A fairness opinion does not prevent litigation, but it provides an independent assessment of the transaction, taking into consideration the same facts and circumstances the key stakeholders are balancing in arriving at a decision to transact.

Capstone's Financial Advisory Services Group has an extensive array of valuation advisory services and litigation support services to help owners, boards, special committees and investors fulfill their fiduciary responsibilities. To learn more about Capstone's fairness opinion capabilities, contact us.

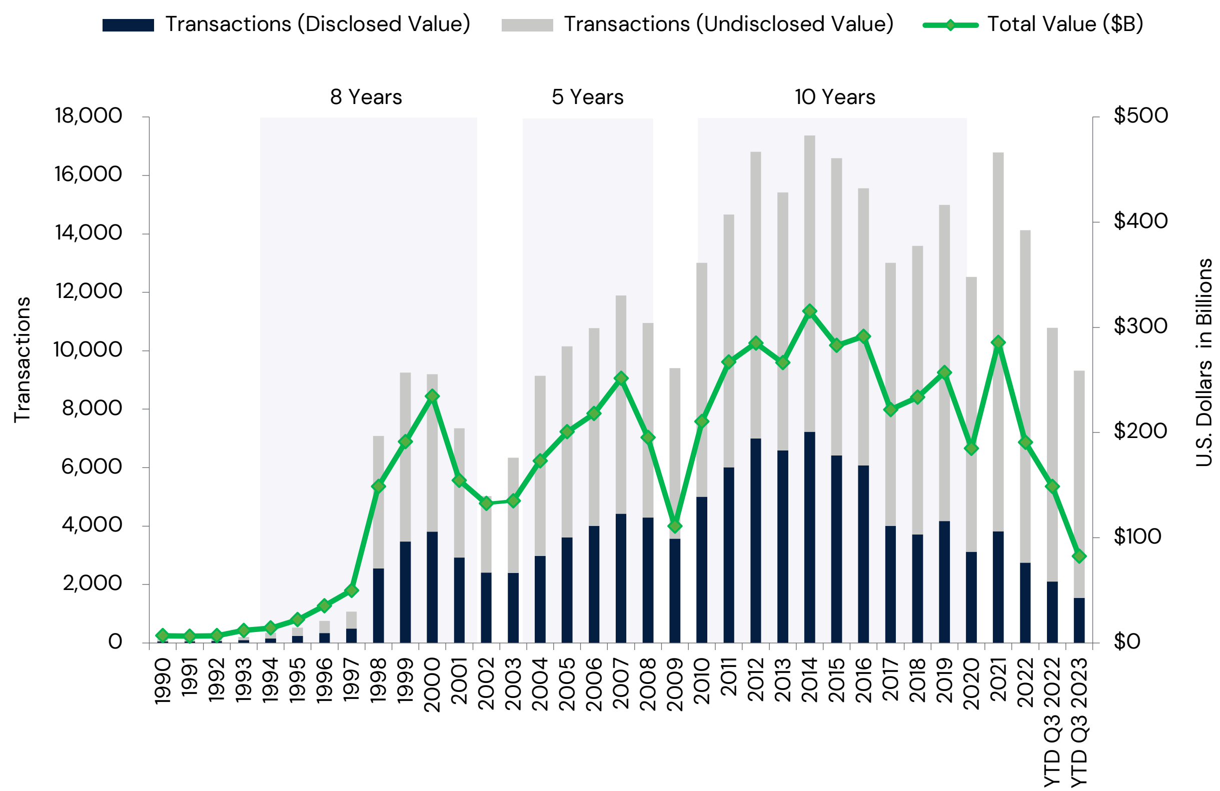
MIDDLE MARKET M&A ACTIVITY

M&A AMID ECONOMIC CYCLES

MIDDLE MARKET VOLUME REMAINS TEPID

- Middle market M&A volume continued to decline through Q3, falling 13.7% YOY. Elevated interest rates, an increasingly stringent regulatory environment, and caution among market participants have dampened transaction appetite.
- Dealmaking in the middle market has remained significantly more resilient than broader M&A markets, which registered a 25.2% YOY decline through Q3.
- Amid a higher-for-longer interest rate regime, M&A participants will likely need to become accustomed to a higher cost of capital which will have far ranging impacts from affecting borrowing capacity to internal rates of return (IRR).

Middle Market Transactions

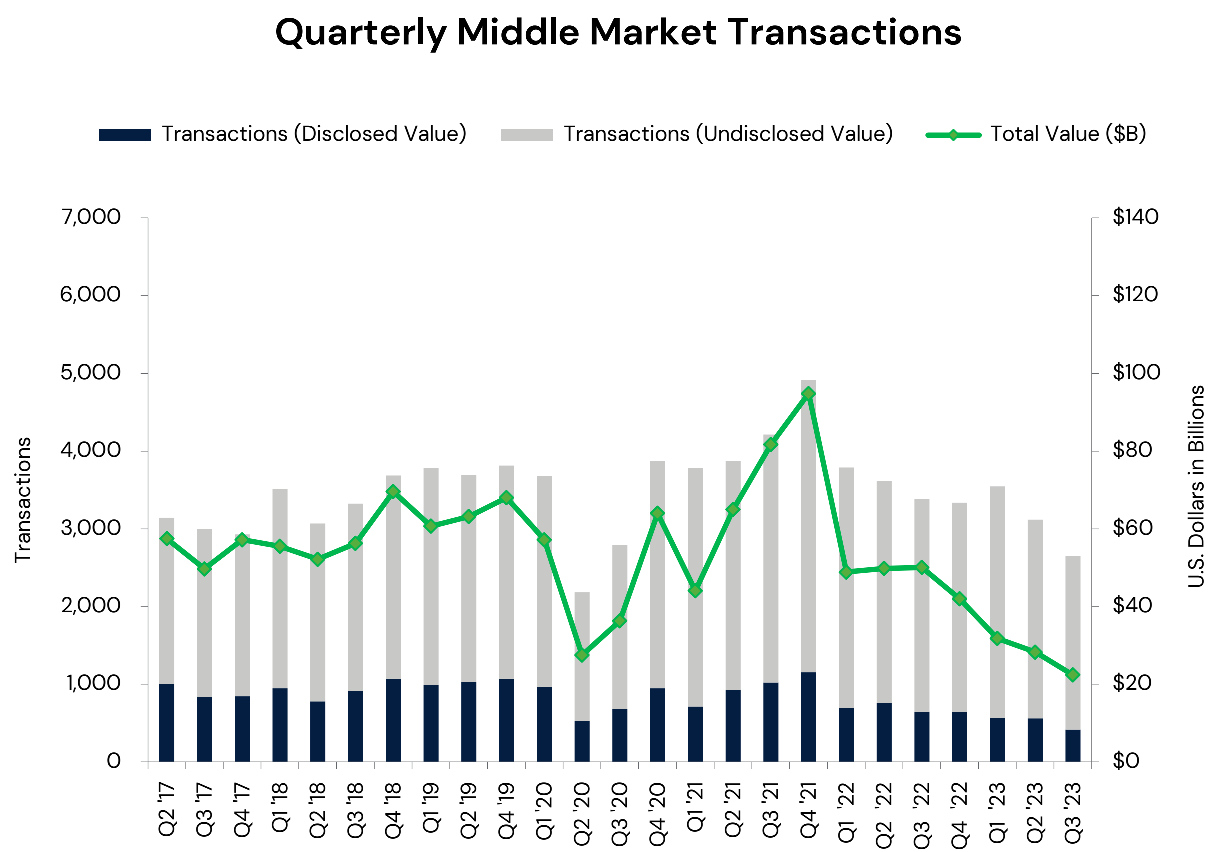


Shaded areas indicate expansion
Source: Capital IQ
Enterprise Value < $500mm

QUARTERLY M&A VOLUME

AVERAGE DEAL VALUE RISES SLIGHTLY FROM Q2

- Total closed transactions in Q3 declined 15% from the previous quarter as many sellers have awaited further economic transparency before testing transaction markets.
- Average closed transaction value increased 6.2% quarter-over-quarter to $53.6 million—indicating that buyers are still willing to allocate cash for high quality assets despite broader market headwinds.
- Middle market M&A is likely to be challenged through year end with the expectation for a recovery in deal volume towards the first half of 2024. Well capitalized buyers will continue to eye attractive acquisition pursuits at favorable valuations.



