# CAPITAL MARKETS UPDATE

Middle Market M&A
**Q2 2024**

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# MARKET COMMENTARY

## Tricks or Troughs? Is the bottom finally here for M&A?

As summer draws to a close and autumn sweeps in, dealmakers, business owners, and capital providers are eager to know if we have finally reached the trough of this 24+ month downcycle for middle market (MM) M&A activity. Will the third and fourth quarters be the start of rebounding activity after the September 18th interest rate cut, or will we be haunted by the hope of stabilization until mid-2025? The results of Q2 2024 may have some clues to guide us.

Deal volume has only increased three times quarter-over-quarter (QoQ) during the ten quarters since Q4 2021. The first two increases were in Q4 of 2022 and Q4 of 2023—both quarters were followed by volume declines. The third increase just took place in Q2 2024, with M&A volume rising 1% QoQ. A small, but noteworthy gain.

What stands out even more prominently in Capstone's M&A analysis on page five, is that Q2 revealed significantly more green shoots than any other time since Q4 2021:

- Average disclosed deal value is up 31% year-over-year (YOY).
- Average EBITDA multiple outpaced Q2 2023 at 9.1x.
- Deals by public strategics are up 23.6% QoQ.

Further, while analyzing 1H earning call transcripts, our Market Intelligence team reported that MM M&A advisors are prepared for a "stronger than average, multi-year M&A upswing," stating:

- The strongest and deepest bench of professionals in history with key additions of senior talent to ensure best positioning.
- Momentum across multiple business lines.
- A strong internal pipeline as CEO confidence strengthens (up 28.6% YOY).

*"The remainder of 2024 may indeed have a few more tricks and turns up its sleeve, but those prepared to adapt will be best positioned to seize the opportunity—or outmaneuver the challenges—that lie ahead."*

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- Expectations that clarity following November presidential election will be relatively uneventful for the current M&A markets, with a step function increase as sponsors return.

On the topic of sponsor activity, for the first time in ten quarters Capstone reported a 5.5% QoQ increase in private equity (PE) transactions as sponsors mobilize their time, talent, and capital in anticipation for a busy 2025. The PE fundraising environment has remained resilient as well, with volume outpacing 2023 ($276 billion though 1H 2024), but total fund count remained low. Our Equity Capital Markets team highlighted that 2024 annual growth equity investments are set to reach $204 billion, outpacing 2023 annual levels which totaled $146 billion (more on page eight).

Platform deals for sponsors increased 21.7% QoQ, and capital overhang grows evermore abundant, exceeding $1.6 trillion (and evermore impatient!). However, Q2 2024 represented the first time since Q2 2022 that add-on acquisitions saw a decline in volume. As the median buyout holding period becomes increasingly elongated, sponsors will likely look towards new platform opportunities to justify limited partner (LP) fundraising.

To answer this shifting dynamic, Capstone is aggressively strengthening its Private Equity solutions and has launched a dedicated buy-side advisory group offering both add-on acquisition advisory for existing private equity platforms, as well as platform searches and retained buy-side/outsourced business development.

The advisor community dedicated to serving these roll-up strategies remains fragmented, and existing product offerings in the arena lack the depth of industry knowledge housed in the industry groups of a sell-side M&A practice. Capstone's new solution positions our industry bankers in the exploration and execution of buy-side mandates to help win new clients, vet target lists, and evaluate targets. This exercise will help us deliver an industry-leading buy-side product and facilitate access to fast-growing private equity-backed companies and their investors. With average pipelines across the market meaningfully higher YOY and QoQ, and with valuations on the rise for companies with profitability and scale, now is the time to ask when will all this pent-up activity will convert into fee events? General sentiment is still that we are indeed plateauing in terms of middle market M&A volume, and the trough came in Q1. There is "cautious optimism" in the next three months of the year, but the market remains focused on 2025-2026 outlook vs. 2024 results, going so far as to speculate that 2025 estimated revenue levels for M&A advisors could be above 2021 high water marks.

If we are to see record-breaking liquidity events in the next 12-24 months, it is important for advisors to identify and navigate their clients through all the transaction complexities, including the often-overlooked and darker side of negativity synergies. Understanding and anticipating potential pitfalls is crucial for any successful M&A strategy; so, in this quarterly update we will take a deeper dive into seven tips for managing negative synergies: "The Hidden Pitfall of Mergers & Acquisitions" (see pages 10-11) written by Capstone's Financial Advisory Services team.

The remainder of 2024 may indeed have a few more tricks and turns up its sleeve, but those prepared to adapt will be best positioned to seize the opportunity—or outmaneuver the challenges—that lie ahead.

# M&A OVERVIEW & OUTLOOK

## Q2 2024 TAKEAWAYS & THEMES

**Middle market M&A showed signs of a plateau in volume following a 24-month downcycle that likely hit its trough in Q1 of this year.**

- While middle market M&A volume in Q2 increased QoQ, sponsor platform transactions also saw an uptick in volume during the quarter.
- Strong average valuations in the core and upper middle market during Q2 indicated a preference among buyers for businesses with high level of scale and defensibility.
- Increasingly muted internal rate of returns (IRRs), coupled with a decline in sponsor fundraising, kept private equity activity healthy in Q2 and above historical lows.
- Industry played an important role in determining both the level of deal activity and the strength of valuations during the quarter.

**M&A activity remains poised for a resurgence as the substantial demand pent-up over the past year has begun to trickle in.**

- An uptick in sponsor platform acquisitions, no matter how marginal, has provided a basis for optimism that financial buyers are mobilizing to re-enter the M&A market.
- A stronger valuation environment has offered increasing incentives for middle market business owners to consider a sale.
- Demographics are a key catalyst for middle market volume, which has created a healthy pipeline of demand as aging founders and entrepreneurs seek to monetize their business.

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# KEY CONSIDERATIONS FOR BUSINESS OWNERS

| | Current State | Takeaways for Business Owners |
|---|---|---|
| Dry Powder | Abundant | Sponsors remain armed with vast reserves of dry powder, which has continued to be primarily used for add-on acquisitions to scale existing portfolio companies. Although fundraising levels have dipped through year-to-date (YTD) Q2, sponsors have needed to raise less capital due to pent-up demand for M&A. |
| Buyer Appetite | Selective with a focus on quality | Private strategic buyers were highly selective in their acquisition pursuits in Q2. Strategics have continued to eye acquisitions that offer synergies while private equity firms have looked for targets with clear exit opportunities. |
| Debt Market | Softening | Debt capital has become more affordable despite an elevated federal funds rate environment and conservative lending standards. The opening of the Syndicated Loan market, coupled with increased competition from private credit lenders, has reduced spreads charged above base rates. |
| Valuations | On the rise with premiums paid for scale | Average M&A valuations in Q2 2024 amounted to 9.1x EV/EBITDA, outpacing the prior year period but still below the historical annual average of 10.7x. Broken out by size, buyers have prioritized profitability and scale, along with a higher appetite for companies in the core and upper middle market which have averaged 10.4x EV/EBITDA and 9.7x EV/EBITDA, respectively. |

# Q2 2024 BY THE NUMBERS

## 1.0% ⇧
### INCREASE IN DEAL VOLUME

*M&A volume rose 1% QoQ in Q2, as middle market transactions have likely plateaued in recent quarters.*

## $70.5M ⇧
### AVERAGE DEAL VALUE

*Average deal value in Q2 increased 31% YOY to $70.5 million alongside a marginal drop in total deal value YOY.*

## 9.1x ⇧
### AVERAGE EBITDA MULTIPLE

*The average EBITDA multiple in Q2 2024 amounted to 9.1x, outpacing Q2 2023 but lower than historical averages.*

## 5.5% ⇧
### INCREASE IN PE TRANSACTIONS

*Private equity transaction volume grew 5.5% QoQ as sponsors have increasingly begun to mobilize for acquisitions.*

## 14.6% ⇩
### DECREASE IN PE FUNDRAISING

*Private equity fundraising fell 14.6% YOY in Q2 to $95.8 billion raised and fund count declined 40.6% YOY in Q2.*

## 11.4% ⇩
### DECREASE IN PE EXIT ACTIVITY

*Private equity exit activity declined 11.4% QoQ to 178 total exits, remained above a historical four-year low seen in Q4 2023.*

## 21.7% ⇧
### INCREASE IN PE PLATOFRM DEALS

*Platform transactions closed by sponsors increased 21.7% QoQ, showing appetite for deals amid softening credit rates.*

## 23.6% ⇧
### DEALS BY PUBLIC STRATEGICS

*Robust equity market returns have strengthened public buyer appetite, leading to a 23.6% QoQ rise in deal volume.*

## $1.6T ⇧
### GLOBAL PE DRY POWDER

*Capital overhang has continued to rise as private equity firms wait for optimal market conditions to deploy capital.*

