LM+Co Capital
Middle-Market Investment Banking

Q1 2016

We are pleased to present LM+Co Capital's Middle-Market Update for Q1 2016. This newsletter offers a recap of Q4 2015 activity and an overview of key trends impacting current US M+A and Capital Markets.

Deal Flow Observations

Following the banner year witnessed in 2014, US middle-market deal activity for 2015 ended with a significant decline in total capital invested, particularly in Q4, despite total deal volume remaining flat. Private Equity firms invested $369.6 billion in the middle-market across 2,017 deals in 2015, representing a 12% decline in total value year-over-year (y-o-y) from the $419.4 billion invested in 2,015 deals recorded in 2014. While part of this decline can be attributed to a record-breaking 2014, it also indicates that deal flow activity is beginning to dissipate.

Q3 2015 witnessed 543 deals closing at a total value of $97.7 billion; Q4 yielded 476 deals for a total value of $81.6 billion. The last quarter of 2015 had the lowest recorded amount invested since Q2 2013 and represented a significant quarter-over-quarter (q-o-q) decline of 16.5% in value and 12.3% in volume, according to Pitchbook estimates. Hampered by the significant fall in oil + gas prices, as well as significant global macro headwinds, deal flow in the US middle-market is slowing due in part to a contraction in the credit markets.

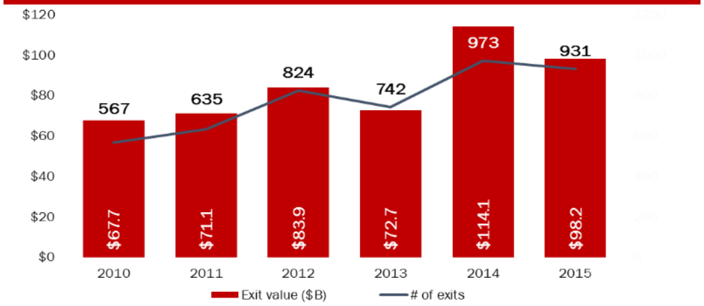
Technology and Healthcare Services were standout industries for investors looking to deploy capital towards high growth areas in an otherwise lackluster market environment. However, the largest story for investors in the second half of 2015 was the dramatic drop in oil + gas prices, with US-based middle-market energy companies experiencing significant volatility and substantially reduced valuations. As the volume of capital declined 37% and value dropped 29% y-o-y, many of these companies are currently engaged in restructuring activities. We see tremendous opportunity for strategic acquisitions in this sector and anticipate increased M+A activity and asset sales throughout 2016 for E+P and related service companies.

Middle-Market Exits

Middle-market exits by US private equity firms followed a similar narrative to deal flow in the second-half of 2015. While middle-market exit value declined 14% and volume fell 4% y-o-y from the records set in 2014, there were 931 private equity-backed sales completed in 2015 with a total value of $98 billion. Q4 2015 witnessed a rush of sale activity with 248 completed exits valued at $26 billion.

As indicated below, private equity exits to corporate/strategic buyers continue to remain the predominate theme in the market.

Middle-Market Exits by Year



Source: Pitchbook

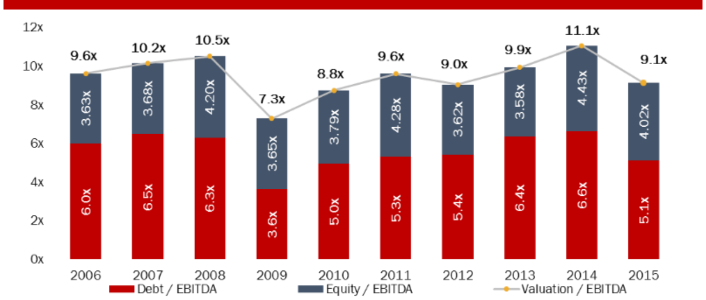
M+A Outlook

Deal multiples and debt levels remain at historic levels but are beginning to moderate in 2016 with median valuation-to-EBITDA multiples for US buyouts falling to 9.1x from 11.1x in 2014. However, this may be mitigated by the fact that more than one-third of all business owners are 55 and older according to US census data. This "baby-boomer" generation may begin to experience owner fatigue and consider some form of a transition. Further, there continues to be a flight to quality as scrutiny intensifies for sellers with poor financial results or business concerns due to cyclical or geopolitical risk. Private equity firms have also become more conservative in their use of debt with debt-to-EBITDA multiples falling to 5.1x compared to 6.6x in 2014. We anticipate private equity firms will continue targeting the lower middle-market and use "roll-up" strategies to increase existing portfolio valuations.