Source: Capital IQ
Enterprise Value < $500mm

CAPSTONE PARTNERS

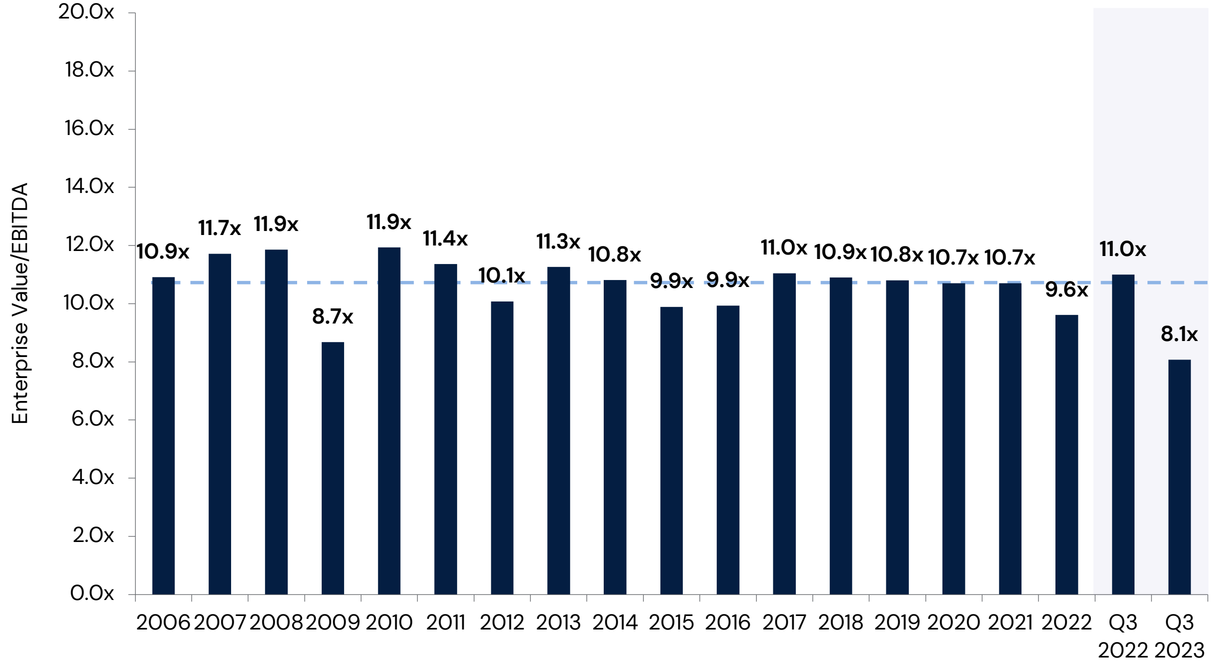
PRICING TRENDS

M&A VALUATIONS REMAIN UNDER PRESSURE

- Middle market M&A valuations have fallen substantially YOY to 8.1x EV/EBITDA in Q3 from 11.0x EV/EBITDA in the prior year. The Fed's monetary tightening campaign has increased the cost of debt for transaction financing, placing downward pressure on valuations.
- Transactions under $100 million in enterprise value accounted for 65% of disclosed deals in Q3, highlighting many buyers' hesitancy to pursue large transactions. Smaller transactions often coincide with lower average EBITDA multiples.
- The current buyer's market has presented opportunities for strategics and sponsors to add assets at attractive prices.

CAPSTONE PARTNERS

Middle Market Average EBITDA Multiple

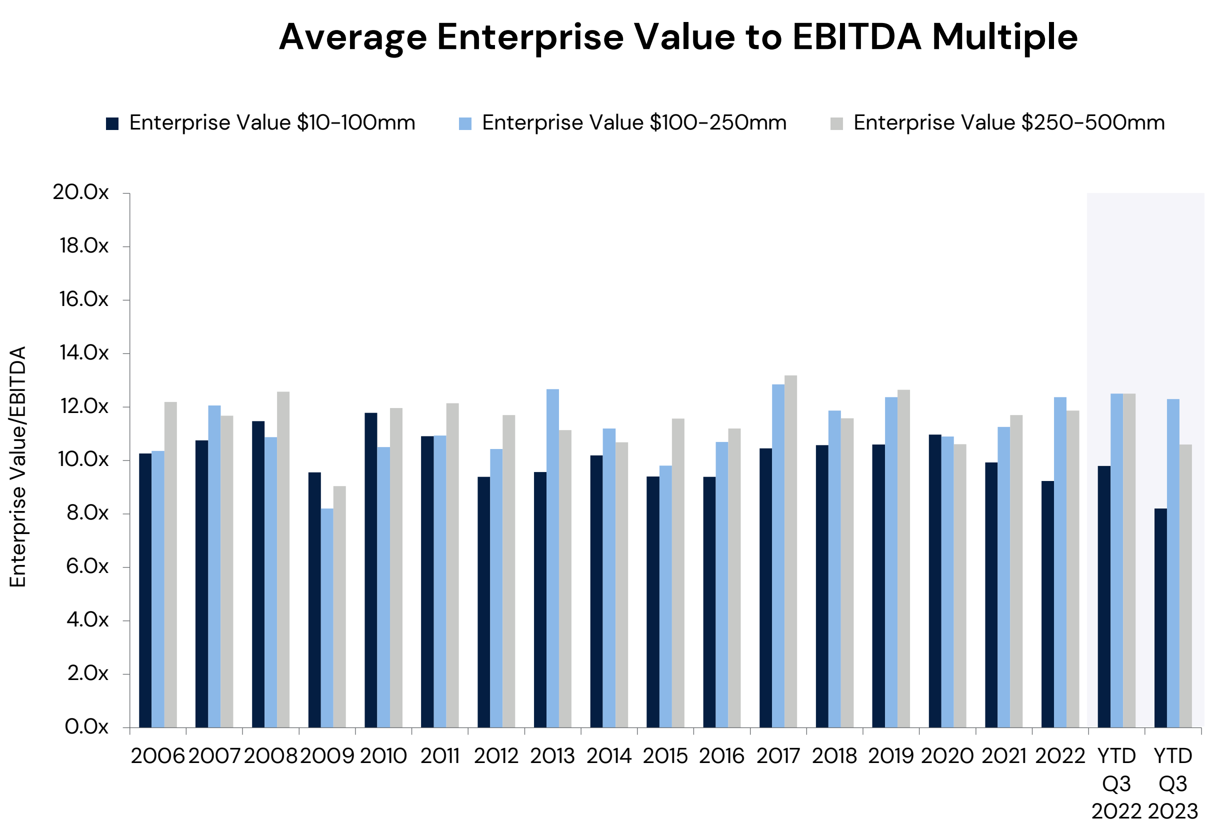


Dotted line indicates 2006 to 2022 average of 10.7x
Source: Capital IQ and Capstone Partners
Includes multiples 3x-30x
Enterprise Value < $500mm

BREAKING IT DOWN BY SIZE

CORE MIDDLE MARKET PRICING REMAINS ROBUST

- Average M&A valuations at the top and bottom end of the market have seen the most notable declines through YTD Q3. Transactions in the $10-$100mm range fell to 8.2x EV/EBITDA through Q3 from 9.8x EV/EBITDA in the prior year.
- Average valuations in the $250-$500 million range fell nearly two turns to 10.6x EV/EBITDA. Buyers have continued to show hesitancy paying up for large businesses in the current market.
- The core middle market, between $100-$250 million, has remained relatively steady through Q3. Average valuations fell modestly to 12.3x EV/EBITDA and remained far above the overall middle market average.