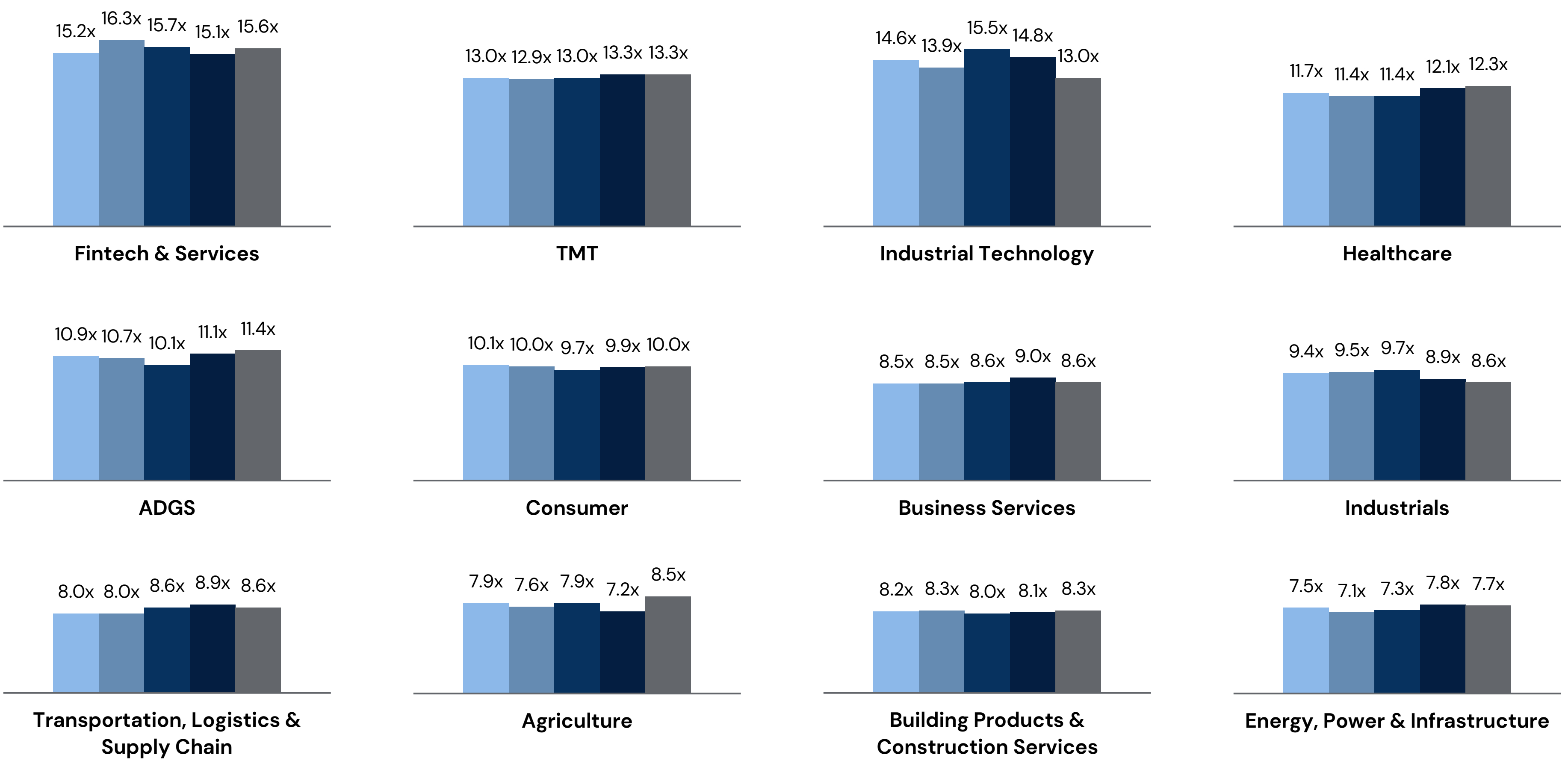
# CAPSTONE'S PROPRIETARY MIDDLE MARKET VALUATIONS INDEX

## Middle Market M&A Valuation Takeaways

- Capstone Partners actively monitors the purchase multiples of middle market transactions through its proprietary database to provide insight and transparency into the pricing environment.
- The FinTech & Services industry commanded the highest valuations in the three-year period ending in Q2 2024, with an average multiple of 15.5x EV/EBITDA.

**EV/EBITDA Last Three Years**

Q2 2023 Q3 2023 Q4 2023 Q1 2024 Q2 2024

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# CAPITAL MARKET DASHBOARD

## YTD EQUITIES

### S&P 500
+9.0%

| Last | 1Y % | P/E LTM |
|---|---|---|
| *5,199.5* | *+15.1%* | *24.3* |

### Dow Jones Industrial
+2.9%

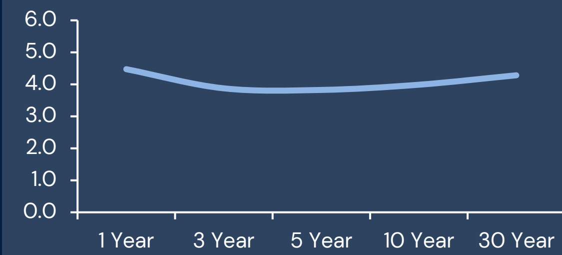
| Last | 1Y % | P/E LTM |
|---|---|---|
| *38,763.5* | *+9.3%* | *20.2* |

### NASDAQ
+7.9%

| Last | 1Y % | P/E LTM |
|---|---|---|
| *16,195.8* | *+15.7%* | *31.0* |

## FIXED INCOME

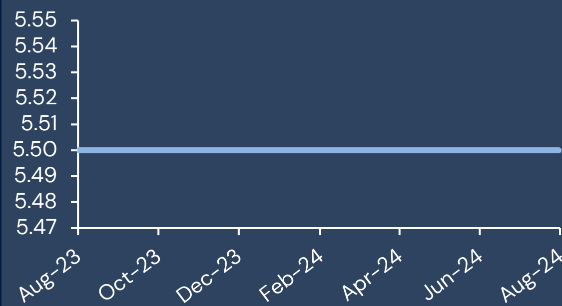
**U.S. Yield Curve**




| 1Y | 3Y | 5Y | 10Y | 30Y |
|---|---|---|---|---|
| *4.474* | *3.875* | *3.825* | *3.988* | *4.283* |

## POLICY RATE

**Federal Funds Target Rate**




## M&A INDICATORS

### GDP, LABOR MARKET, & INFLATION

| | Last | YOY |
|---|---|---|
| *GDP* | *2.8%* | *+0.7%* |
| *Unemployment* | *4.3%* | *+22.9%* |
| *Consumer Price Index* | *313.1* | *+3.0%* |

### CONFIDENCE LEVELS

| | | |
|---|---|---|
| *Consumer Confidence* | *100.3* | *-12.0%* |
| *CEO Confidence* | *54.0* | *+28.6%* |

### FINANCING

| | | |
|---|---|---|
| *High Yield Bond Yield* | *7.3%* | *-0.6%* |
| *Investment Grade Bond Yield* | *5.1%* | *-0.6%* |

### FOREIGN EXCHANGE

| | | |
|---|---|---|
| *USD Major Currencies Fed Index* | *115.8* | *+1.1%* |

*Source: FactSet and PitchBook LCD as of 08/08/24*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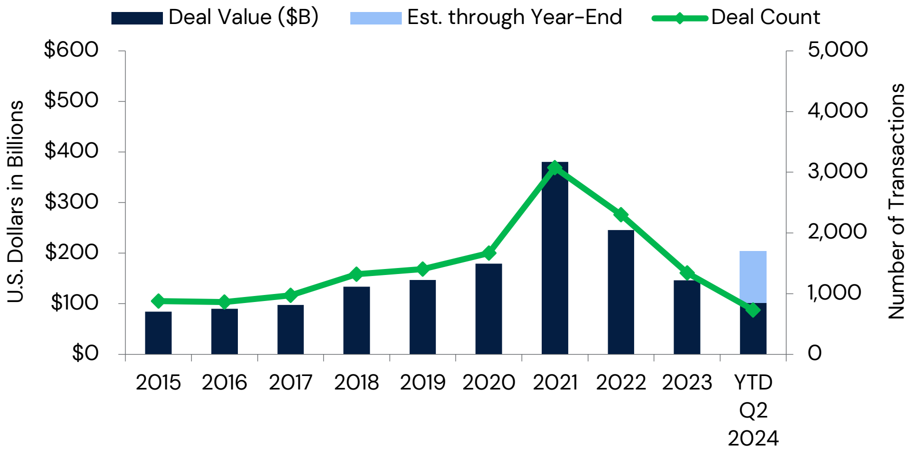
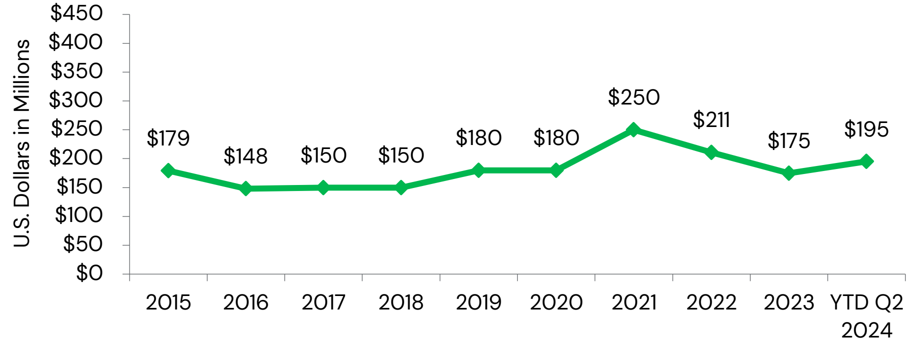
- **Growth capital financing volumes are outpacing levels from the prior year.** In Q2 2024, growth equity investments into late-stage private companies totaled $60 billion, the highest mark over the past seven quarters. At the current rate, 2024 annual growth equity investments are set to reach $204 billion, outpacing 2023 annual levels which totaled $146 billion. In Q2 2024, there were eight transactions valued at $1 billion or higher, including a $6 billion investment in xAI from a16z, Sequoia Capital, and Valor Equity Partners (June); Fisher Investment's $3 billion raise from the Abu Dhabi Investment Authority (ADIA) and Advent International (June); and CoreWeave's $1.1 billion raise led by Coatue Management and Magnetar Capital (May).