PE-Backed Exits by Type

Source: Pitchbook

Median EBITDA Multiples for Buyouts



Source: Pitchbook

Technology and Healthcare Services commanded the highest valuation multiples in 2015, while Energy Services valuations were lowest at 3.9x. Retail recorded the largest y-o-y decline from 8.5x in 2014 to 5.8x.

TEV/EBITDA - BY INDUSTRY							
Industry	2003-2010	2011	2012	2013	2014	2015	Total
Manufacturing	5.9x	6.0x	5.9x	5.9x	6.3x	6.8x	6.0x
Business Services	6.2x	6.6x	5.9x	6.6x	6.5x	6.4x	6.3x
Healthcare Services	6.8x	7.5x	7.1x	7.6x	7.2x	7.6x	7.1x
Retail	6.6x	5.8x	5.9x	7.5x	8.5x	5.8x	6.7x
Distribution	6.0x	6.4x	6.6x	6.8x	7.1x	6.7x	6.3x
Media + Telecom	7.6x	8.4x	11.4x	6.1x	NA	7.3x	7.6x
Technology	6.3x	8.1x	7.2x	10.0x	9.5x	8.6x	7.8x
Energy Services	NA	NA	NA	NA	5.1x	3.9x	4.2x
Other	5.9x	5.9x	6.3x	6.2x	6.8x	6.0x	6.0x

Source: GF Data

Capital Markets Outlook

Valuations for companies with $100+ million in TEV have increased with average TEV/EBITDA in 2015 of 9.0x compared to 7.8x in 2014.

TOTAL ENTERPRISE VALUE (TEV) / EBITDA							
TEV	2003 - 2010	2011	2012	2013	2014	2015	Total
10 - 25	5.6x	5.3x	5.8x	6.0x	5.4x	5.9x	5.6x
25 - 50	6.2x	6.4x	6.2x	6.8x	6.6x	6.7x	6.3x
50 - 100	6.7x	7.5x	6.7x	6.8x	8.6x	7.5x	7.0x
100 - 250	7.2x	7.7x	7.4x	7.5x	7.8x	9.0x	7.6x
Total	6.1x	6.4x	6.3x	6.5x	6.7x	6.7x	6.3x

Source: GF Data

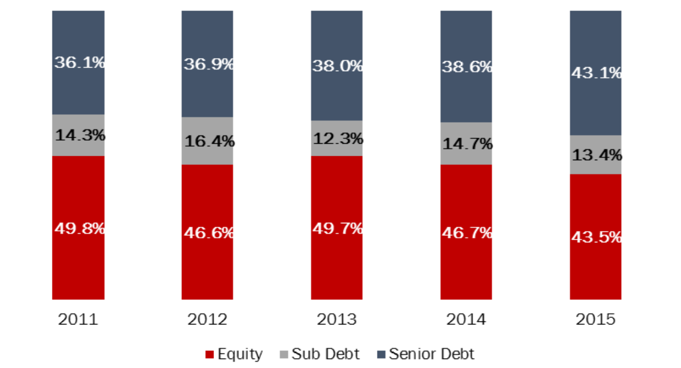
The Federal Reserve raised its benchmark interest rate for the first time in nine years, effectively beginning the path to rate normalization. We see debt markets progressively tightening throughout the next 12 – 18 months. Buyers continue to place a size premium on above-average financial performance and institutional ownership prior to the deal with a much greater reward for large businesses. “Quality” firms averaged EBITDA multiples of 8.9x in 2015 compared to the 6.8x average multiple for all Buyout transactions.

