



CALABASAS CAPITAL

Summer 2017 Middle Market M&A Update

About Us

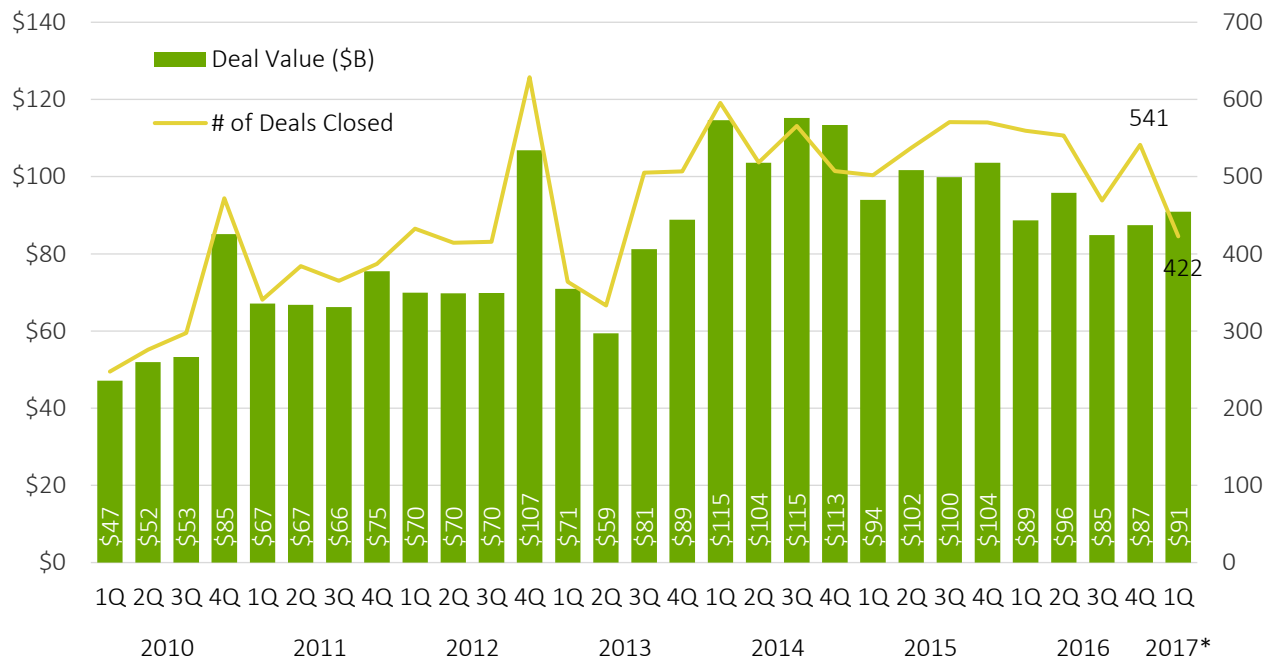
Calabasas Capital is a boutique investment banking firm focused on serving lower middle-market privately-held companies and their business owners. We specialize in representing and advising businesses on sell-side and buy-side mergers, sales and acquisitions and we raise private equity and debt capital.

Deal Activity in the First Quarter of 2017 was Okay

Middle market private equity deal activity (\$25 million to \$1 billion in value) in the first quarter of 2017 was okay but not great.

- The volume (number of deals) was down 24% year over year but the value of deals was up 3%.
- The implication is fewer but larger deals.

Middle Market Private Equity Deal Activity by Quarter



Source: Pitchbook Data.