- **Valuations continue to steadily rebound after the market reset following record levels in 2021.** A rebound in public equity markets over the last year, coupled with high levels of dry powder among U.S. private equity firms ($914.5 billion, according to PitchBook), have supported stronger valuations for growth companies in 2024. A lower inflation reading, and signs of a weakening labor market have set the stage for an interest rate cut in the Federal Reserve's meeting in September 2024 which could support future valuations. Median pre-money valuations through Q2 2024 settled between 2022 and 2023 levels at $195 million. When looking at pre-money valuations by quarter, Q2 2024 saw a slight step-down from Q1 2024 as median valuations decreased from $200 million to $190 million.

**Growth Capital Raised by Year**



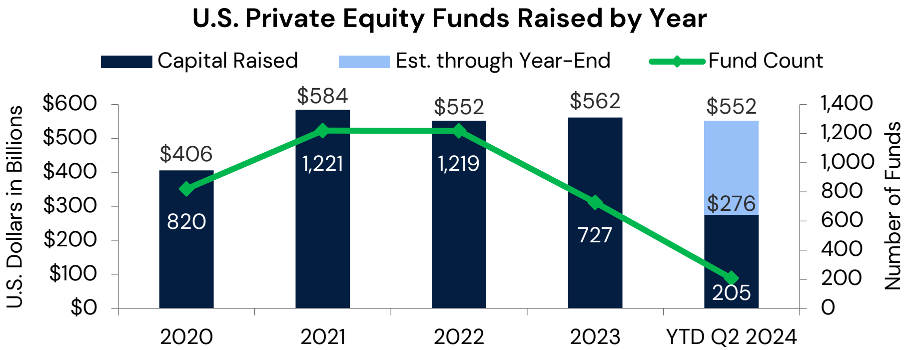

**Median Pre-Money Valuations for Growth Companies**




*Note: Includes Capstone projections; Includes all VC stages and Growth Equity transactions excluding deals < $25 million*
*Source: Capital IQ, PitchBook, and Capstone Partners*

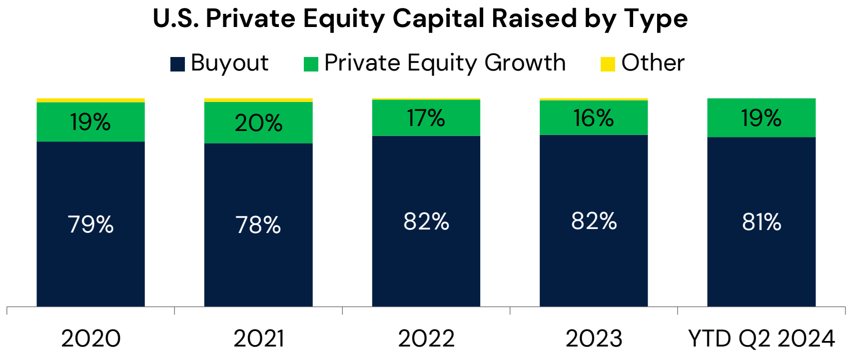
# EQUITY PRIVATE CAPITAL MARKETS CONDITIONS (CONTINUED)

- **North American M&A volume for deals with $25 million or more in enterprise value decreased by 12% YOY while deal value decreased more than 32% YOY, according to PitchBook. Deal makers continued to turn toward smaller deals in the face of higher financing costs, reduced lending, and lingering valuation disconnect.** Because of this, many founders have considered postponing a full sale until M&A valuations stabilize. One solution for founders has been to sell a minority stake today to pave the way for a full sale in the future. Founders doing so could: 1) use some portion of the raise for secondary liquidity, and 2) provide growth capital to accelerate their business plan as they grow EBITDA.
- **Private Equity fundraising volumes are on pace with 2023 levels, while fund count remains low.** Despite headwinds including a lack of exits and distributions to LPs, the fundraising environment remains resilient. Through the end of June, U.S. private equity and growth equity funds have raised $276 billion across 205 funds. In comparison with the first half of the prior year, 2024 is tracking ahead in terms of fund volume, but behind in terms of fund count. This indicates that larger private equity firms are attracting more capital than their smaller counterparts.




*Note: Includes Capstone projections; Source: PitchBook and Capstone Partners*

- **Compared to recent years, U.S. private equity growth funds have made up a larger share of 2024 sponsor fundraising.** Through Q2 2024, 19% of private equity capital raised was for growth strategies, up from 16% in 2023 and 17% in 2022. In addition to increased growth fund capital formation, the deployment of growth capital has remained strong YOY. Growth deals accounted for 20% of all private equity deals through Q2 2024 by value. This is well above its historical 10-year average of 11%. On a deal count basis, growth equity accounted for one out of every four private equity deals through Q2 2024.




*Source: PitchBook and Capstone Partners*

## EQUITY CAPITAL MARKETS GROUP

The Equity Capital Markets Group focuses on raising equity capital financing for growth-oriented companies and structured equity for more mature middle market enterprises. Our team works closely with companies to secure equity capital to fund growth initiatives, recapitalize the balance sheet (often including shareholder liquidity), and to finance M&A transactions.

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## Managing Negative Synergy in an M&A Process

Mergers and acquisitions (M&A) are often pursued for the potential positive synergies they can bring, such as increased market share, enhanced operational efficiencies, and expanded product portfolios. However, the darker side of these transactions, characterized by negative synergy, frequently gets overlooked. Negative synergy—collectively dis-synergies—can erode value, disrupt operations, and lead to significant financial losses.

Understanding and planning for negative synergies is not just about avoiding potential pitfalls; it is about maximizing the value of the deal and ensuring the long-term success of the combined entity.

### Common Types of Negative Synergy

While this is by no means an exhaustive list, some common factors show up over and over in our clients and produce some of the most significant headwinds that affect post-transaction productivity and value. These typically include: customer attrition; service and fulfillment deterioration; employee exodus; internal inefficiencies; cultural clashes; regulatory and compliance costs; brand dilution; and technology integration issues. A more in-depth exploration of these factors can be found in Capstone's recent article, Understanding Negative Synergy: The Hidden Pitfalls of Mergers and Acquisitions.

### Seven Recommendations for Managing Negative Synergy

1. **Do Your Homework**
   Thorough due diligence should include an assessment of potential dis-synergies. This involves evaluating the compatibility of corporate cultures, systems, and customer bases. Identifying potential areas of conflict and challenges early on can help in developing strategies to mitigate these risks. For example, understanding cultural differences can inform the development of integration plans that address these issues proactively.

2. **Make Realistic Projections**
   Financial models should incorporate conservative estimates for cost savings and revenue enhancements, taking into account potential disruptions and inefficiencies during the integration process. By setting realistic expectations, companies can avoid overestimating the benefits of the merger and better prepare for any unforeseen challenges. This includes accounting for potential customer attrition and increased operational costs due to integration efforts.

3. **Keep the Core Team**
   Develop and implement strategies to retain key employees, such as offering retention bonuses or clear career progression paths, to minimize the loss of talent and associated customer accounts. Retention plans should be communicated clearly and early in the process to alleviate employee concerns and prevent turnover.

# FINANCIAL ADVISORY SERVICES (CONTINUED)

Additionally, fostering a sense of inclusion and participation among employees from both companies can help in building a cohesive post-merger culture.

4. **Communicate**
   Proactively communicate with customers about the merger, highlighting the benefits and addressing any concerns they may have. Maintaining open lines of communication and providing reassurances can help retain customer loyalty. For instance, companies can reach out to key customers individually to discuss how the merger will benefit them and address any specific concerns they may have. Transparency in communication can also help in managing customer expectations and reducing uncertainty.

5. **Invest Time in Integration Planning**
   Create detailed integration plans that outline the steps for combining systems and processes. This should include timelines, responsible parties, and milestones to ensure a smooth transition. Effective integration planning involves setting clear objectives, identifying potential risks, and developing contingency plans to address any issues that may arise. Regular monitoring and adjustment of the integration plan can help in addressing challenges promptly and keeping the integration on track.

6. **Monitor and Adjust**
   Continuously monitor the integration process post-merger and be prepared to make adjustments as necessary. Regular progress reviews can help identify issues early and allow for timely interventions. Companies should establish key performance indicators (KPIs) to track the success of the integration and measure the impact of negative synergies. By staying agile and responsive, companies can mitigate the impact of dis-synergies and ensure a successful integration.

7. **Understand and Mitigate Regulatory Risks**
   Mergers often attract regulatory scrutiny, which can lead to delays and additional costs. To mitigate these risks, companies should:

   - Proactively engage with regulatory bodies early in the M&A process to understand potential concerns and requirements. This can help in addressing issues before they escalate and in building a cooperative relationship with regulators.

   - Conduct regulatory impact assessments to understand the regulatory implications of the merger. This includes analyzing antitrust issues, compliance with industry-specific regulations, and potential impacts on market competition.

   - Develop compliance strategies to address regulatory requirements and ensure compliance. This can involve setting up dedicated compliance teams, implementing robust monitoring systems, and seeking legal counsel to navigate complex regulatory landscapes.

   - Maintain transparent communication with all stakeholders, including regulators, investors, and Clear and honest communication can help in managing expectations and reducing uncertainty, which is crucial in maintaining trust and minimizing regulatory risks.