VALUATION DRILLDOWN 2015										
			Buyouts Only							
TEV	All	Buyouts Only	Platform	Add-Ons	Indiv/Family Seller	PEG/Corp Seller	Above Average	Post-Closing Mgt.	PEG/Corp, Above Average and Mgt.
10 - 25	5.9x	6.0x	5.9x	6.1x	5.9x	6.3x	6.1x	6.1x	6.2x
25 - 50	6.7x	6.6x	6.5x	7.5x	6.7x	6.3x	7.2x	6.5x	7.1x
50 - 100	7.5x	7.6x	7.6x	8.0x	7.7x	7.3x	8.3x	7.6x	8.4x
100 - 250	9.0x	9.0x	8.7x	11.1x	8.2x	9.3x	10.3x	9.2x	11.2x
Total	6.7x	6.8x	6.8x	6.8x	6.6x	7.4x	7.4x	6.8x	8.9x

Source: GF Data

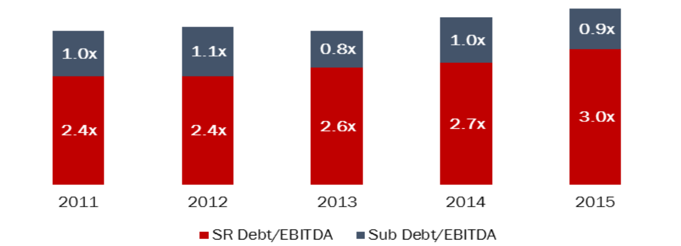
During 2015, leverage multiples appeared elevated due to alternative debt sources and increasing competition in the market. Increased levels of leverage have decreased the average amount of equity required in transactions and levels of subordinated debt remains below its five-year average; however this may gradually change during the course of 2016.

Equity + Debt Contributions



Source: GF Data

Debt Multiples



Source: GF Data

As highlighted below, subordinated debt pricing appears to be falling due to increased competition in the market.

ALL-IN SUB DEBT PRICING 2015				
TEV	COUPON	PIK	WBR/FEES	TOTAL
10 - 25	11.6%	1.9%	2.3%	15.0%
25 - 50	11.5%	1.9%	1.6%	14.7%
50 - 100	11.2%	2.2%	1.7%	14.7%
100 - 250	11.1%	0.8%	1.8%	13.2%
Total	11.4%	1.8%	1.9%	14.6%

ALL-IN SUB DEBT PRICING 2014				
TEV	COUPON	PIK	WBR/FEES	TOTAL
10 - 25	11.8%	2.3%	2.8%	15.9%
25 - 50	11.9%	2.5%	2.8%	15.9%
50 - 100	11.6%	1.9%	2.8%	15.5%
100 - 250	11.9%	1.7%	2.9%	14.4%
Total	11.8%	2.2%	2.8%	15.6%

Source: GF Data

Conclusion

Overall deal flow in the US middle-market slowed throughout 2015. Uncertainty continues to permeate the market and we anticipate M+A deal flow will decline during 2016. However, this decline may be tempered. Due to increased flow related to the "baby-boomer" generation looking to "cash-out" while market conditions remain somewhat favorable.

Valuations appear to be declining as credit markets continue to contract into the foreseeable future. To achieve maximum valuations in this market, middle-market companies considering a sale must develop an "exit readiness" plan that includes a detailed strategic plan, strong back office capabilities and a diversified customer base.

The middle-market will remain in a state of flux in 2016, driven by a substantial over-hang of available capital to invest and a limited number of quality assets available for purchase.

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With over 30 years of investment banking, accounting and financial advisory experience, Richard leads LM+Co Capital. He has substantial M+A (sell-side and buy-side) as well as Capital Advisory (debt and equity) experience and has raised in excess of $2 billion of senior and subordinated debt and equity capital for companies in the middle-market.

LM+Co Capital is a boutique investment banking and financial advisory firm specializing in middle market transactions, including traditional M+A, Capital and Financial Restructuring Advisory. Our professionals have in excess of 75 years of collective transactional experience, developing creative solutions for clients under specific and often significant time constraints.