LM+Co Capital
Middle-Market Investment Banking

Q2 2018

We are pleased to present LM+Co Capital's Q2 2018 Middle-Market Update. This quarterly newsletter offers an overview of key trends impacting current Capital Markets and US Mergers and Acquisitions (M+A) for the middle-market.

Outlook

We anticipate strong M+A activity during the remainder of 2018 and into early 2019. As underlying economic fundamentals remain robust, the investment community continues to actively seek investment opportunities in the market. Fueling this activity is the steady rise in US GDP, coupled with tax cuts which, together, are feeding economic growth. Inflation concerns and related Fed rate hikes during the remainder of 2018 may, however, cause some pullback of this activity during 2H 2019. Buyers will continue to search for relative value in lower middle-market transactions, specifically those valued under $100 million of enterprise value. In addition, we predict financial sponsors will continue to focus on operational improvements and add-ons for their existing portfolio companies in an effort to expand future exit valuations and/or take advantage of current market premiums.

Capital Markets Outlook

The abundance of debt capital in the market continues to be the key factor driving M+A activity. BDCs, hedge funds and alternative financing companies continue to put pressure on traditional banks and are providing credit facilities that are attractive to borrowers in terms of real cashflow with nominal amortization and covenant light (if any) deals. However, raising eyebrows in the market is the rise in short-term borrowing costs. The London Interbank Offered Rate (LIBOR), a proxy for short-term borrowing costs (which, according to Bloomberg, has approximately $350 trillion worth of loans and financial instruments tied to it), has been rising sharply. For example, 90-day commercial paper rates have risen to levels not seen since late 2008, from a post crisis low of 0.06% in 2015 to the most recent reading of 2.28%, as reported by the Fed.

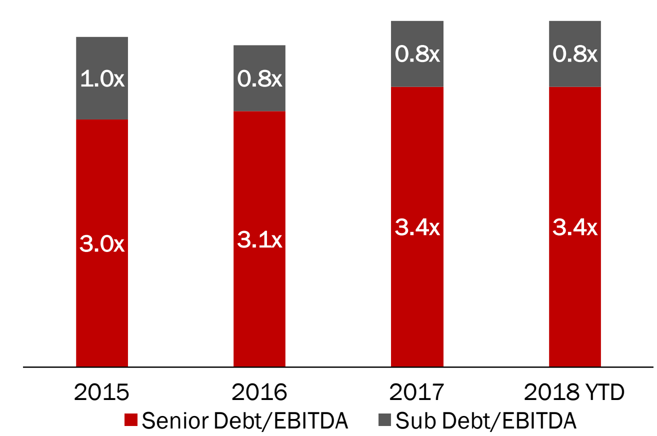
Debt Pricing vs. LIBOR

	Q2 2016	Q3 2016	Q4 2016	Q1 2017	Q2 2017	Q3 2017	Q4 2017	Q1 2018
Senior Debt Pricing	5.1%	5.0%	4.8%	5.3%	5.7%	5.7%	5.6%	5.3%
Subordinated Debt Pricing	11.6%	11.7%	11.2%	11.3%	11.8%	11.1%	11.3%	10.9%
90-Day LIBOR*	0.6%	0.8%	1.0%	1.1%	1.3%	1.3%	1.7%	2.3%
Senior Debt Spread	4.5%	4.1%	3.8%	4.1%	4.4%	4.3%	3.9%	3.0%
Subordinated Debt Spread	11.00%	10.90%	10.20%	10.20%	10.50%	9.70%	9.60%	8.60%

Source: GF Data, transactions between $10 million - $250 million. Libor rates are as of quarter end

Since Q2 2016, the margin above the benchmarks has been accommodating the increase in LIBOR in both Senior and Subordinated Debt pricing. This suggests that the spreads remain under pressure and bond pricing remains tight. If the credit cycle corrects, the compression against spreads might not continue, resulting in higher yields on debt.