**For More Information**

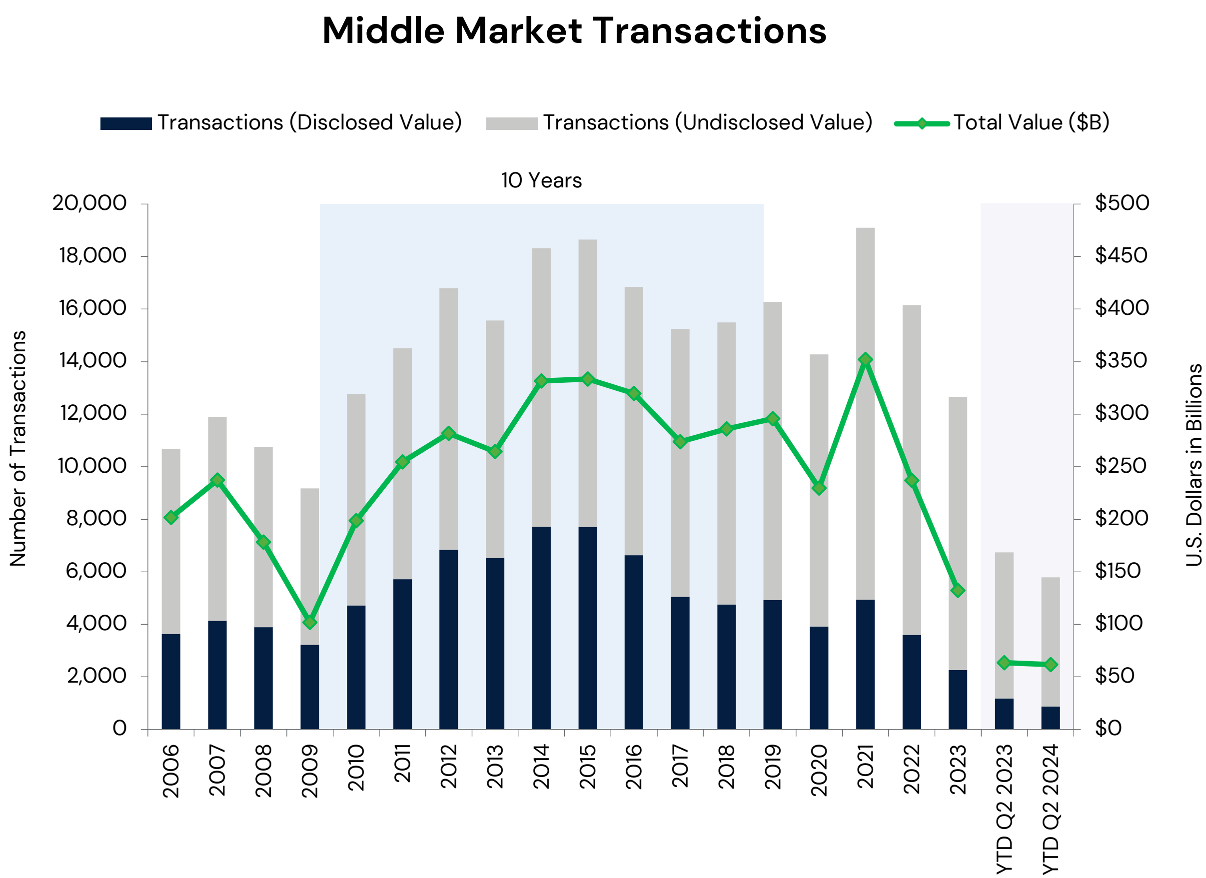
Capstone Partners has significant experience helping business stakeholders navigate complexity across the entire transaction lifecycle, from acquisition and integration, through the operational period, and then to a successful exit. Contact a member of our team to discuss how we can help you accelerate and optimize the value of your transaction.

# MIDDLE MARKET M&A ACTIVITY

# M&A AMID ECONOMIC CYCLES

## M&A ACTIVITY HITS TROUGH, POISED FOR COMEBACK

- Interest rate pressures and the continued lack of appetite for middle market M&A among private equity firms caused a 13.9% YOY decline in transaction volume through YTD Q2 2024.
- Despite the decline in volume, the average enterprise value paid among disclosed transactions rose 31% YOY to $70.5 million through YTD Q2 2024. Buyers have been willing to pay premium valuations for profitable businesses with scale.
- The prolonged downcycle can be attributed to a lack of sellers entering the market, rather than uncertainty around deal closings. Cancelled middle market transactions declined 29.5% YOY in YTD 2024.




*Note: New data methodology used for this report; Blue shaded areas indicate economic expansion*
*Source: Capital IQ and Capstone Partners*
*Enterprise Value < $500mm*

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# QUARTERLY M&A VOLUME

## QUARTERLY VOLUME AND VALUE HOLD STEADY

- Total closed transactions in Q2 2024 rose 1% QoQ. Since Q3 2023, quarterly transaction volume has risen or fallen less than 5% QoQ. This likely indicates a plateau in deal volume and that middle market M&A has hit its trough.
- The average deal value in Q2 was $69.9 million, a 1.8% QoQ decline. Despite the dip, the average enterprise value paid for middle market businesses has held steady around $70 million for the last three consecutive quarters.
- Total disclosed deal value increased 4% QoQ in Q2. This was largely due to acquisitions made by well-capitalized public strategic buyers, which comprised 46.6% of total middle market deal value in the quarter.

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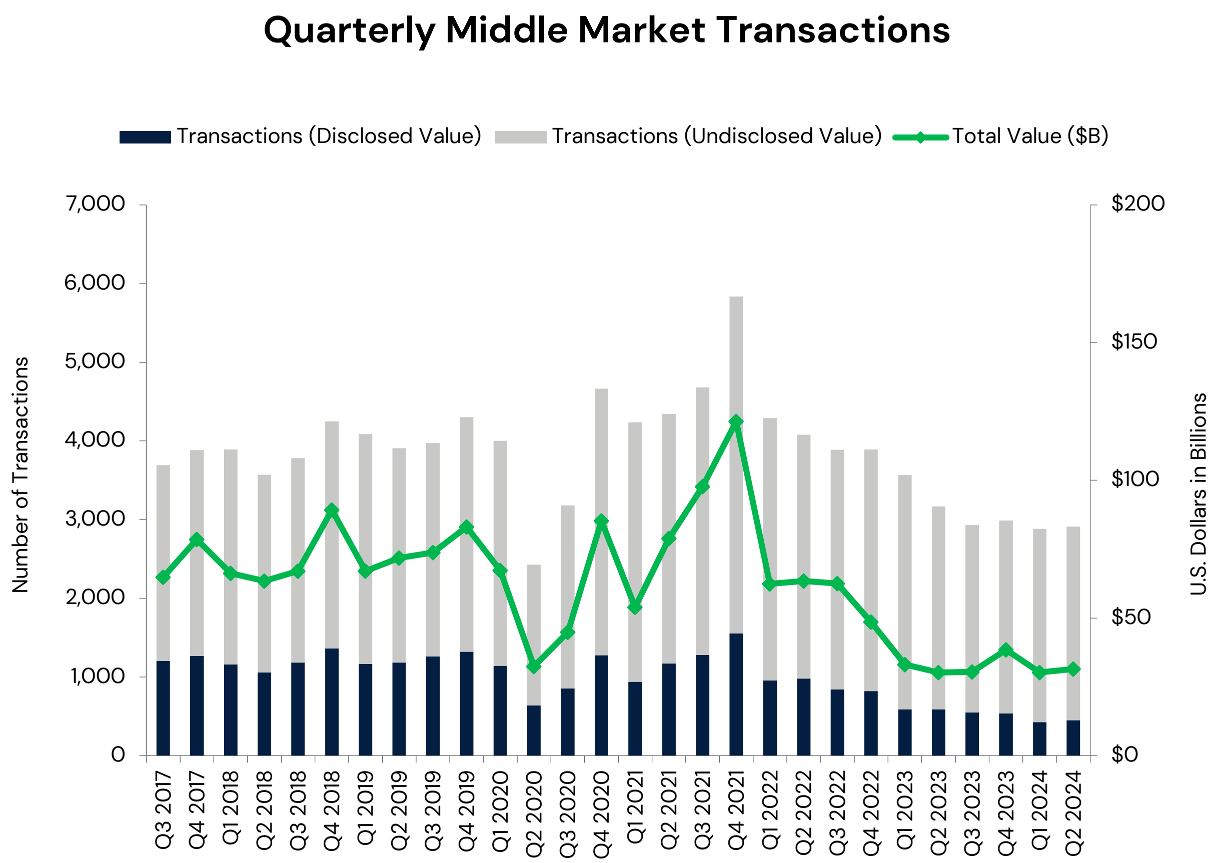
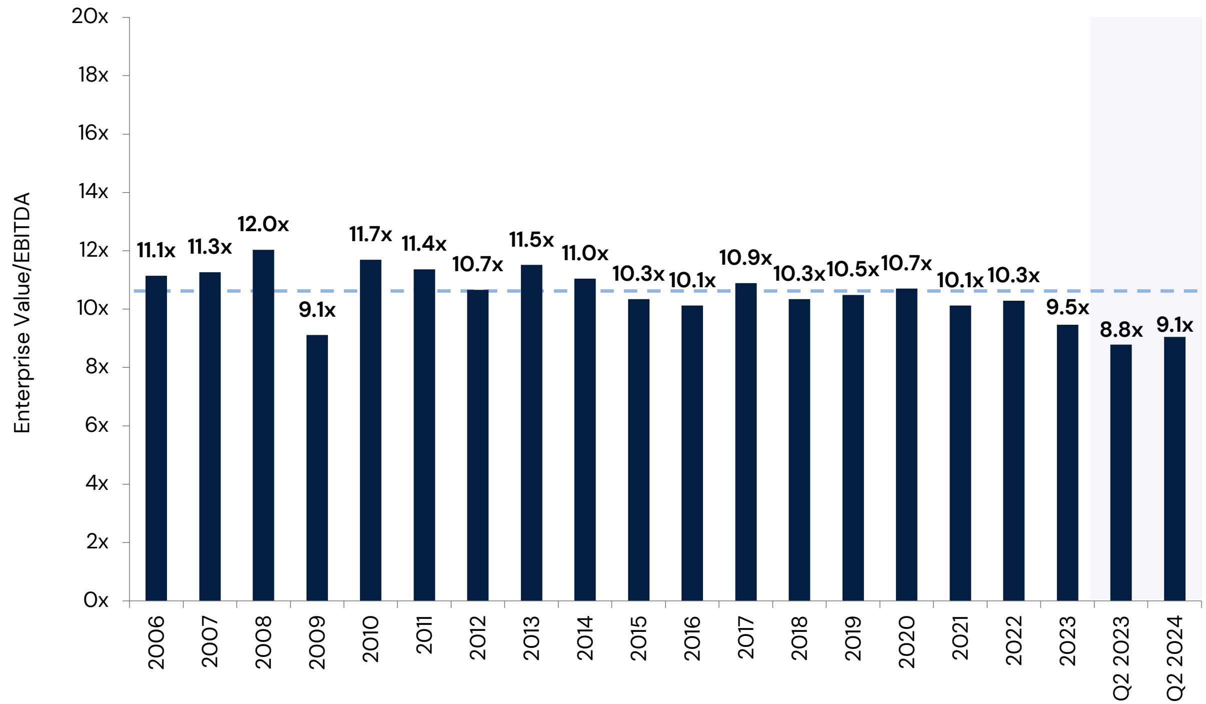