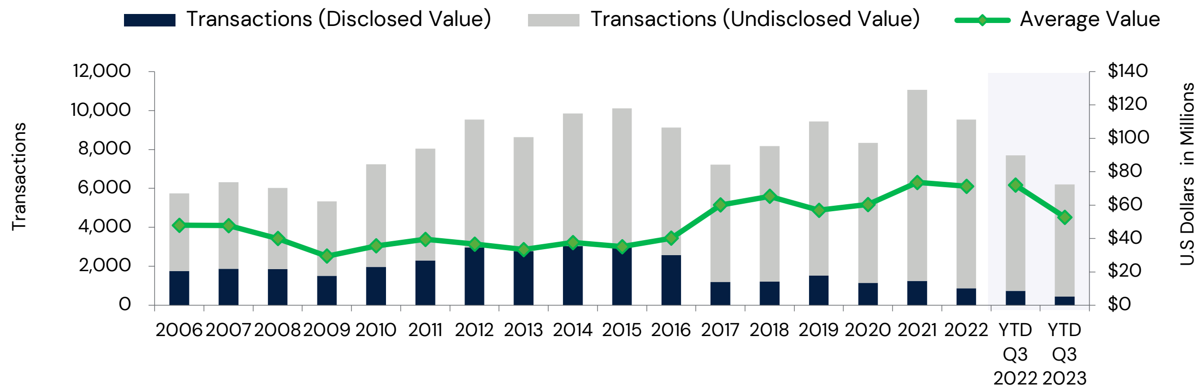


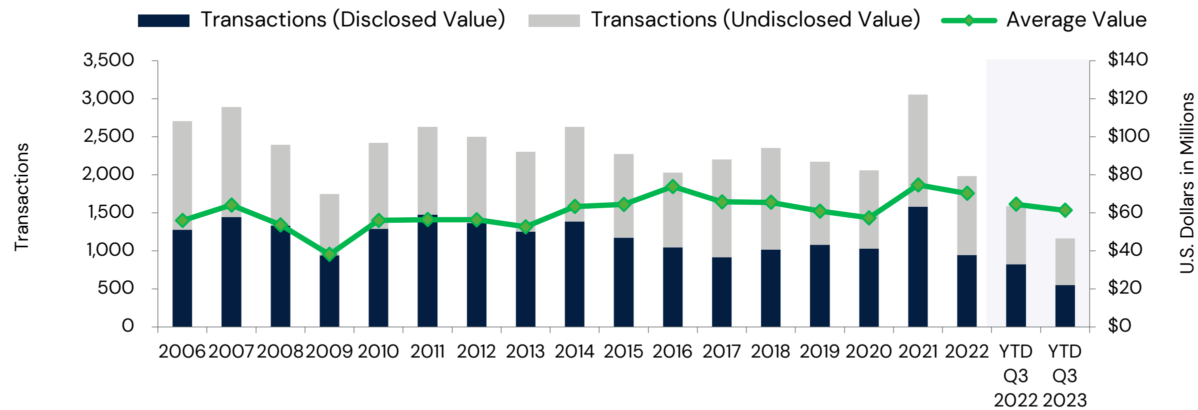
Source: Capital IQ
Includes multiples 3x-30x
Enterprise Value < $500mm

STRATEGIC ACQUIRERS

STRATEGIC BUYER ACTIVITY SLOWS IN Q3

- Strategic buyers have continued to focus internally, fortifying balance sheets, monitoring interest coverage, and bracing for a potential downturn.
- The number of transactions closed by private companies fell 19.4% YOY through Q3. In Q3 alone, average deal value improved 3.6% from Q2 to $51.1 million.
- Closed transactions by public companies dropped more drastically, with volume falling 26.7% YOY through Q3. Publicly traded companies often face greater shareholder scrutiny than their private company counterparts, which may contribute to more prudence in inorganic growth initiatives.





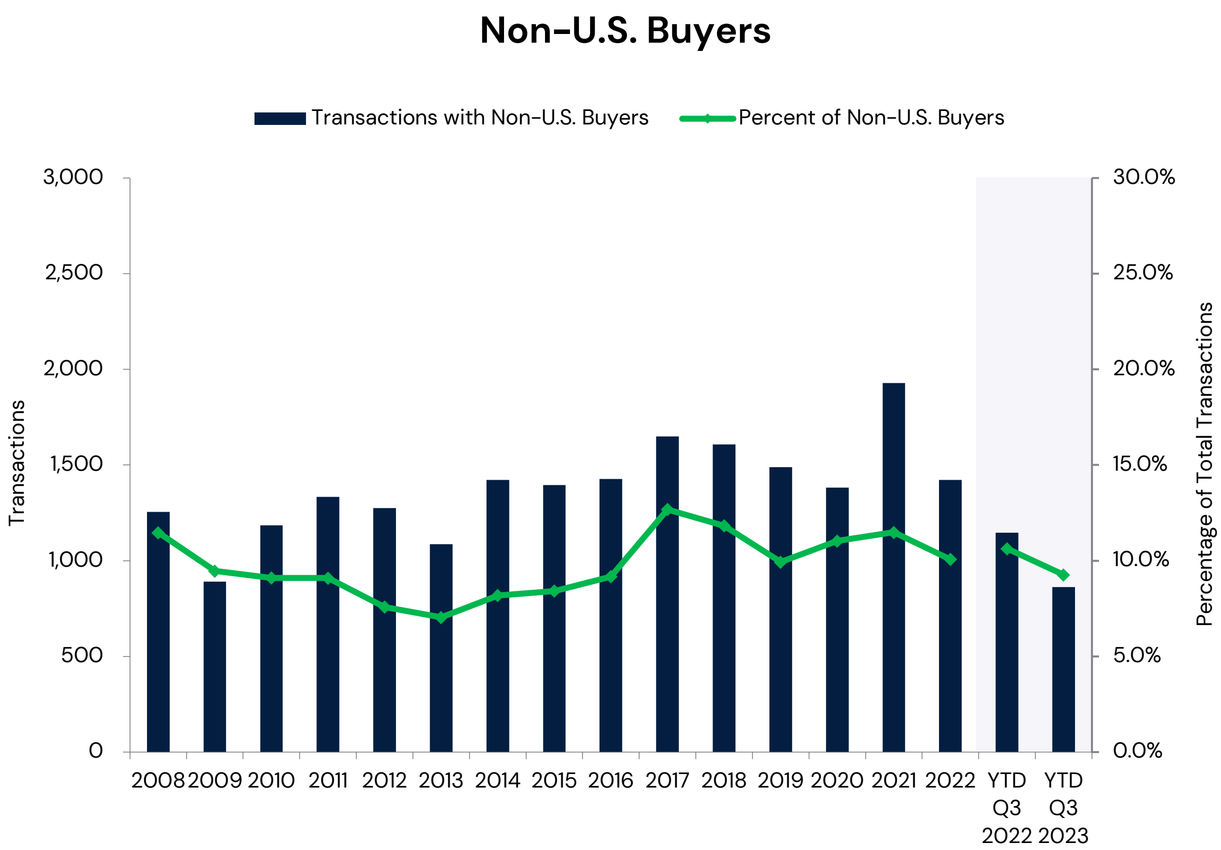
Source: Capital IQ
Enterprise Value < $500mm

CAPSTONE PARTNERS

FOREIGN ACQUIRERS

FOREIGN ACQUIRERS SLOW ACQUISITION PURSUITS

- Foreign buyer activity remained sluggish through Q3 with transactions involving an international buyer falling 24.8% YOY. Central bank monetary tightening, a strong U.S. dollar, and geopolitical conflicts have served as impediments to cross border M&A.
- Canada-based buyers have accounted for the largest percentage of acquisitions of U.S.-headquartered targets, followed by the United Kingdom.
- Heightened regulatory scrutiny across M&A markets and broadening geopolitical tensions will likely serve as continued headwinds for international transaction activity.



Source: Capital IQ
Enterprise Value < $500mm
To ensure accuracy, data methodology has changed as of 2022 publication

