JUNE 2023

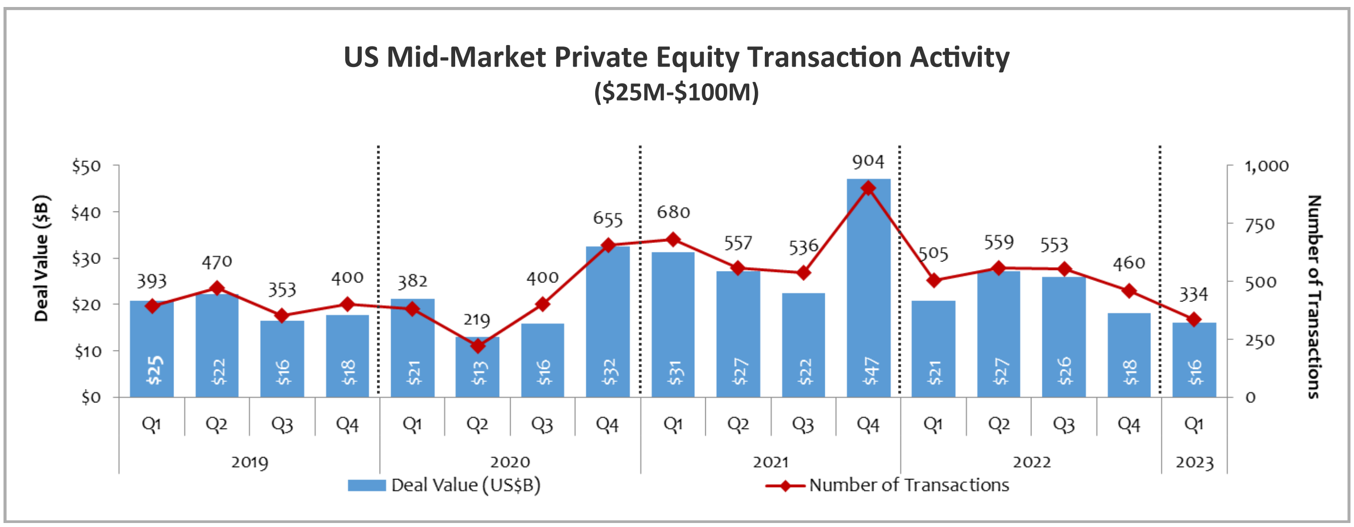
Perspectives

SPOTLIGHT ON PRIVATE EQUITY

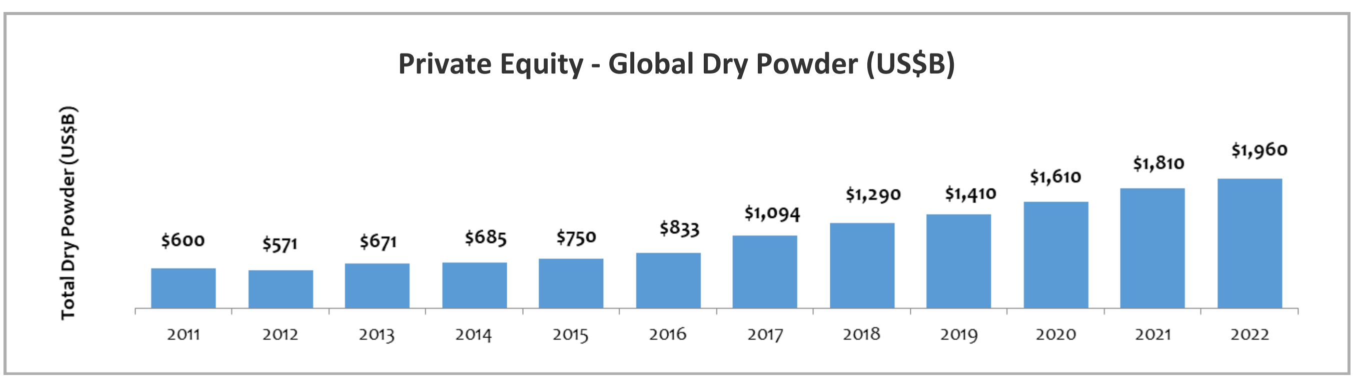
VIEWS ON INDUSTRY TRENDS AND NEWS

Private Equity in the Mid-Market

As the global economy emerges from a post-COVID surge into a period facing multiple headwinds, we wanted to take this opportunity to update you on the mid-market private equity landscape. We do this because this data is a good proxy for mid-market M&A metrics more broadly. In *Perspectives* last year, we mused about the possible ramifications of rising interest rates, creeping inflation, concerns about an economic downturn, ongoing supply chain bottlenecks, and geo-political issues on PE activity. Not surprisingly, those factors contributed to a 22% drop in mid-market PE deal activity in 2022 compared with the peak levels recorded in 2021. Despite this decline, deal activity remained above the 3 year average. There was further softness in Q1 2023 as transaction volume was off 36% from the 2022 quarterly average. It will be interesting to observe how PE activity trends in the coming quarters with certain key factors working in opposite directions; significantly higher interest rates, more conservative leverage packages from lenders and the threat of a recession on one side, countered by record levels of dry powder needing to be deployed (nearly $2 trillion) and an attractive valuation environment on the other side.