Waiting for the Trump Bump

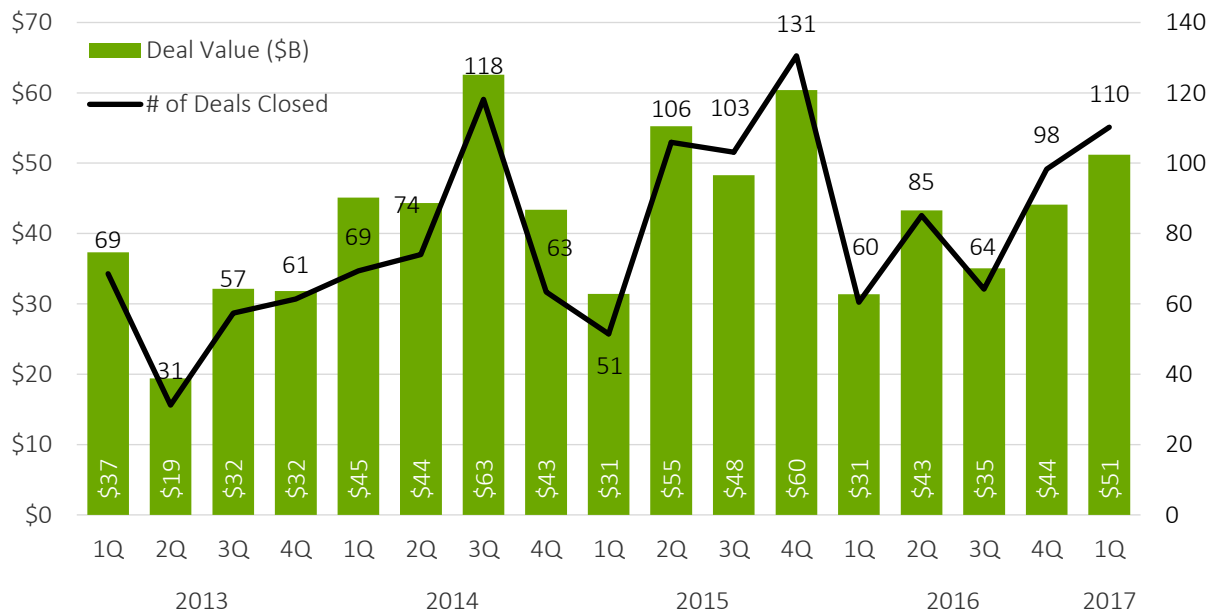
While a continuation of these negative activity trends is disappointing, we see reason for significant market optimism in the near future.

- The surprising outcome of the U.S. Presidential election and the resulting “Trump Rally” has resulted in the return of a more positive feeling across the business community.
- Improved small business optimism and a feeling that Company valuations are likely at peak levels has increased business owner interest in considering their strategic alternatives including a company sale.
- We believe this strong level of interest in exploring strategic alternatives may be a leading indicator for significant growth in middle market M&A activity during the remainder 2017.

A Bounce in the Upper Middle Market

Contrary to the trends in recent quarters, the first quarter of 2017 saw an increase in activity in the upper middle market (\$500MM to \$1Bn) relative to the lower middle market (\$25MM to \$100MM) and the core middle market (\$100MM to \$500MM).

Upper Middle Market Private Equity Deal Activity



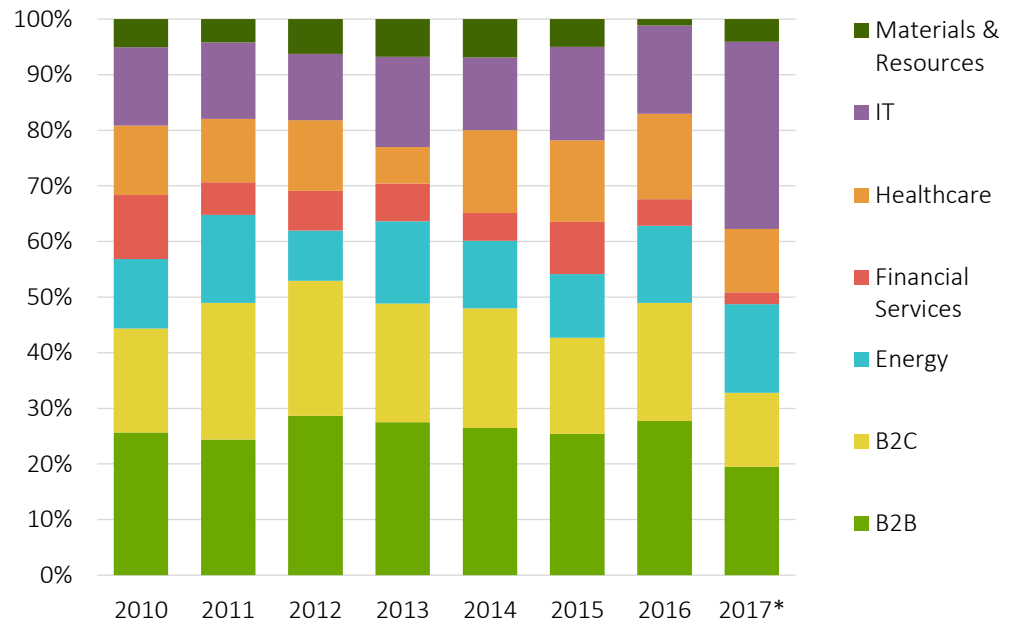
Source: PitchBook Data.