PRIVATE EQUITY DRY POWDER

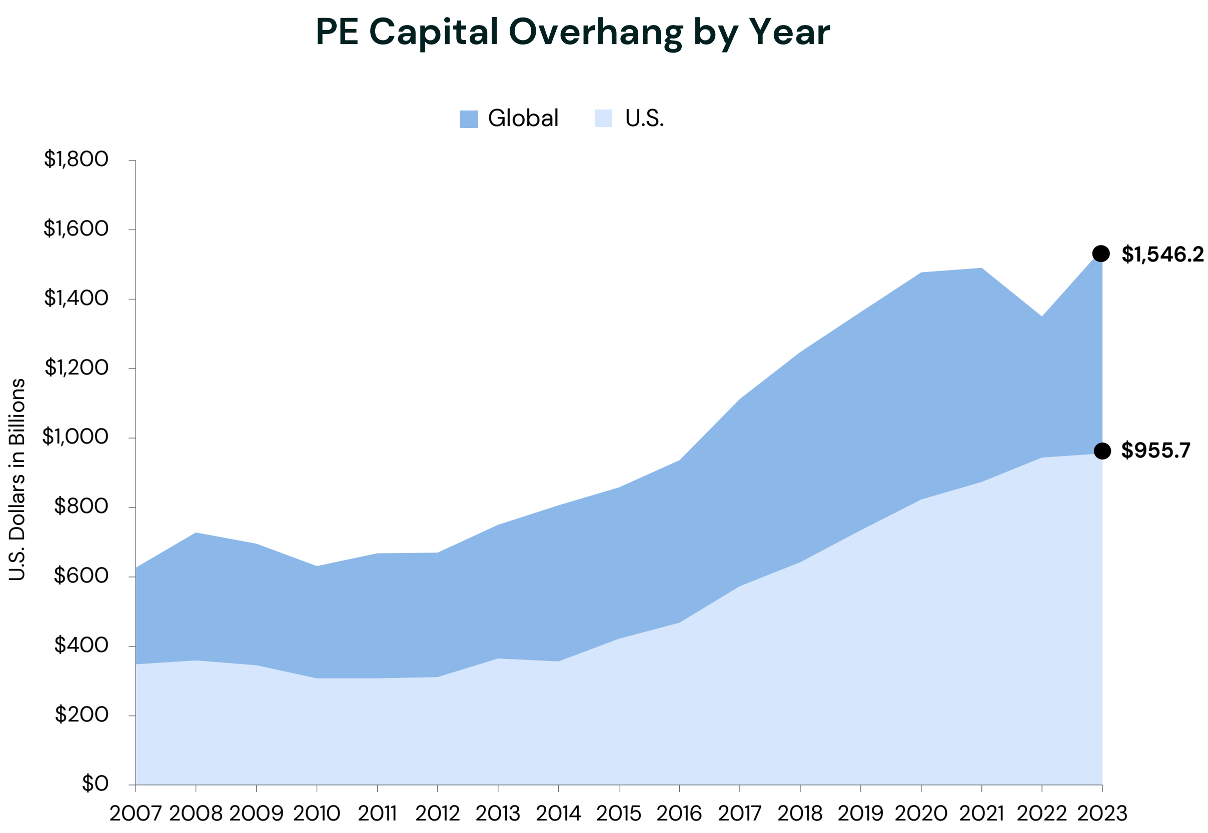
CAPITAL OVERHANG LEVELS REMAIN ROBUST

- Sponsors remain armed with significant dry powder, which has exceeded $1.5 trillion. Upon a return to a more normalized market, sponsors will likely face LP pressure to increasingly deploy capital to generate sufficient investment returns.

- Many sponsors have become more selective in acquisition pursuits. However, the current economic downturn will likely present private equity firms with ample opportunities to acquire underperforming assets trading at a discount.

- The majority ($955.7 billion) of dry powder is held in U.S.-domiciled funds, with a favorable outlook for stateside private equity deals through year end.

CAPSTONE PARTNERS



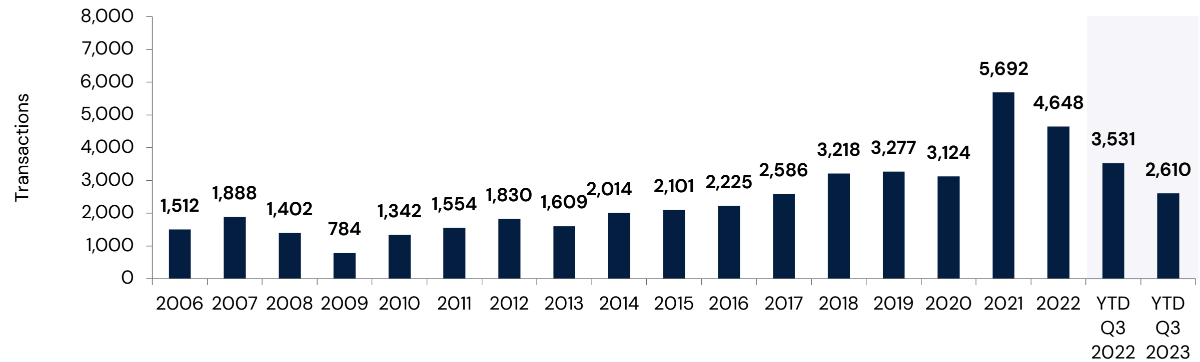
2023 dry powder figures as of March 31, 2023
Source: PitchBook

PRIVATE EQUITY ACTIVITY

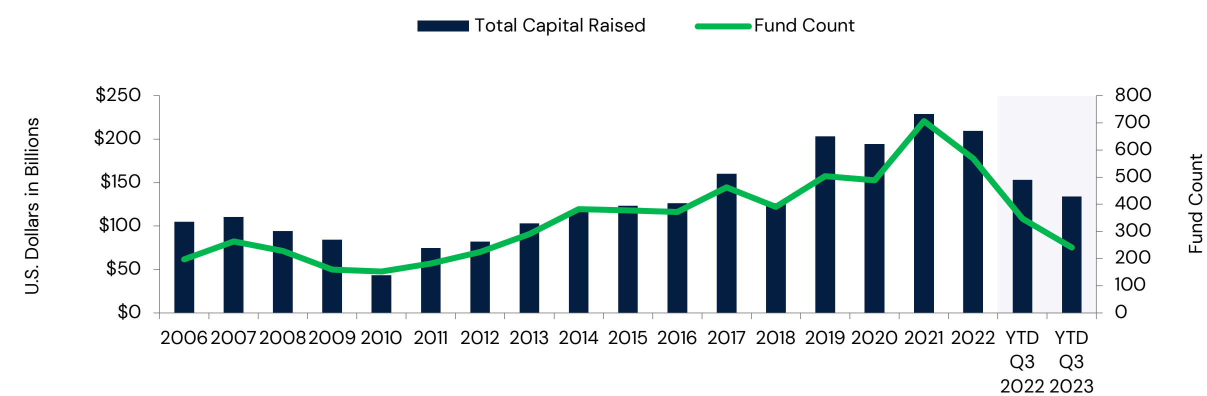
PRIVATE EQUITY REMAINS CAUTIOUS IN CURRENT MARKET

- Closed transactions by private equity firms declined 26.1% YOY through Q3 as sponsors have been increasingly selective amid higher transaction financing costs. Targets with proven cash flows, defensible gross margins, and scalability have continued to receive healthy sponsor interest.
- Private equity as an asset class has struggled to generate the excess rates of return experienced in 2021. However, middle market private equity has outperformed the broader market with a rolling IRR of 3.0% in 2023 compared to 0.7% across all fund sizes.
- Private equity fundraising through Q3 amounted to $134 billion, falling 12.5% YOY.