*Note: New data methodology used for this report*
*Source: Capital IQ and Capstone Partners*
*Enterprise Value < $500mm*

## AVERAGE PURCHASE MULTIPLE TICKS UP YEAR-OVER-YEAR

- The middle market deal environment experienced valuation expansion on a YOY basis, rising to 9.1x EV/EBITDA in Q2 2024, compared to 8.8x EV/EBITDA during the prior year.
- On a quarterly basis, the average EBITDA multiple paid for middle market businesses declined from 10.5x in Q1. However, historical dealmaking trends have shown a tendency for buyers to pay higher multiples in the back half of the year.
- Private equity firms paid an average multiple of 10.2x EV/EBITDA for middle market businesses in Q2, hinting that sponsors have begun moving up market for businesses they believe will provide stronger returns on an eventual exit.

### Middle Market Average EBITDA Multiple




*Note: New data methodology used for this report*
*Dotted line indicates 2006 to 2023 average of 10.7x*
*Source: Capital IQ and Capstone Partners*
*Includes multiples 3x-30x*
*Enterprise Value < $500mm*

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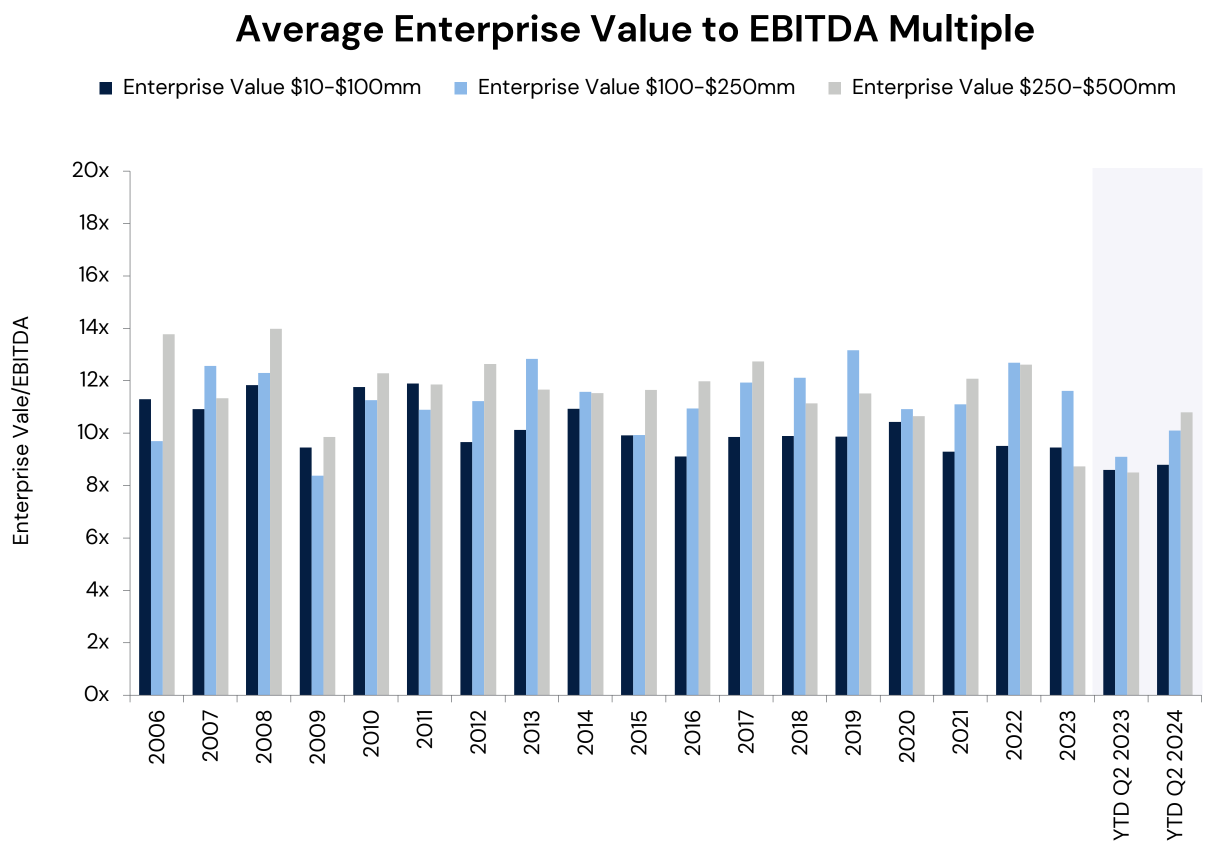
# BREAKING IT DOWN BY SIZE

## VALUATIONS EXPAND ACROSS THE MIDDLE MARKET

- The average valuation in the upper middle market ($250-$500 million) improved YOY to 10.8x EV/EBITDA—leading average pricing across all enterprise value ranges. Additionally, core middle market valuations expanded YOY through YTD Q2 to 10.1x EV/EBITDA.
- The lower middle market ($10-$100 million) saw the greatest valuation compression QoQ with the average multiple falling to the lowest in the middle market at 8.8x EV/EBITDA.
- Average EBITDA multiple increases in the upper and core middle market, coupled with compression in the lower middle market, has highlighted buyers moving up market for businesses with established scale.




*Note: New data methodology used for this report*
*Source: Capital IQ and Capstone Partners*
*Includes multiples 3x-30x*
*Enterprise Value < $500mm*

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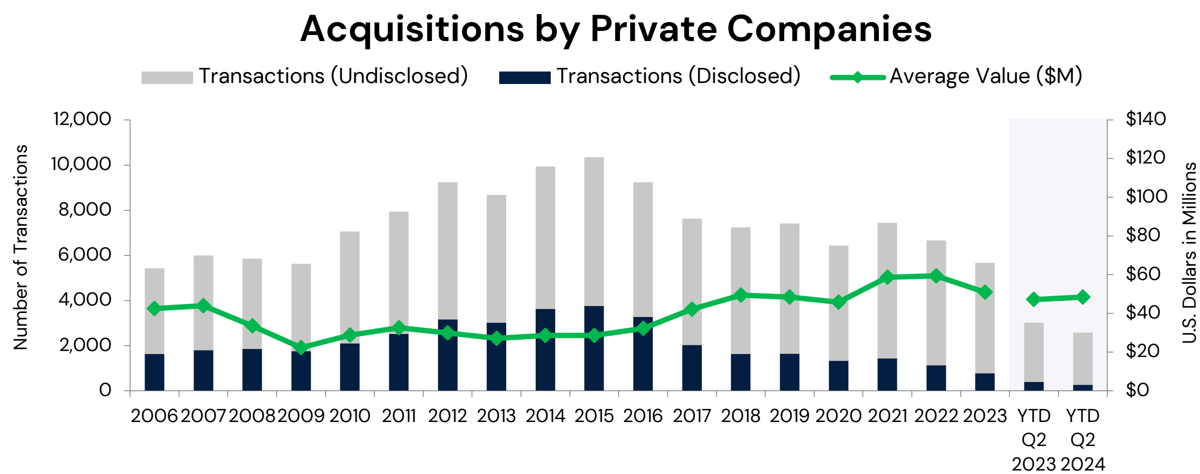
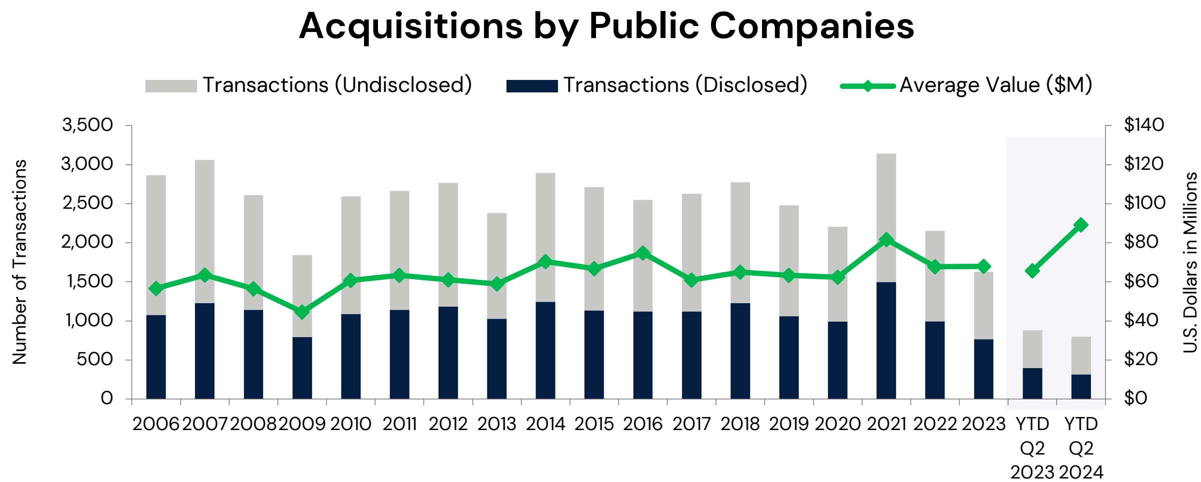
# STRATEGIC ACQUIRERS

