



GULFSTAR GROUP

INVESTMENT BANKERS

Middle Market Commentary - First Half of 2017

The size effect persists in middle market deals in the first half of 2017. According to GF Data, a robust debt market, supported by non-bank lenders, continues to drive up unprecedented valuations for middle market companies, specifically for larger or more desirable properties. The average EBITDA multiple for transactions in Q2 2017 reached 7.4x, the highest mark in the 15-year history covered by GF Data. Deal terms also support higher realized values for sellers, as participants increasingly rely on rep and warranty insurance, leading to significant decreases in indemnification caps, particularly in the \$50-\$100 million range.

Unfortunately, deal volume was somewhat dampened by political risk – only 45 deals were completed in Q2, a drop-off from the 75 closed in Q2 of 2016. Companies valued in the \$10-\$25 million range sold at an average of 5.8x EBITDA, while those in the \$100-\$250 million range sold at an average of 8.7x EBITDA (see chart below). The market continues to be strong for sellers across all size categories, as multiples remain above their long-term averages (2003-2016) in all enterprise value ranges.

TOTAL ENTERPRISE VALUE (TEV)/EBITDA

TEV	2003-2012	2013	2014	2015	2016	YTD 2017	Total	N =
10-25	5.6	5.9	5.6	5.8	6.0	5.8	5.7	1049
25-50	6.2	6.8	6.6	6.6	6.5	6.6	6.3	800
50-100	6.8	6.8	8.4	7.8	7.3	7.6	7.1	550
100-250	7.3	7.5	7.8	9.0	9.0	8.7	7.8	263
Total	6.2	6.5	6.7	6.7	6.9	6.9	6.4	
N =	1731	163	216	236	213	103	2662	

Please note that N for 2003-12 encompasses ten years of activity.

Source: GF Data®

Quality in the middle market is linked to higher EBITDA margins and growth rates. Buyout transactions involving quality firms constitute more than half (56%) of the entire GF database, and these firms received, on average, greater EBITDA multiples than other firms in the database. This quality premium has been rising during the period studied by GF Data (2003-2016). While the average quality premium in the full period is 7%, it has consistently risen in recent years: 14%, 11%, 24%, 20% and 33% in 2013, 2014, 2015, 2016 and 1H 2017 respectively.

Approximately 80% of the transactions in the GF Database involve firms in four industry groups. These industries and the 1H 2017 multiple for each are manufacturing (6.6x), business services (6.7x), healthcare services (7.5x), and distribution (6.8x). Valuation multiples were higher than long-term averages for

all industries except Media & Telecom and Technology, which saw multiples inline with their long-term averages.

Availability of capital to close a transaction impacts a buyer's ability to pay, and the availability of senior debt for buyout transactions is a ready indicator and predictor of full market valuations. For 1H 2017, senior lenders provided 2.8x EBITDA to the average small buyout (\$10-\$25 million), while the largest deals (\$100-\$250 million) received 4.0x EBITDA. In 1H 2017, total debt (senior and sub) in the average small deal was 3.65x, while in the largest transactions it was 4.95x. These debt statistics support the correlation between availability of debt and deal size as well as multiples paid by buyers.

GF Data provides information on the cost to the buyer as well as the price to the seller. This difference arises because of transaction costs. The buyer's returns are based on its all-in costs including transaction costs. In 1H 2017, buyer transaction costs averaged 0.27x EBITDA, making the average all-in cost to the buyer 7.2x EBITDA.

Indemnification caps are on the decline, dropping from an average of 15.8% of Total Enterprise Value (TEV) in 2016 to 10.5% in 1H 2017. The decline in indemnity caps positively correlates to the dramatic increased use of rep and warranty (R&W) insurance. In 1H 2017, the average indemnity cap for firms in the \$10 - \$25 million range decreased slightly from 19.6% in 2016 to 16.2%, and the average indemnity cap for firms in the \$25 - \$50 million range decreased slightly from 13.5% to 10.3%. The drop in indemnity caps becomes more dramatic in the \$50 - \$100 million range, where the average decreased from 21.7% of TEV in 2016 to 4.8% in 1H 2017. While the average indemnity cap for transactions over \$100MM did increase from 4.2% in 2016 to 6.6% in 1H 2017, this level of indemnity for these transactions was already low and reflective of reliance on R&W insurance.

In summary, although the number of transactions was down slightly in 1H 2017, GulfStar continues to view conditions in the middle market as being highly favorable to the seller. Valuation levels have continued to increase over the past five years across industries and size ranges, and average multiples remain above their long-term averages. These positive conditions are expected to continue through 2018. GulfStar continues to actively represent businesses in downstream energy, manufacturing, retail, consumer, healthcare, software, technology, and business and industrial services, where buyer interest continues to be strong.

About GF Data® - GF Data provides data on private equity-sponsored M&A transactions with enterprise values of \$10 to 250 million. GF Data gives private equity firms and other users more reliable external information to use in valuing and assessing M&A transactions. GF Data collects transaction information from private equity groups on a blind and confidential basis. Two hundred private equity firms have provided information on deals included in this report. Market data is proprietary to GF Data and may not be reprinted, reproduced or used without the permission of GF Data Resources LLC or GulfStar Group. Securities offered through GulfStar Group I, Ltd. an affiliated entity, member FINRA - SIPC (www.BrokerCheck.com).