Middle Market Transactions Closed by Private Equity Firms



Middle Market Fundraising by Private Equity Firms



Source: PitchBook
Enterprise Value; $25-$500mm, Fund size < $5B

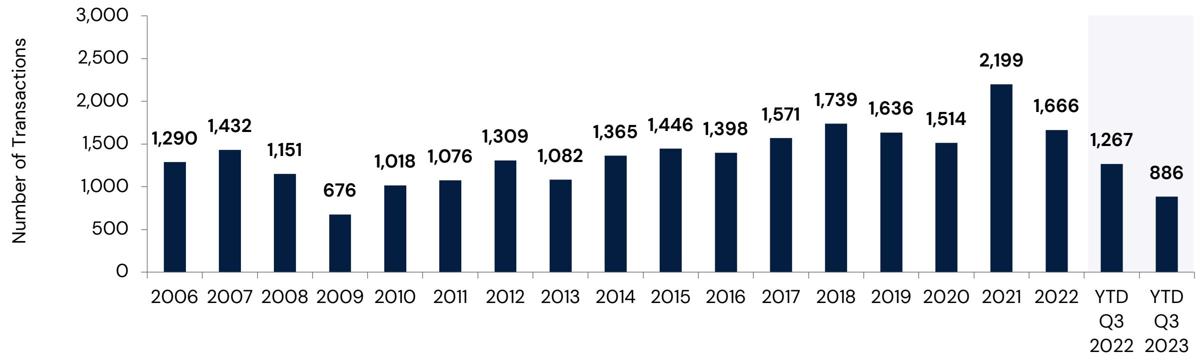
CAPSTONE PARTNERS

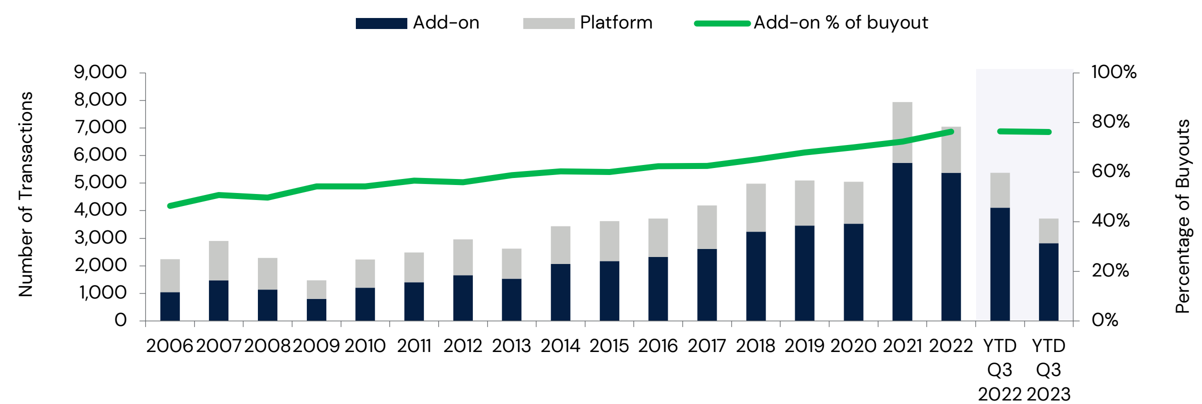
PRIVATE EQUITY TRANSACTION TYPES

ADD-ONS PREFERRED AMID HIGHER BORROWING COSTS

- The number of sponsor platform investments continued to decline through Q3, falling 30.1% YOY. Banks have demonstrated a more conservative lending approach which has caused leverage ratios to contract—negatively impacting middle market buyout activity.
- Add-on acquisitions have continued to comprise a growing share of total private equity buyouts, accounting for 76.1% of transactions through Q3. Sponsors have continued to adopt buy-and-build strategies to bolster returns upon exit.
- Private equity firms have placed increased focus on sustainability of cash flows to analyze a target's ability to service debt.

CAPSTONE PARTNERS



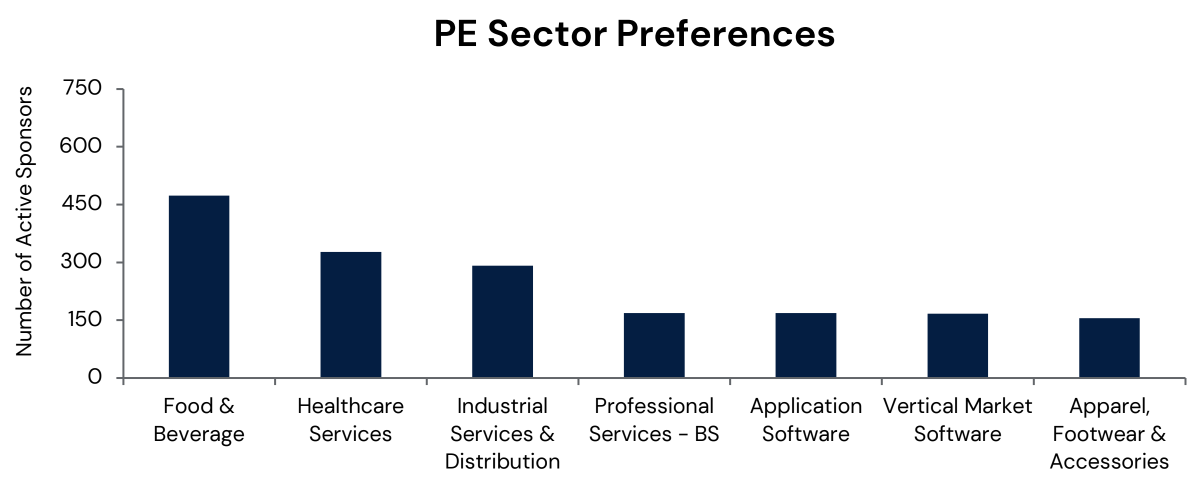


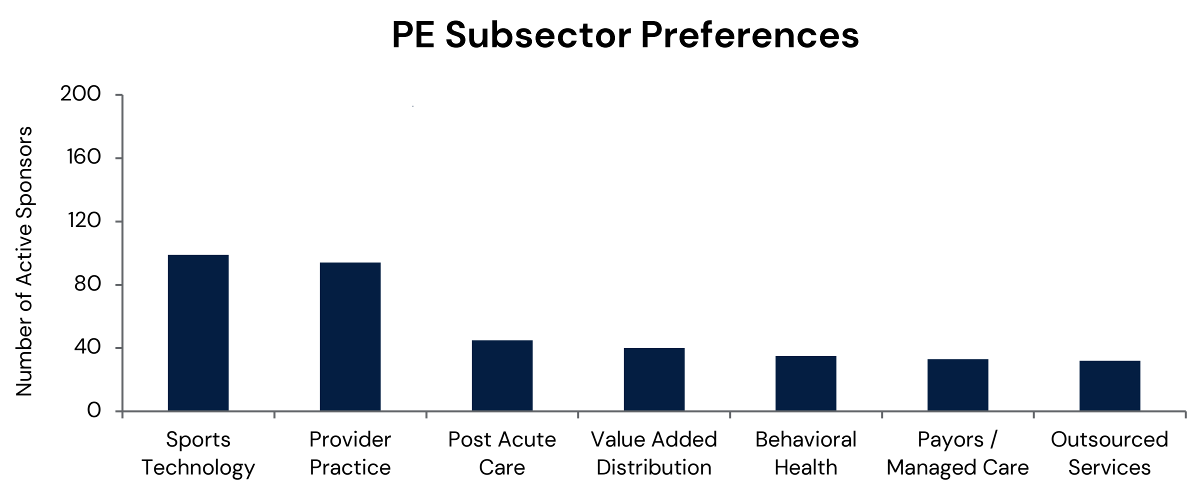
Source: PitchBook
Includes all U.S. PE transactions

CAPSTONE'S PRIVATE EQUITY NETWORK PREFERENCES

FOOD & BEVERAGE REMAINS TOP PE SECTOR

- Food & Beverage and Healthcare Services remain the most preferred sectors among Capstone's sponsor network, followed by Industrial Services & Distribution.
- Application Software has surpassed Vertical Market Software for the most preferred sector in the Technology, Media & Telecom (TMT) industry by Capstone's sponsor network.
- Sports Technology has become the most preferred subsector among Capstone's sponsor network, passing Provider Practice, as growing digital fan engagement capabilities have prompted sponsors to build platforms in the space.