## PUBLIC STRATEGICS MOVE UP MARKET

- Strategic buyer activity in Q2 continued to outperform financial acquirers led by a strong quarter among public strategic buyers, who experienced a 23.6% QoQ increase in volume and a 12.2% YOY increase in Q2 alone. Public strategics continued to move up market in their acquisition pursuits, paying an average of $89.2 million.
- Public strategic activity has been catalyzed by strong public equity returns through Q2, as increased management confidence and fortified cash flows have enhanced buying capacity.
- Middle market transactions closed by private strategic buyers fell 8.9% QoQ in Q2, and 14.4% YOY through YTD Q2.



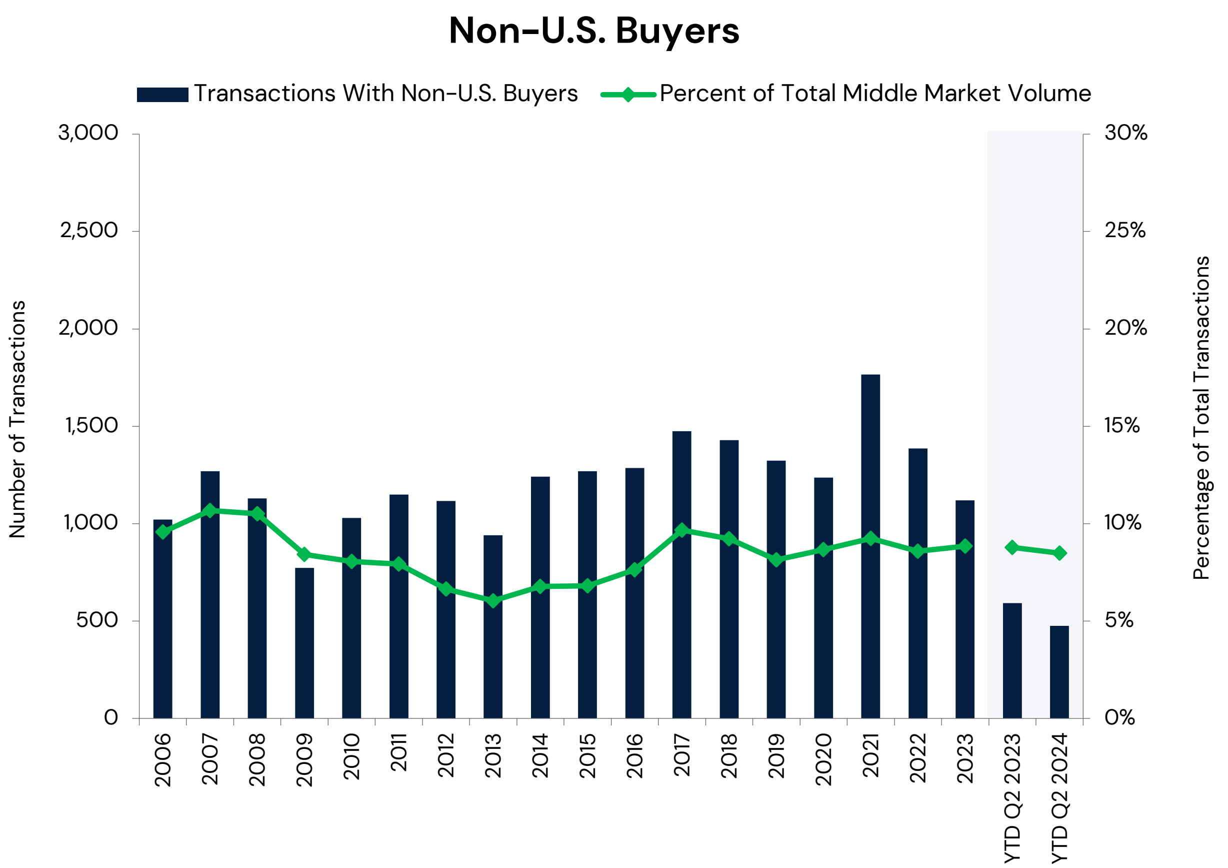




*Note: New data methodology used for this report*
*Source: Capital IQ and Capstone Partners*
*Enterprise Value < $500mm*

# FOREIGN ACQUIRERS

## FOREIGN BUYER ACTIVITY EXPERIENCES DECLINES

- Foreign buyer activity declined 19.6% YOY through YTD Q2, however, closed transactions by non-U.S. buyers improved on a quarterly basis, rising 8.5% QoQ. Additionally, purchase multiples paid by foreign buyers improved significantly in Q2, elevating by nearly two full turns QoQ to 8.2x EV/EBITDA.
- Canada-based buyers accounted for the most acquisitions of U.S.-headquartered targets through YTD Q2 at 139, followed by the U.K. with 90 transactions.
- U.S. dollar strength, cross-border regulatory scrutiny, and boiling geopolitical conflicts have hampered transaction activity, and will likely serve as headwinds to international dealmaking for the foreseeable future.




*Note: New data methodology used for this report*
*Source: Capital IQ and Capstone Partners*
*Enterprise Value < $500mm*

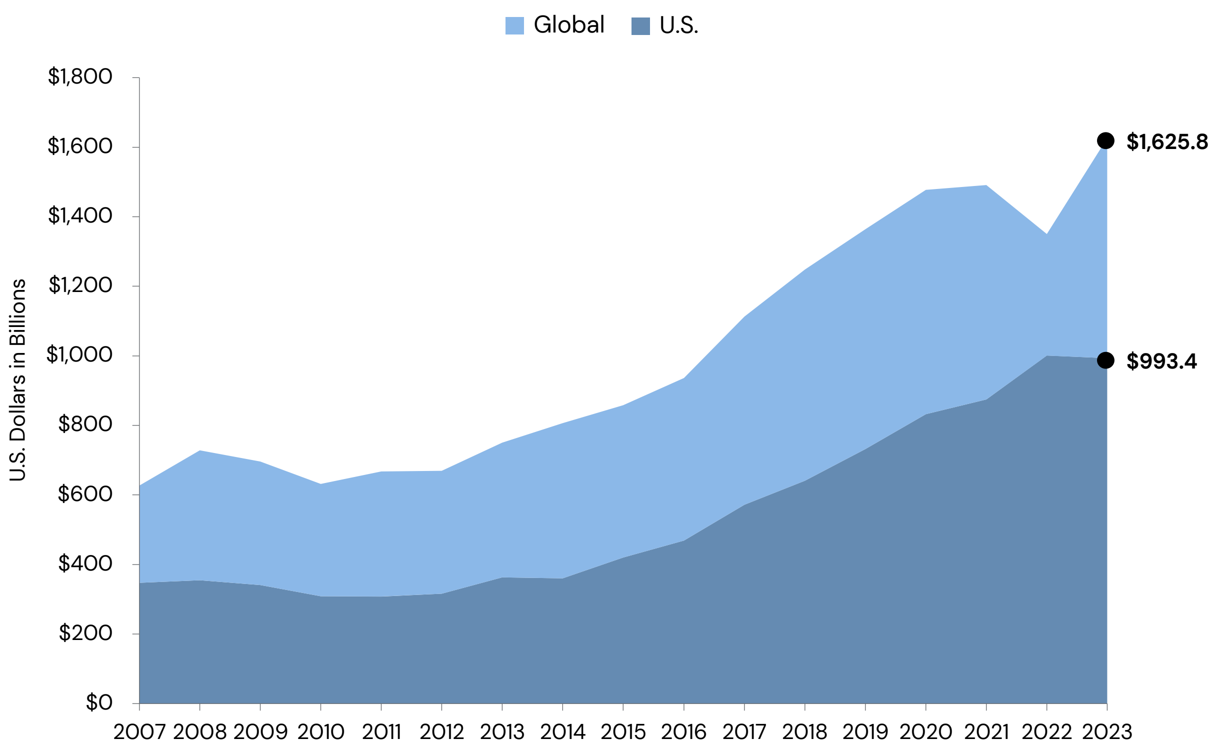
CAPSTONE PARTNERS

# PRIVATE EQUITY DRY POWDER

## DRY POWDER CONTINUES TO REMAIN ROBUST

- More than $1.6 trillion in dry powder remains for private equity firms to deploy. With LPs increasingly pressuring funds to generate returns, sponsors initially opted to use stop gap measures such as dividend recapitalizations to ease investors. However, softening credit rates have prompted sponsors to mobilize capital for new acquisitions.
- The opening of the Syndicated Loan market and growing competition from private credit lenders have driven down interest rate spreads charged above base rates for high yield bonds, allowing sponsors to finance transactions more comfortably. However, financial buyers will likely continue to be reserved in their acquisition pursuits until the cost of capital is significantly reduced.