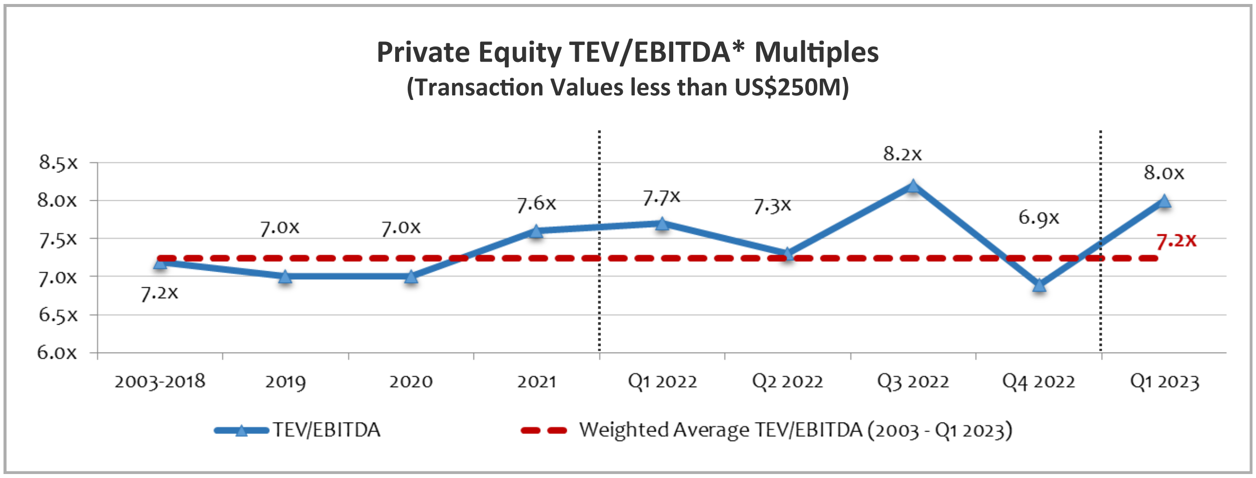
Source: Pitchbook



Source: Preqin Ltd.

Valuations: Rebound to 4-Year Highs

Mid-market valuations remained robust in 2022, with TEV/EBITDA multiples averaging 7.6x, in line with 2021 levels. Q1 2023 valuations got off to a strong start averaging 8.0x EBITDA. This could be in part because the mix of deals completed in Q1 were on balance higher quality as lower quality businesses failed to trade.



**Total enterprise value / earnings before interest, taxes, depreciation and amortization*

Source: GF Data®

Market data from GF Data® is proprietary and may not be reprinted, reproduced or used in any form without written permission from GF Data Resources LLC or Crosbie & Company Inc.

Valuation by Industry Sector: Tech Cools Off While Business Services Rallies

While valuations have been broadly trending above their long term averages, not all industries have benefited equally. Valuations for Business Services transaction jumped to 9.0x EBITDA in Q1 2023, an increase of 1-2 turns above the averages for the prior years. Healthcare deals averaged 9.5x EBITDA in Q1 2023, exhibiting similar increases over prior periods. Meanwhile, the Technology sector cool-down that we saw in 2022 (8.1x vs 10.3x in 2021) continued in Q1 2023 (7.8x), consistent with the declines experienced in the broader public Tech market. The largest multiple slump in Q1 2023 was experienced by the Retail industry, hitting a low of 5.7x EBITDA.