Debt Multiples for US Middle-Market Transactions

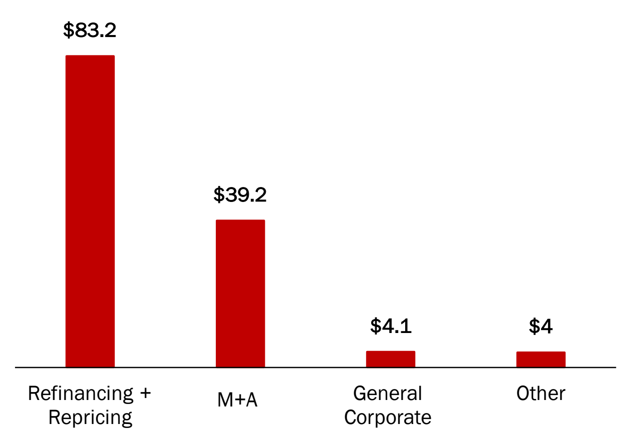


Source: GF Data, transactions between $10 million - $250 million

Debt multiples in Q2 2018 remained at elevated levels established in early 2017. Senior Debt multiples are in the mid-threes and Total Debt multiples in the mid-fours. We believe it is likely these levels will continue through the early part of 2019.

Given the low cost of debt and the leverage available, most borrowers are utilizing proceeds of new debt financing to refinance existing debt. To that end, approximately $83.2 billion, or two-thirds of the proceeds from all leveraged loan issuances during year-to-date 2018, were used for refinancing and repricing of debt.

Usage of Total Leveraged Loan Proceeds YTD 2018



Source: Debtwire

The recent tax reform will limit deductibility of interest payments on debt. This change will be effective in FY 2019 and will become a significant consideration for future financing decisions.

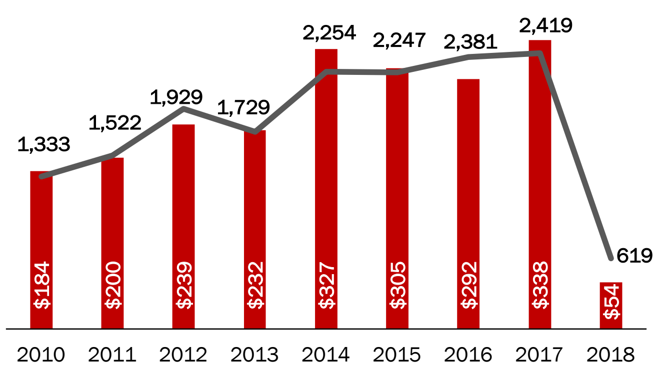
The equity markets continue their lofty valuations but, unlike prior years of stability, volatility has returned to the market. We view this transition as the new norm.

M+A Outlook

Transaction activity in 2017, in terms of deal count and valuation experienced a record breaking year-on-year growth in the US middle-market. Q1 2018 appeared to be, according to PitchBook, a mixed bag. Compared to Q1 2017, the number of deals rose to 619, representing an increase of 17%. Total deal value fell to $53.6 billion, representing a sharp decline of 40%. This results in an average deal size of $86 million in Q1 2018, as compared to $146 million in Q1 2017.

This signals a shift in targets from the core middle-market to the lower middle-market. We see lower middle-market sellers more receptive to transaction offers due to the desire to take advantage of high exit valuations and liquidity that was historically not offered to them in the market.

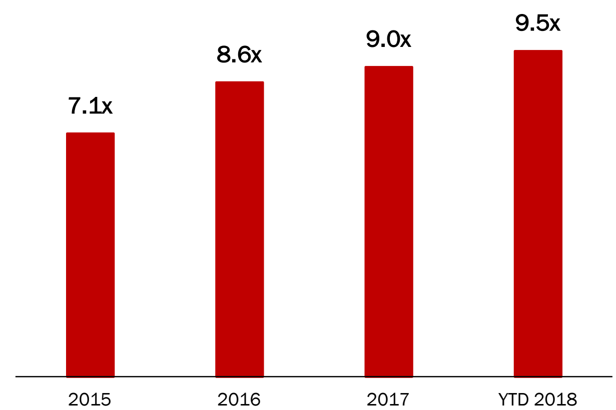
Deal Value and Count in US Middle-Market M+A



Source: PitchBook, transactions between $25 million - $1 billion

YTD 2018 deal multiples have already surpassed the historic levels of 2017, as median multiples reached 9.5x across the middle-market. This is attributed to favorable capital markets, limited supply of quality assets for sale and a stronger economic outlook. We believe this competition is one of the factors that is driving the growing interest in the lower middle-market.

Median EBITDA Multiples for US Middle-Market M+A



Source: PitchBook, transactions between $25 million - $1 billion

We continue to see interesting trends in valuation metrics for different sizes and sectors. The size premium between the smallest lower middle-market categories have been converging over time, which indicates the competition for quality assets leading to market premiums.