### Private Equity Capital Overhang by Year




*2023 dry powder figures as of June 30, 2023*
*Source: PitchBook and Capstone Partners*

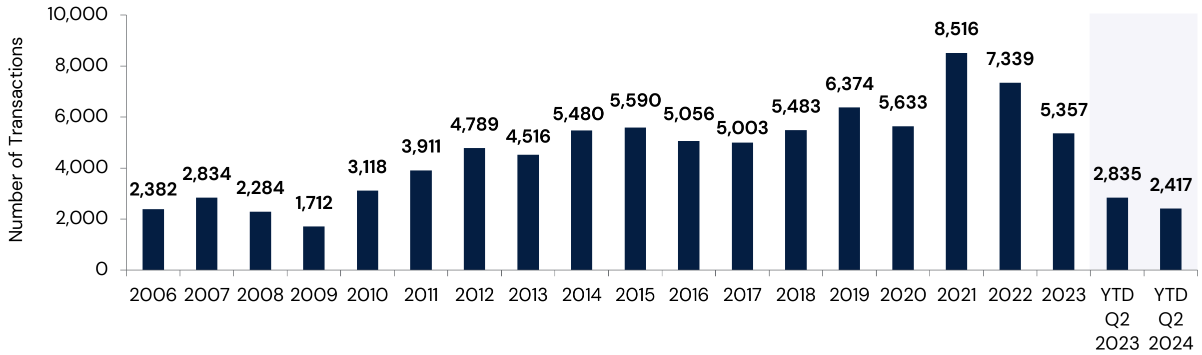
CAPSTONE PARTNERS

# PRIVATE EQUITY ACTIVITY

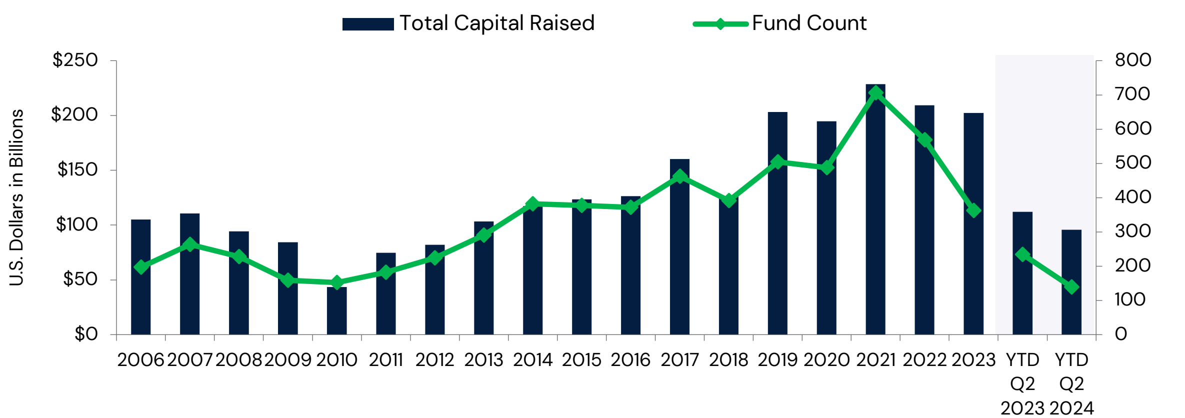
## SPONSOR DEAL VOLUME AND FUNDRAISING SOFTENS

- Closed transactions by sponsors registered a 14.7% decline YOY through YTD Q2 and 5.5% QoQ. Private equity platform acquisitions rose 21.7% QoQ while add-on transactions fell 1.9%. This has bucked the trend among financial buyers of quarterly declining platform transactions seen across the last seven consecutive quarters.
- Longer fundraising periods and a lack of returns for LPs provided headwinds for sponsor fundraising through YTD Q2 2024. Total capital raised dropped 14.6% YOY through YTD Q2 2024.
- The value of global leveraged buyout issuance rose 16.1% YOY to $36.5 billion through YTD Q2 2024, providing an optimistic outlook for the future of acquisition appetite among financial buyers.

**Middle Market Transactions Closed by Private Equity Firms**




**Middle Market Fundraising by Private Equity Firms**




*Source: Capital IQ, PitchBook, and Capstone Partners*
*Note: New data methodology used for this report; Enterprise Value; $25-$500mm, Fund size < $5B*

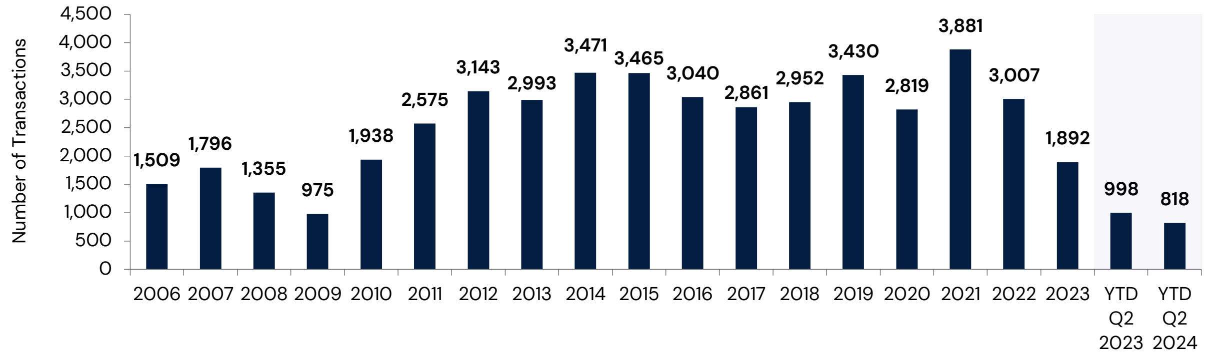
CAPSTONE PARTNERS

# PRIVATE EQUITY TRANSACTION TYPES

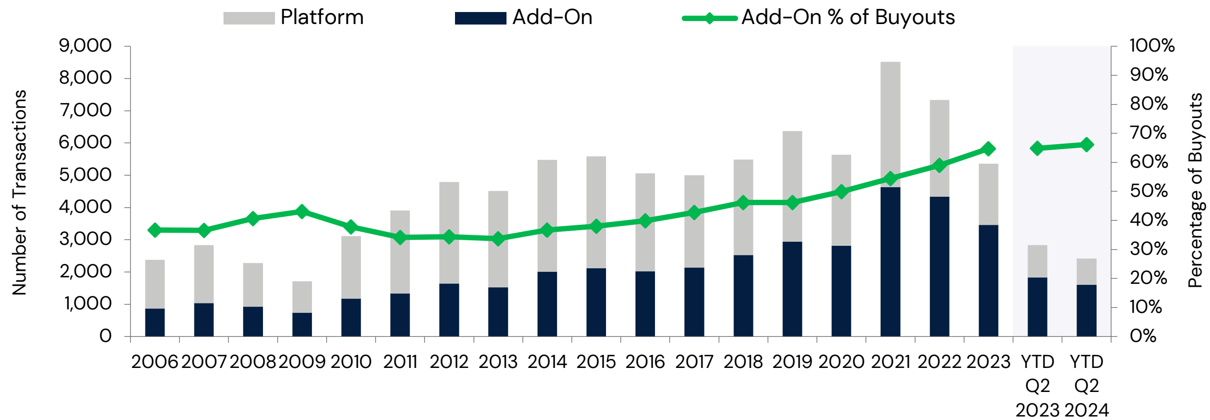
## ADD-ONS COMPRISE HIGHER SHARE OF SPONSOR DEALS

- Private equity platform acquisitions declined 18% YOY in YTD Q2 2024 as interest rate pressures continued to stall a wave of new investments.
- Add-on deals experienced a 13% YOY drop in volume through YTD Q2. Although add-ons comprised 63.8% of all financial buyer activity in Q2, this was a 4.8% decrease compared to Q1.
- This quarter represents the first time since Q2 2022 that add-on acquisitions saw a decline in volume coupled with a subsequent rise QoQ in platform activity. As the median buyout holding period becomes increasingly elongated, sponsors will likely look towards new platform opportunities to justify LP fundraising.