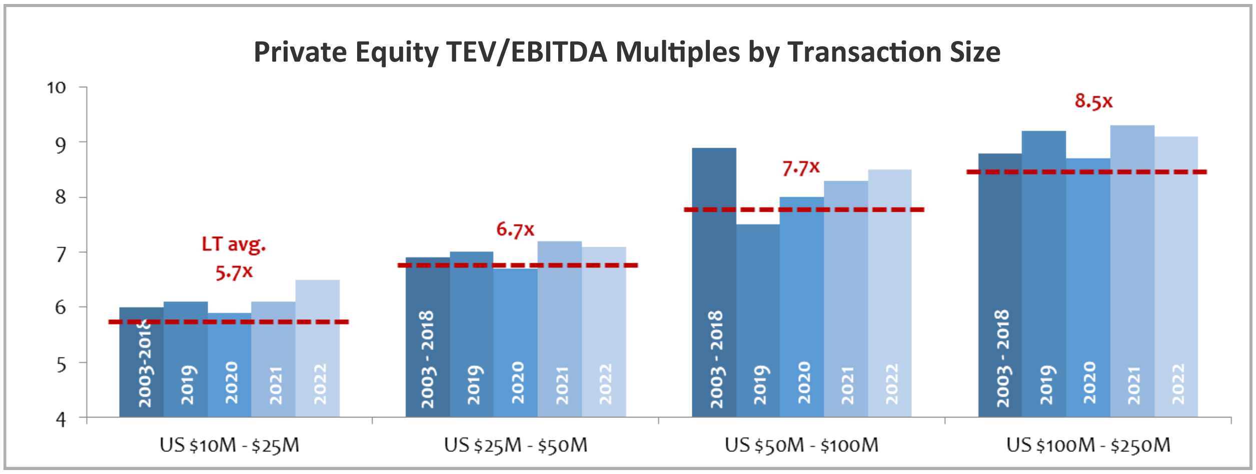
TEV/EBITDA by Industry (US $10M—$250M TEV)

	2003-2018	2019	2020	2021	2022	2023 YTD	Long Run Average
Manufacturing	6.8x	6.5x	6.7x	7.1x	7.3x	7.0x	6.4x
Business Services	7.1x	7.2x	7.1x	7.3x	7.4x	9.0x	6.9x
Health Care Services	7.8x	8.0x	7.6x	8.1x	8.4x	9.5x	7.6x
Retail	8.1x	9.3x	6.5x	8.3x	8.0x	5.7x	7.1x
Distribution	6.9x	7.0x	7.5x	7.2x	7.2x	6.5x	6.8x
Media and Telecom	7.8x	9.4x	8.3x	6.3x	9.1x	NA	7.6x
Technology	9.6x	10.0x	7.6x	10.3x	8.1x	7.8x	8.5x
Other	7.2x	6.5x	6.2x	7.3x	6.7x	9.6x	6.4x

Source: GF Data®

Valuations: Size and Quality Matters

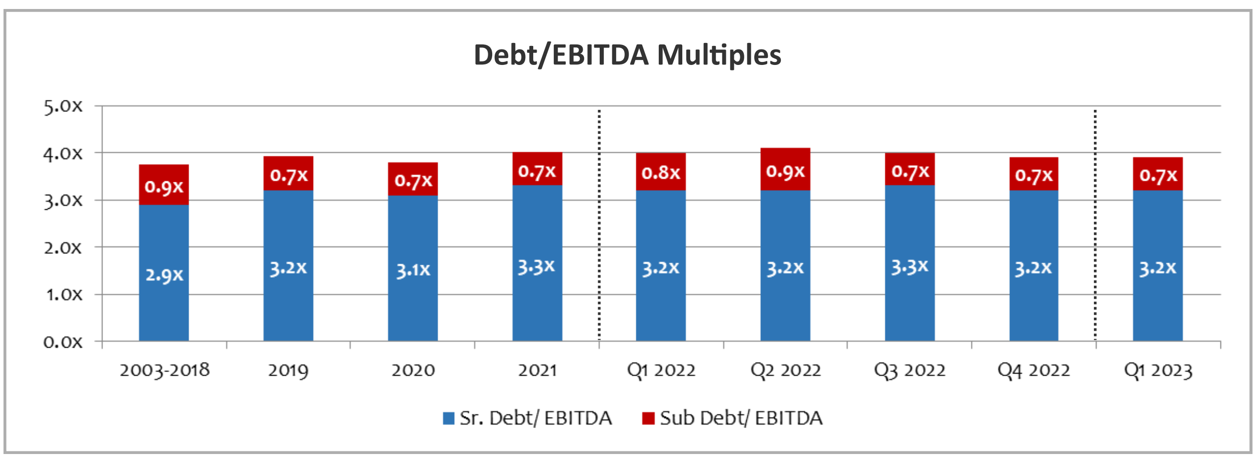
Segmenting valuation multiples by transaction size shows that larger companies with TEV between $100 and $250M traded at an average of 9.1x in 2022, representing a 40% premium relative to smaller companies with TEV between $10 and $25M. While size is important, growth and profitability are also key determinants in valuation. Companies that exhibited above-average financial performance (i.e. TTM EBITDA margins and revenue growth rates both exceeding 10%) fetched a 23% premium in 2022. This represents a significant increase relative to the long term average (15% premium), confirming that private equity buyers continue to compete aggressively for the top performers.