Source: Capstone proprietary data

CAPSTONE PARTNERS

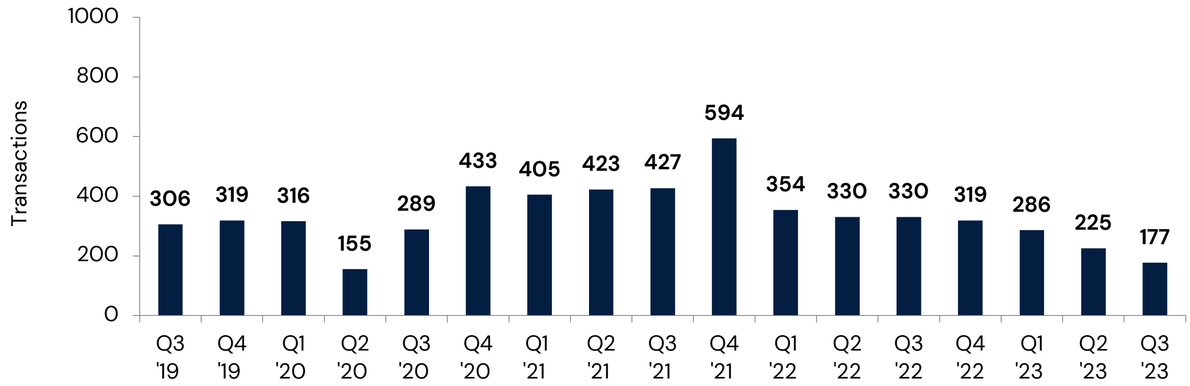
PRIVATE EQUITY ACTIVITY

PRIVATE EQUITY EXIT ENVIRONMENT REMAINS SOFT

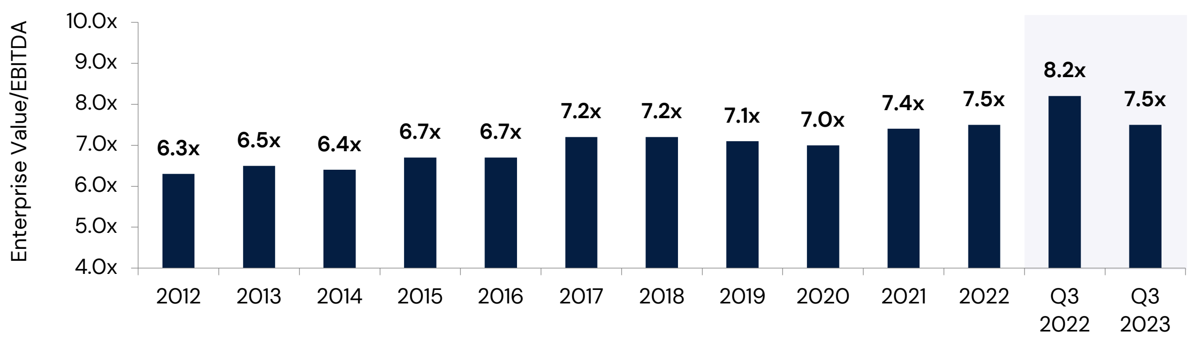
- Private equity exit activity continued to decline in Q3, falling to its lowest levels since Q2 2020. Many sponsors have extended holding times for their investments, awaiting a more favorable valuation environment.
- EBITDA multiples paid by private equity firms fell to 7.5x EV/EBITDA in Q3, from 8.2x EV/EBITDA in the prior year. However, valuations appreciated on a QoQ basis, potentially signaling a more optimistic pricing backdrop.
- Sponsors have been starved for acquisition targets, presenting an opportunity for middle market businesses engaging in sell-side M&A.

CAPSTONE PARTNERS

Private Equity Exit Activity



Average EBITDA Multiple Paid By Financial Buyers

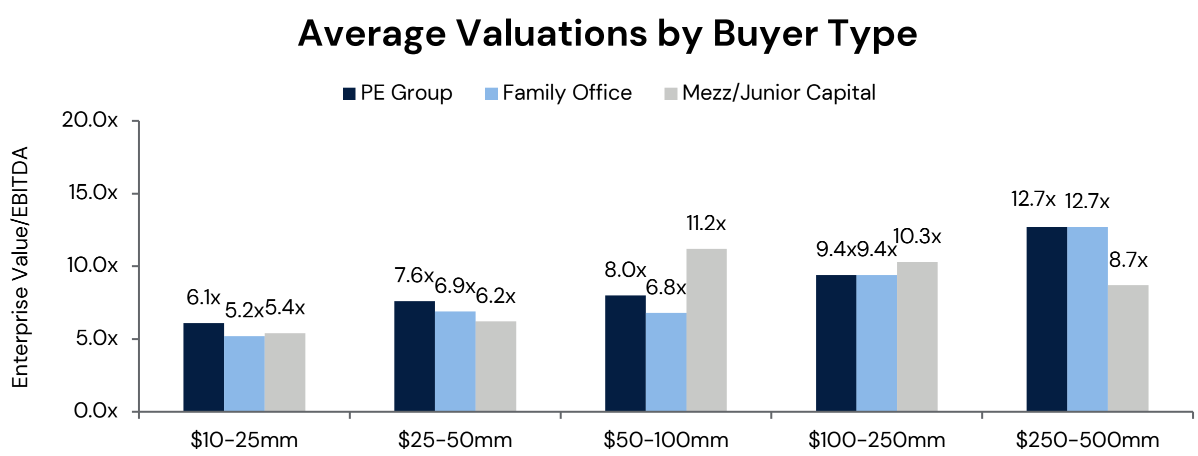


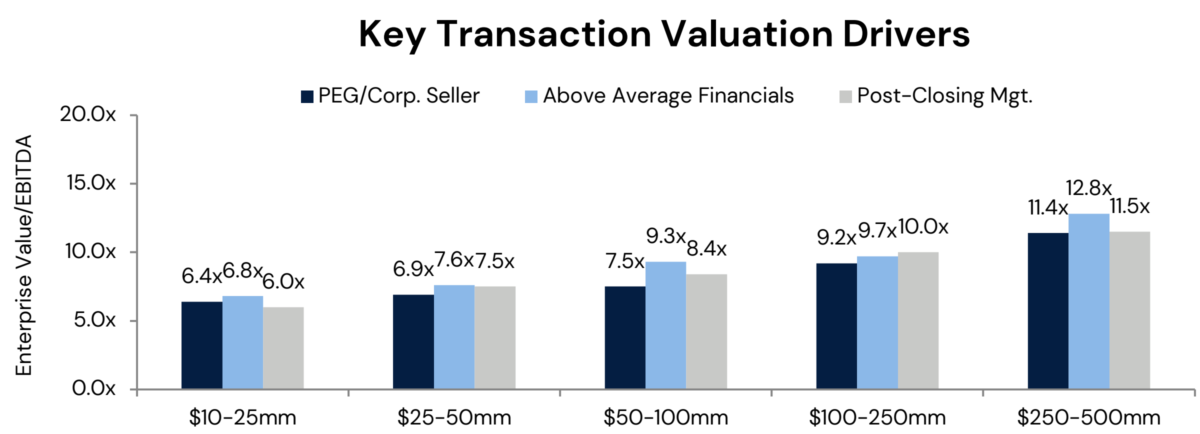
Note: Exit activity inclusive of all enterprise value ranges
Source: PitchBook and GF Data®
Includes multiples 3x-15x; Enterprise Value $10mm-$250mm

PRIVATE EQUITY VALUATIONS

STRONG FINANCIALS REMAIN KEY VALUATION DRIVER

- Private equity firms have paid the highest multiples out of the financial buyer universe to complete deals at the lower end of the market. At the top end of the market ($250-$500 million), sponsors and family offices have demonstrated a willingness to pay elevated values despite higher debt financing costs.
- Mezzanine/Junior capital providers have been most competitive at the $50-$100 million enterprise value range, outbidding both sponsors and family offices.
- An above average financial profile has remained a key determinant of pricing as buyers have sought targets with robust and recurring cash flows.





Source: GF Data®
GF Data® defines Above Average Financial Performers as businesses with TTM EBITDA margins and revenue growth above 10%, or one above 12% and the other metric at least 8%
Includes multiples 3x-15x; Enterprise Value $10mm-$500mm