- According to PitchBook Data, the median deal size in the private equity middle market surged in the first quarter to **\$239MM from \$128MM** in 2016 (and a range of \$100MM - \$150MM since 2010).
- The likely cause of this spike in larger deal activity is the increase in the average size of PE funds. In 2015, the average size of middle-market buyout funds reached \$790.2 million, the highest in six years.

- These larger funds have led to heightened levels of dry powder, which stood at a record \$552.6 billion in the U.S. as of 3Q 2016.
- With well-stocked coffers and influenced by the guise of an improved economic outlook, mid-market PE firms are chasing larger targets to deploy more capital across a similar number of deals.

Tech Up, Consumer Down

U.S. Private Equity Middle Market Deal Value by Sector



Source: PitchBook Data.

Further contributing to the increase in deal size in the first quarter was PE’s interest in the tech sector.

- Between 2011 and 2016, the IT industry represented on average 15% of the value of all middle market deals but in 1Q2017, IT jumped to 34% of deal value.
- Between 2011 and 2016, the IT industry represented on average 13% of the volume of all middle market deals but in 1Q2017, IT jumped to 20% of deal volume.
 - Software companies, many of which have developed stable annual recurring revenue via SaaS models, have become popular targets for PE lately and accounted for 15.4% of all middle-market PE transactions in the first quarter. The increase in activity is due in part to strong recent performance by the sector
 - The IT sector has penetrated a larger portion of the economy overall, as more goods and especially services can be provided with new technologies. Thus, we have witnessed the development of an entire financial ecosystem specializing in IT, including investors, lenders, diligence firms and other service providers.

- At the same time, in 1Q2017, the B2C, B2B and healthcare sectors all saw quarter-over-quarter decreases in PE deal flow.
 - PE deal flow in the consumer sector has been hampered by concerns about a possible border-adjustment tax or other trade policies that would reduce unit economics in the industry.
 - Compounding these worries, the industry is already struggling with changing consumer tastes and rising costs, which have compressed margins.
 - Just 79 PE deals totaling \$12.1 billion were completed in the first quarter—32.6% and 36.2% behind last year’s pace, respectively.

Resurgence in Manufacturing M&A

According to Mergers & Acquisitions, acquisition interest in manufacturing by financial and strategic buyers has been increasing significantly over the past year. While much of this is due to expectations of a more business friendly regulatory environment, lower taxes and a tax holiday on repatriated earnings, the impact of technology has also been a major factor.

- Today manufacturing encompasses humans with automated processes and the increasing use of robotics to make the process more efficient. Manufacturing advancements have had an astoundingly positive impact on many different broad manufacturing processes that affect many sectors.
- “We are bullish on manufacturing in North America,” says Steve Karol, the managing partner at Watermill Group. “Advanced manufacturing is creating a lot of new opportunities in many different sectors for many different companies.”
- Apple Inc. CEO Tim Cook said during a CNBC interview on May 4 that the company plans to create a \$1 billion fund to invest in U.S. companies that do advanced manufacturing. The term, advanced manufacturing, typically refers to processes that leverage technology to improve the efficiency of how products are made.
- The techniques are being used especially in such sectors as technology, aerospace, automobiles, medical devices and precision machining, all of which have seen a pickup in M&A activity.

Calabasas Capital

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- Financial Restructuring

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- Business Services
- Building Products & Materials
- eCommerce & Software
- Industrial Services
- Telecom
- Healthcare

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