Source: GF Data®

Leverage Analysis: Debt Markets Becoming More Selective

Average leverage levels for mid-market PE transactions have remained in a relatively tight range over the last 4 years: 3.8x to 4.1x Total Debt/EBITDA. Anecdotally, we are hearing that US lenders have become more selective on which deals they pursue. However, in Canada, we continue to see relatively accommodative lending markets, particularly for higher quality situations. With the significant increase in interest rates over the past year and signs of economic uncertainty on the horizon, it will be interesting to see if lenders shift to a more conservative stance.

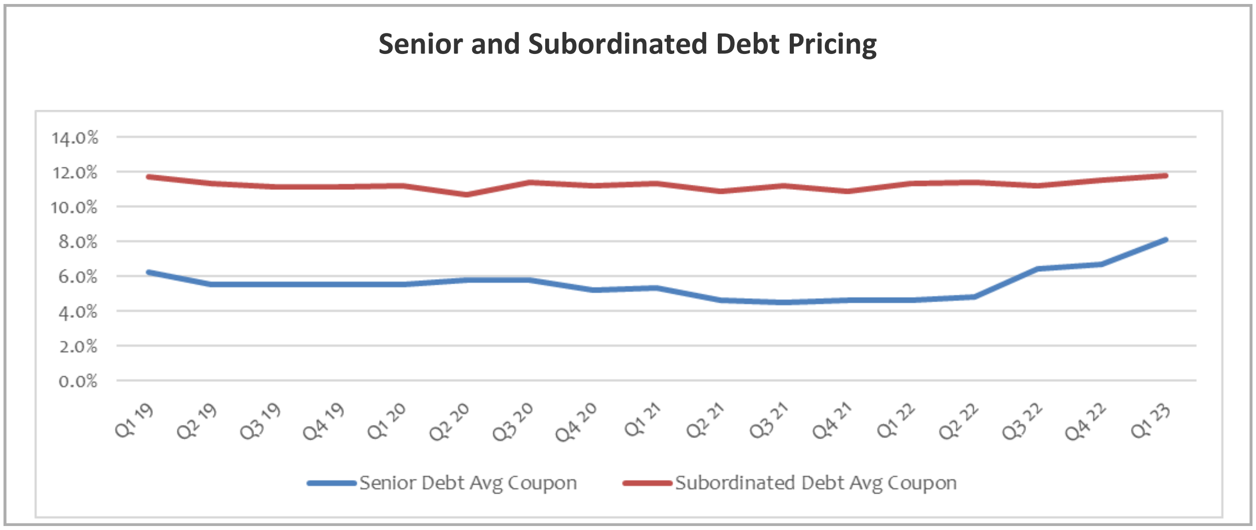


Source: GF Data®

CROSBIE

Leverage Analysis: Higher Cost of Capital

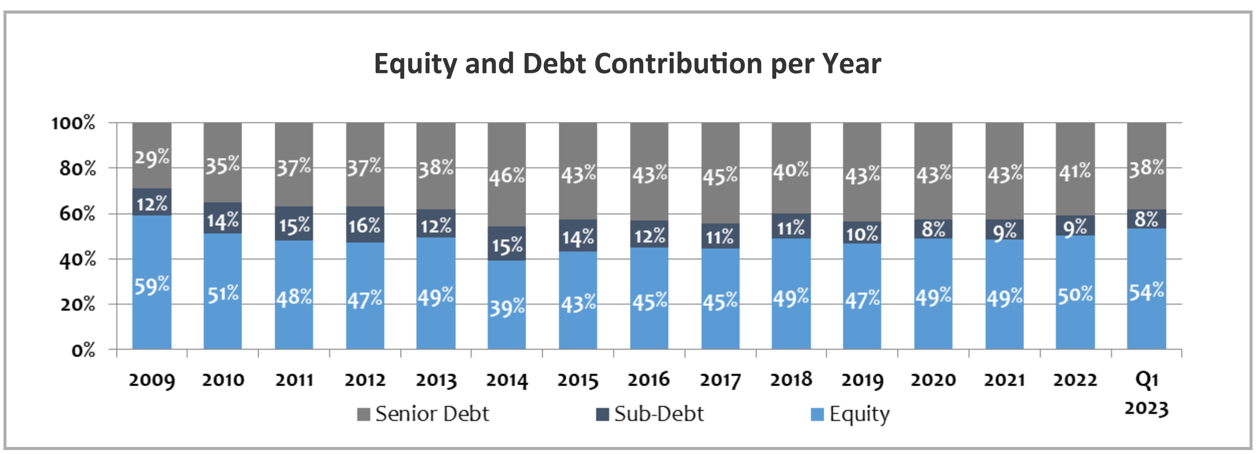
After years of stable or declining cost of debt, borrowing costs began rising in Q2 2022, particularly for senior debt. This obviously reflected the effect of the Fed's tightening monetary policy on the wider capital market. In less than a year, interest rates for senior debt have increased almost 4% points to reach a high of 8.1% in the first quarter of 2023. The cost of subordinated debt also increased but to a lesser degree. Not surprisingly, the higher costs of borrowing have put a damper on overall PE activity, particularly for lower quality situations.



Source: GF Data®

Leverage Analysis: Capital Structure

The chart below illustrates the average capital structure of North American mid-market PE acquisitions. The proportion of equity used in acquisitions spiked in the first quarter of 2023 to the highest level since the Great Financial Crisis as credit markets tighten and lenders require greater equity buffers.



Source: GF Data®

Contributing Editor:

Richard Betsalel is a Managing Director at Crosbie & Company and has over 20 years of corporate finance and M&A advisory experience. Richard has a Bachelor of Science from McMaster University and an MBA from the Schulich School of Business.

Tel: 416-362-4882 | rbetsalel@crosbieco.com

RECENT TRANSACTIONS

QUESTRADE

A leading provider of investment accounts, brokerage, and other financial services has completed a strategic acquisition

ACQUISITION SEARCH & ADVISORY

blended perspectives

A leading North American software sales and consulting services provider of Atlassian solutions has been sold to

CONTEGIX | STRATTAM CAPITAL

A US-based managed services Atlassian partner and a portfolio company of Strattam Capital

SALE ADVISORY

ONTARIO EXCAVAC GET MORE OUT

A leading utility services provider and portfolio company of

Market Sq. EQUITY PARTNERS

has been sold to a North American energy infrastructure investor

SALE ADVISORY

Cheme

A specialty process engineering firm focused on the biotechnology, pharmaceutical, nuclear, and food & beverage sectors has been acquired by Consultys, a subsidiary of

VULCAIN ENGINEERING

SALE ADVISORY

ABOUT CROSBIE

Crosbie is an independent investment banking firm focused on mid-market businesses. For over 30 years, Crosbie has built its reputation by providing advice and investment banking services to private and public companies, business owners, families and shareholder groups, as well as Boards of Directors.

M&A

- Company Sales
- Exit Strategies
- Acquisitions
- MBOs

Financing

- Raising Capital
- Debt Advisory
- Recapitalizations
- Restructuring

Advisory

- Shareholder Advisory
- Strategic Advice
- Fairness Opinions
- Valuations

Crosbie & Company Inc.
150 King Street West
15th Floor, P.O. Box 95
Toronto, ON M5H 1J9

Please visit our website at
www.crosbieco.com
or contact us at 416.362.7726

GLOBAL M&A PARTNERS