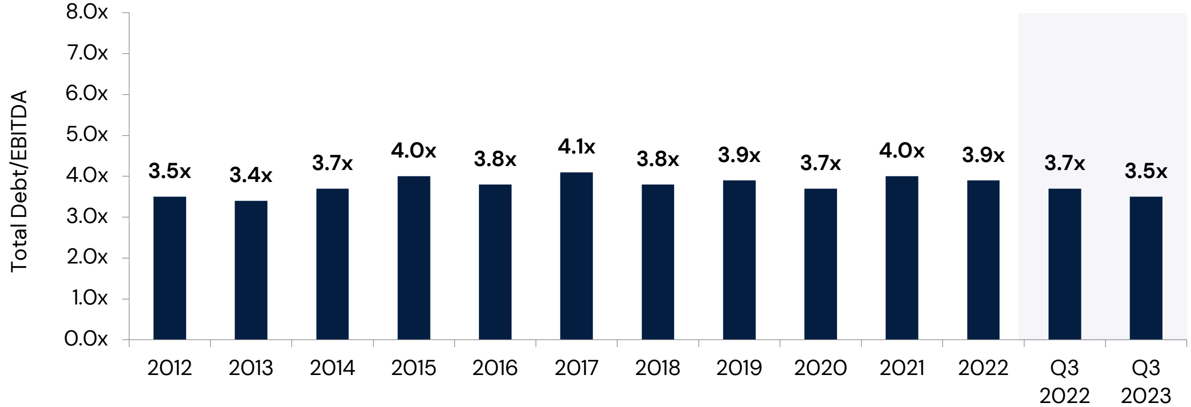
CAPSTONE PARTNERS

PRIVATE EQUITY VALUATIONS

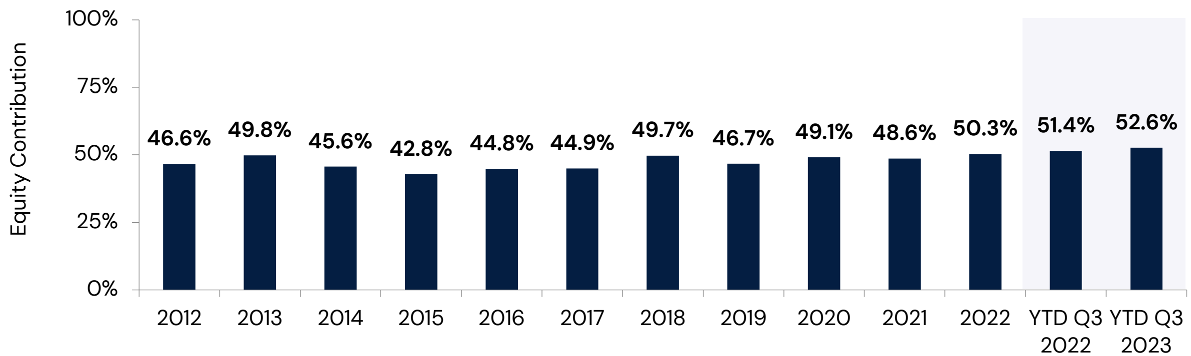
AVERAGE DEBT MULTIPLES DECLINE IN Q3

- The average debt multiple declined to 3.5x Total Debt/EBITDA in Q3 from 3.7x in the prior year. However, debt coverage improved on a QoQ basis, rising from 3.3x. Senior debt multiples improved meaningfully in recent months, expanding to 3.8x in Q3 from 3.3x in Q2.
- Lenders, particularly commercial banks, have increased senior debt pricing in Q3, further contributing to lower debt utilization in private equity platform transactions.
- The lower levels of debt utilization in deals have forced buyers to increase equity contributions, which rose to 52.6% in YTD Q3.

Average Debt Multiples of Middle Market LBO Transactions



Average Middle Market LBO Equity Contribution



Source: GF Data®
Includes multiples 3x-15x; Enterprise Value $10mm-$250mm

CAPSTONE PARTNERS

CAPSTONE BAROMETERS

CAPSTONE PARTNERS' FULLY INTEGRATED EXPERTISE

We have developed a service delivery model that can address the needs of any client situation, supported by vast internal resources. These capabilities are delivered together with deep domain expertise across 12 dedicated industry groups with an established, real-time access to the private equity community.

Mergers & Acquisitions

- Sell-side Advisory
- Buy-side Advisory
- Recapitalizations
- Mergers & Joint Ventures

Capital Advisory

- Equity Advisory
- Debt Advisory
- Infrastructure Finance

Financial Advisory

- Transaction Advisory
- Interim Management
- Performance Improvement
- Valuation Advisory
- Litigation Support

Special Situations & Restructuring

- Special Situations
- Turnaround
- Restructuring
- Bankruptcy
- Insolvency

ESOP Advisory

- Preliminary Analysis
- Feasibility Study
- ESOP Implementation
- Liability Study
- IRC § 1042 Design

Industry Groups

- Aerospace, Defense, Government & Security
- Building Products & Construction Services
- Business Services
- Consumer
- Education & Training
- Energy, Power, & Infrastructure
- FinTech & Services
- Healthcare
- Industrials
- Industrial Technology
- Technology, Media, & Telecom
- Transportation & Logistics

Sponsor Coverage Group

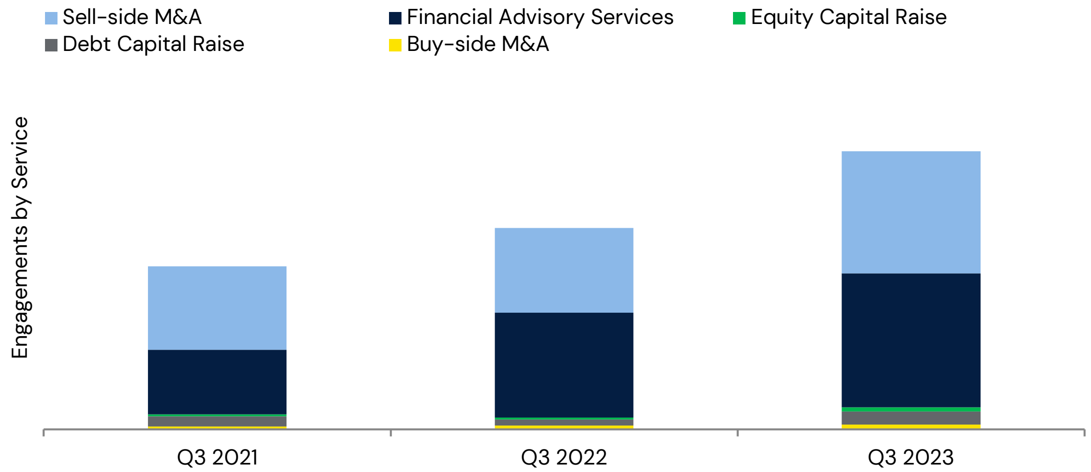
FIRM DATA

MIDDLE MARKET ACTIVITY PERSISTS AMID HEADWINDS

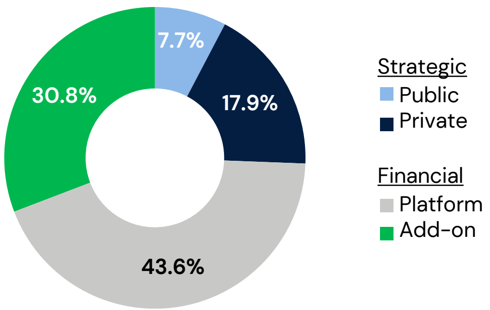
- While middle market dealmaking has been challenged by economic headwinds, the backlog of transaction inventory has remained robust. Increased visibility in near term market conditions may provide momentum for dealmaking through year end, into 2024.
- Financial buyers have accounted for 74.4% of trailing twelve-month transactions (TTM), with platform deals comprising 43.6%.
- Strategic buyers have maintained their presence in the middle market, accounting for 25.6% of TTM transactions, led by private buyers which comprised 17.9%.

CAPSTONE PARTNERS

Capstone Engagements By Service



Capstone TTM Buyer Breakdown



Source: Capstone proprietary data based on live engagements and closed sell-side engagements

RECENT DEAL CLOSINGS

Capstone is an active leader in middle market M&A advisory, serving many clients and their needs, despite the unprecedented disruptions to the economy. Select our recent tombstones below to read the full press release.

TSP
HAS BEEN ACQUIRED BY
O'DONNELL
a portfolio company of
SLATE CAPITAL GROUP

HAZTEK SAFETY MANAGEMENT
HAS BEEN ACQUIRED BY
CODE RED SAFETY
a portfolio company of
WARREN EQUITY PARTNERS

GRIDBRIGHT
HAS BEEN ACQUIRED BY
QUALUS
a portfolio company of
NMC

RK ELECTRIC
HAS BEEN ACQUIRED BY
HURON CAPITAL

nationalgrid ENERGY MANAGEMENT
HAS BEEN ACQUIRED BY
RADIUS MECHANICAL

POULOS & BENNETT
HAS PARTNERED WITH
PAPE-DAWSON ENGINEERS

CITY LINE FOODSERVICE
HAS BEEN RECAPITALIZED BY
Frontenac

A&M Cold Storage & Trailer Leasing
HAS BEEN ACQUIRED BY
WILLSCOT
mobile mini

granmark
A SUBSIDIARY OF
Party City
HAS BEEN ACQUIRED BY
IMPULSORA EURO S.A. DE C.V.

BYRD
HAS BEEN ACQUIRED BY
BLACK & VEATCH

Mama Rosie's
HAS BEEN ACQUIRED BY
SEVIROLI
MILL POINT CAPITAL

Aldinger
HAS BEEN ACQUIRED BY
INCLINE EQUITY PARTNERS

ARCANE CAPITAL PARTNERS
ENGAGED CAPSTONE PARTNERS TO PROVIDE BUY-SIDE TRANSACTION ADVISORY SERVICES

norwood paper
HAS BEEN ACQUIRED BY
BULK LIFT INTERNATIONAL
A portfolio company of
NEW WATER CAPITAL

orangelogic
HAS RECEIVED A GROWTH INVESTMENT FROM
BregalSagemount

Waste Solutions
ENGAGED CAPSTONE PARTNERS DURING A CHAPTER 11 REORGANIZATION

INSA
HAS ACQUIRED
Integra Data Systems Corp.