TEV / EBITDA by Size – Lower Middle-Market

TEV	2014	2015	2016	2017	YTD 2018	Total
10-25	5.5x	5.8x	5.8x	6.4x	5.7x	**5.6x**
25-50	6.4x	6.6x	6.4x	6.6x	6.7x	**6.3x**
50-100	7.5x	7.8x	7.3x	8.3x	9.2x	**7.0x**
100-250	7.5x	9.0x	8.9x	9.2x	8.6x	**7.9x**
Total	**6.4x**	**6.7x**	**6.8x**	**7.4x**	**6.9x**	**6.3x**

Source: GF Data, transactions between $10 million - $250 million

2017 rewarded companies with higher valuations in industry sectors that displayed strong operating margins and positive outlook (Technology, Media + Telecom and Heathcare). YTD 2018 does not illustate this trend. This may be skewed, though, due to a number of announced but yet to be completed deals. As the economic outlook for Retail remains bleak, we believe the Retail valuation of 10.6x appears to be an aberration.

TEV / EBITDA by Sector – Lower Middle-Market

Industry	2014	2015	2016	2017	YTD 2018	Total
Manufacturing	6.1x	6.6x	6.1x	6.9x	7.1x	**6.1x**
Business Services	6.1x	6.3x	7.3x	7.5x	6.5x	**6.3x**
Health Care Services	7.2x	7.8x	7.6x	8.1x	6.6x	**7.1x**
Retail	6.0x	5.5x	7.1x	7.6x	10.6x	**6.6x**
Distribution	7.1x	6.7x	7.5x	7.6x	7.5x	**6.4x**
Media & Telecom	NA	6.4x	6.7x	8.2x	5.0x	**7.1x**
Technology	7.7x	8.0x	7.4x	10.2x	9.7x	**7.6x**
Other	6.4x	5.6x	7.0x	6.6x	5.7x	**6.0x**
Total	**6.4x**	**6.7x**	**6.8x**	**7.4x**	**6.9x**	**6.3x**

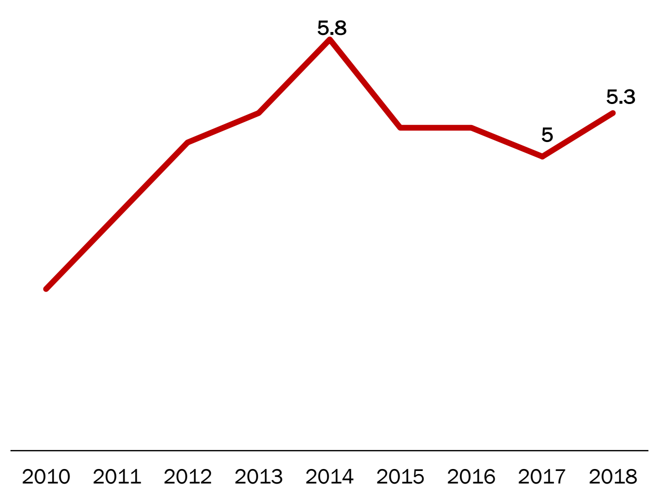
Source: GF Data, transactions between $10 million - $250 million

Deal Flow Observations

Private Equity (PE) remains an attractive asset class due to its superior returns relative to public markets.

The median hold time of portfolio companies by middle-market PE firms has increased from the pre-crisis median age of three years to now stabilizing around 5.3 years. We attribute this to the shift from purely financial engineering to increased emphasis on performance improvement. This manifests from internal value creation, successful add-on acquisitions + integration, or both.

Median Holding Period for Middle-Market PEs



Source: PitchBook, transactions between $25 million - $1 billion

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With more than 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 more than half a century of collective transactional experience, developing creative solutions for clients under specific and often significant time constraints.

Conclusion

We believe there is enough evidence to support a growing economy for the next several years. Inflation is slowly rising and interest rates are normalizing on the short end of the yield curve, but so far haven't caused much damage to longer rates. Corporate costs are rising, but so far not enough to imperil profitability. Buyers in the market are paying premiums (9.5x) and north for good assets. The capital markets are flush with cash seeking investment which in-turn leads to a compression in yield. Distractions in the market with North Korea, NAFTA and Fed movements are all white noise. Underpinning a strong economic outlook for the foreseeable future, we believe the current favorable trends in the US M+A activity will continue for the remainder of 2018 and into mid-2019.