ARTISTIC PAVER
HAS BEEN ACQUIRED BY
BLUE RIDGE CONSTRUCTION CAPITAL

CONNORS GROUP
HAS BEEN RECAPITALIZED BY
RLH Equity Partners

PATERSON
HAS BEEN ACQUIRED BY
hoffmaster Group, Inc.
a portfolio company of
WELLSPRING CAPITAL MANAGEMENT LLC

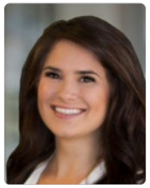
SC SHADPOUR CONSULTING ENGINEERS
HAS BEEN ACQUIRED BY
LEGENCE
a portfoliocompany of
Blackstone

LEADERSHIP TEAM

JOHN FERRARA, FOUNDER AND PRESIDENT

jferrara@capstonepartners.com | 617-619-3325

John has dedicated 30+ years to serving as a trusted advisor to privately held businesses. Representative of over 200 engagements, he has acted as investment banker, management consultant, interim executive, investor, founder and board member. John has been recognized as one of the Top 50 M&A advisors in the U.S. and honored as an M&A Advisor Hall of Fame inductee. Under his leadership, Capstone has expanded to 19 offices in the U.S., U.K., and Brazil with an international platform that spans over 450 professionals in 40 countries worldwide. John graduated from Wesleyan University with an MBA from UCLA and The London School of Economics.



OLIVIA FERRIS, COO

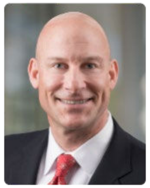
oferris@capstonepartners.com | 303-962-5772

Olivia Ferris has over 10 years of investment banking experience with Capstone Partners and currently serves as Chief Operating Officer on the firm's executive team. In this role, Olivia is responsible for overall firm strategy, corporate development, partnerships, strategic initiatives, and investments. She is central to communicating, executing, and sustaining Capstone's priorities and translating them into a comprehensive strategic plan. Olivia earned a BSBA in Finance from Daniels College of Business, University of Denver.

PAUL JANSON, HEAD OF INVESTMENT BANKING

pjanson@capstonepartners.com | 303-887-0174

With 25 years of executive experience, Paul manages all investment banking operations for the firm. On the M&A Advisory side, he is active in telecommunications services, manufacturing and infrastructure. Previously, Paul served as President & CEO of Camiant, a Packet Cable Multimedia broadband company. Paul was also CEO of Worldbridge Broadband Services Inc, a broadband and telecommunications company that was later acquired by C-Cor. Paul then became President of C-Cor's Global Services Division. He earned a BA in Business from Saint Anselm College.



PETER ASIAF, HEAD OF BUSINESS DEVELOPMENT

pasiaf@capstonepartners.com | 617-619-3368

Peter has more than 20 years of experience as a senior business development executive across the professional and financial services industries. He has been a growth-oriented leader in early-stage, middle-market and Fortune 500 enterprises, helping them to design and execute strategic expansion plans, optimize brand positioning and strengthen key market relationships. Peter is a Certified Exit Planning Advisor (CEPA) designated by the Exit Planning Institute

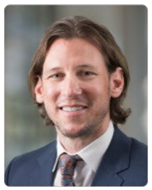
BRENDAN BURKE, HEAD OF SPONSOR COVERAGE

bburke@capstonepartners.com | 303-531-4603

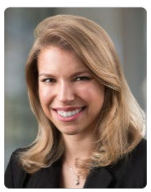
Brendan has 16 years in investment banking experience. He oversees the firm's outreach to private equity sponsors and recruitment of senior investment bankers. Since joining Headwaters MB (now Capstone) in 2004, he has held roles in transaction execution, business development, recruiting and marketing. In 2012, he was awarded 40 UNDER 40 by the M&A Advisor. He received a BA in Politics, Philosophy, Economics from Pomona College.

LEADERSHIP TEAM (CONTINUED)

DANIEL MCBROOM, HEAD OF PRIVATE CAPITAL MARKETS
dmcbroom@capstonepartners.com | 303-951-7128
Daniel has 15 years of private and investment banking experience and is responsible for sourcing and analyzing hundreds of companies a year introduced by the firm's institutional clients and partners. Select companies are engaged and his team will stay involved until the transaction is closed. Before his financial career, Daniel spent seven years as a pilot in the United States Air Force. He earned an MBA from the University of Notre Dame and a BS from the United States Air Force Academy.



MARK CASPER, CHIEF FINANCIAL OFFICER, SUPERVISING PRINCIPAL
mcasper@capstonepartners.com | 303-531-4604
Mark joined Capstone in 2016 and currently serves as the CFO and the Supervising Principal. In that capacity, Mark manages the FPA, oversees tax, financial, and regulatory reporting, and heads the firm's corporate development. Mark works in tandem with the President and COO ensuring financial feasibility for strategic initiatives as well as current business lines. In addition, he works closely with each banker to assist them in client management, regulatory efforts, and provides guidance around finance, accounting, and taxation. Prior to his current role, Mark spent over 11 years in public accounting. During his career, he has specialized in assurance, taxation, and business valuation consulting.



SARAH DOHERTY, DIRECTOR OF MARKET INTELLIGENCE
sdoherty@capstonepartners.com | 617-619-3310
Sarah has more than 10 years of professional research, writing, and data visualization experience and leads the strategic coverage and development of Capstone's middle market insights. She manages the firm's Market Intelligence Team, which produces 150+ reports, articles, white papers, surveys, and capital markets updates each year. Her team's award-winning M&A commentary and analysis has been featured in more than 50 of the nation's top news outlets. Sarah earned a BA from Biola University and was recognized in 2021 with the "Emerging Leader Award" by the M&A Advisor.

BRIAN DAVIES, MANAGING PARTNER, FINANCIAL ADVISORY SERVICES GROUP
bdavies@capstonepartners.com | 617-619-3328
Brian has 20+ years of experience working in the fields of corporate recovery, business reorganization and interim management services. He has provided financial advisory services to lenders, debtors, creditors' committees, trustees and equity holders in bankruptcy matters and out-of-court restructurings. Brian has provided assistance to under-performing businesses, acquirers of distressed companies. He has worked with companies to develop cost containment and asset rationalization plans, improve liquidity, re-engineer financial and other back-office functions. He received a MS from Bentley University and MSF from The McCallum School, Bentley University.

JIM CALANDRA, HEAD OF FINANCIAL ADVISORY SERVICES GROUP
jcalandra@capstonepartners.com | 617-619-3395
Jim has more than 25 years of experience in turnaround management consulting, interim management, fraud and forensic accounting, mergers and acquisitions, and recapitalizations. He has advised more than 50 companies through significant strategic transitions involving both public and private middle market companies with varying situations. Jim received a BS in Accountancy from Bentley University and an MS in Accountancy from The McCallum Graduate School of Business, Bentley University.

Capstone Partners, a subsidiary of Huntington Bancshares Incorporated (NASDAQ:HBAN), has been a trusted advisor to leading middle market companies for over 20 years, offering a fully integrated range of investment banking and financial advisory services uniquely tailored to help owners, investors, and creditors through each stage of the company's lifecycle. Capstone's services include M&A advisory, debt and equity placement, corporate restructuring, special situations, valuation and fairness opinions, and financial advisory services. Headquartered in Boston, the firm has 175+ professionals in multiple offices across the U.S. With 12 dedicated industry groups, Capstone delivers sector-specific expertise through large, cross-functional teams. For more information, visit www.capstonepartners.com.

Sign Up for Industry Insights

Delivering timely, sector-specific intelligence to your inbox

One of our core capabilities is to deliver sector-specific intelligence designed specifically for industry leaders, private equity firms and their advisors. Our industry reports and featured articles include:

- Emerging industry trends
- Acquirer and investor appetites
- Mergers & acquisitions market analysis
- Notable transactions
- Public company data

Receive email updates with our proprietary data, reports, and insights as they're published for the industries that matter to you most.

Subscribe

Market Intelligence Team Report Contributors

Sarah Doherty, Director of Market Intelligence
sdoherty@capstonepartners.com | 617-619-3310

Connor McLeod, Vice President of Market Intelligence
cmcleod@capstonepartners.com | 617-619-3319

Max Morrissey, Market Intelligence Manager
mmorrissey@capstonepartners.com | 617-619-3336

Joseph Collins, Market Intelligence Analyst
jcollins@capstonepartners.com | 617-619-3344

Neve Adler, Market Intelligence Analyst
nadler@capstonepartners.com | 617-619-3387

Follow Us