### PE Platform Investments




### PE Add-On Acquisitions



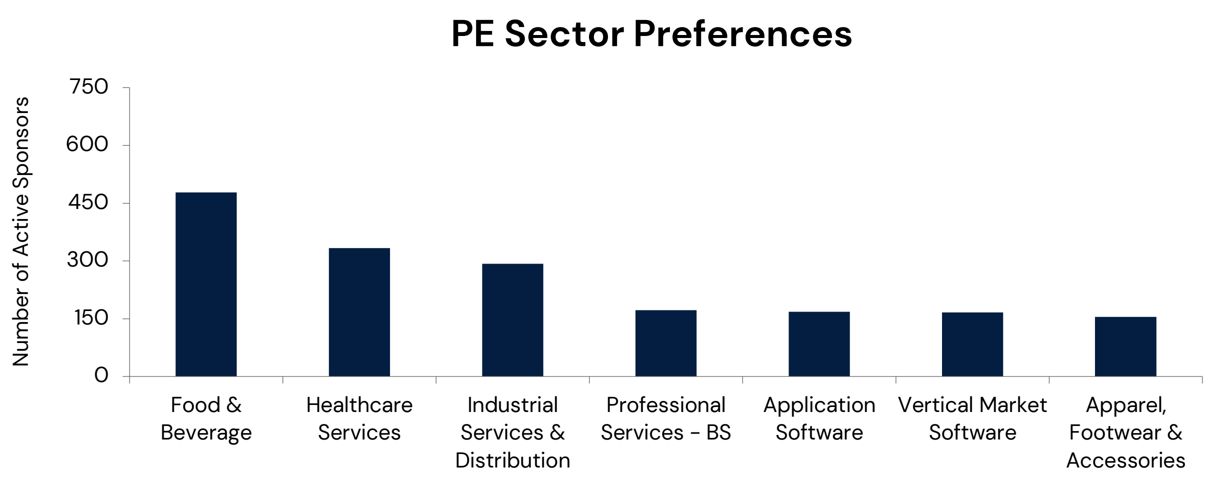

*Source: Capital IQ and Capstone Partners*
*Note: New data methodology used for this report*

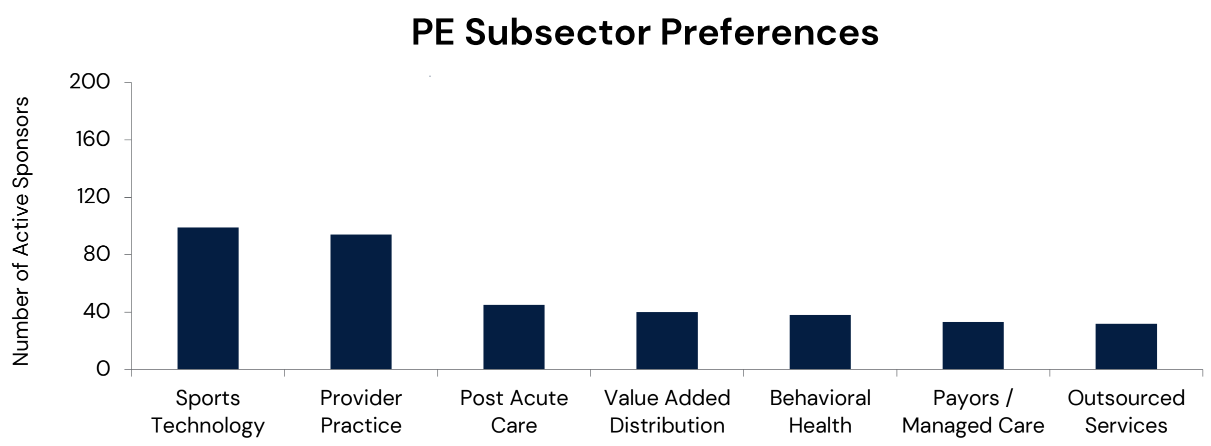
CAPSTONE PARTNERS

# CAPSTONE'S PRIVATE EQUITY NETWORK PREFERENCES

## FOOD & BEVERAGE REMAINS TOP PE SECTOR

- Food & Beverage continued to be the top sector preferred by Capstone's sponsor network through Q2 2024, with the Healthcare Services and Industrial Services & Distribution sectors maintaining second and third place in Q1.
- Professional services surpassed Application Software to become the fourth most preferred sector by Capstone's sponsor network. Application Software continued to lead the Vertical Market Software sector for the second quarter in a row.
- Sports Technology and Provider Practice remained the most preferred subsectors among Capstone's sponsor network, followed by Post Acute Care and Value-Added Distribution.



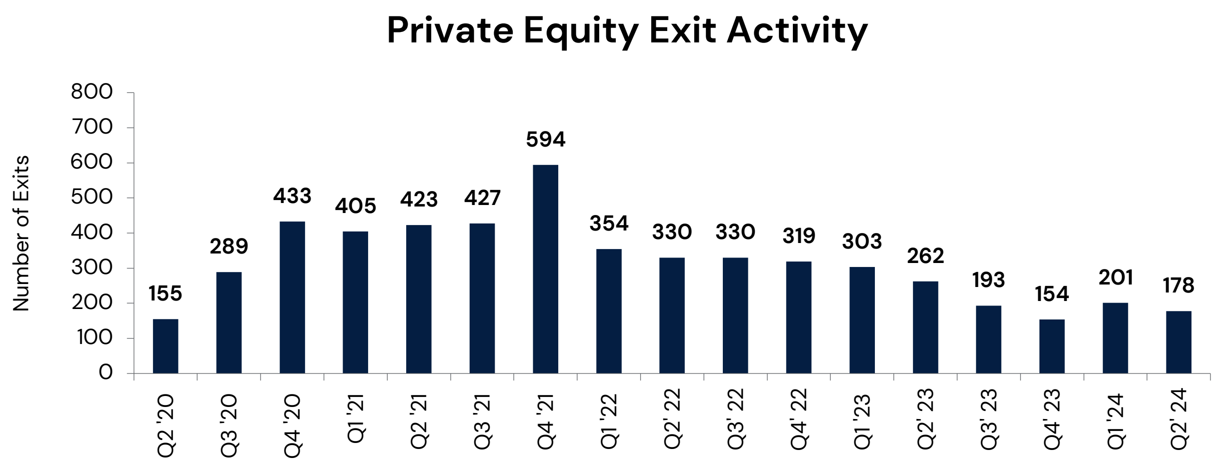

*Source: Capstone proprietary data*

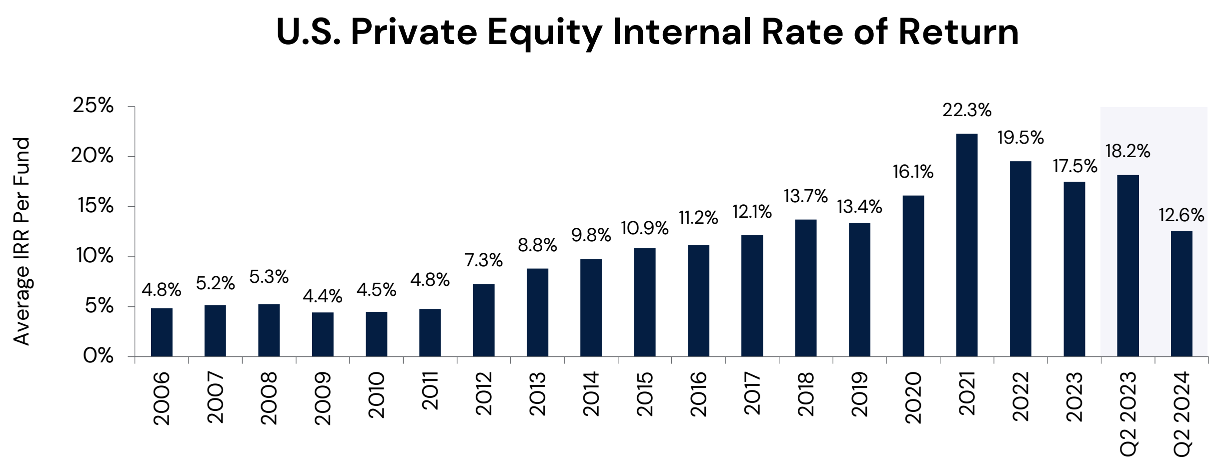
CAPSTONE PARTNERS

# PRIVATE EQUITY EXIT ACTIVITY

## SPONSOR EXITS HIT A SNAG AS RETURNS FALL

- Sponsors' average IRR per fund dropped YOY from 18.2% to 12.6% in Q2 as extended holding times and the knock-on effects of a lackluster valuation environment in 2023 brought lower returns for LPs.
- Diminishing IRRs have prompted private equity firms to begin to mobilize exits of existing platform investments and start increasing direct buyouts of new platforms.
- Although exit activity decreased 11.4% QoQ, sponsor exit activity in Q2 was still 15.6% above Q4 2023. Exit activity is expected to pick up in the back half of the year as the wave of continuation funds that started towards the end of 2022 begin to look for liquidity.



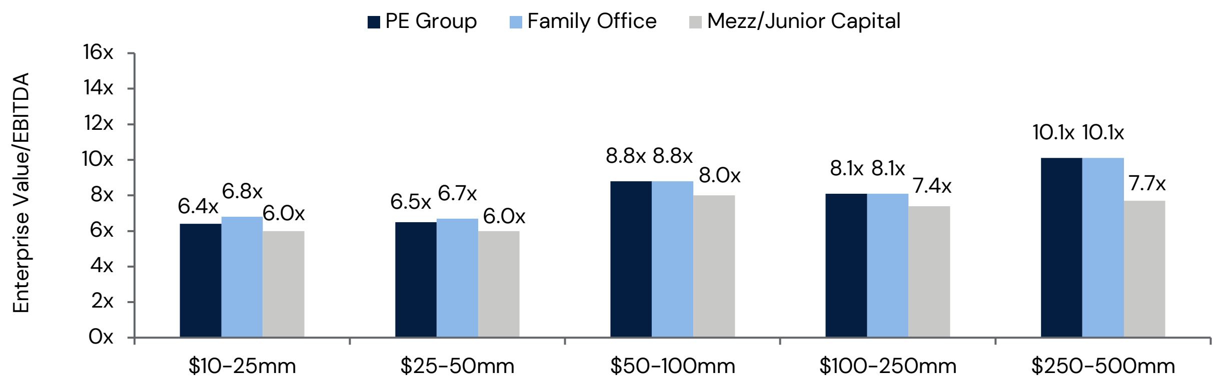

*Note: Exit activity inclusive of all enterprise value ranges*
*Source: PitchBook and Capstone Partners*

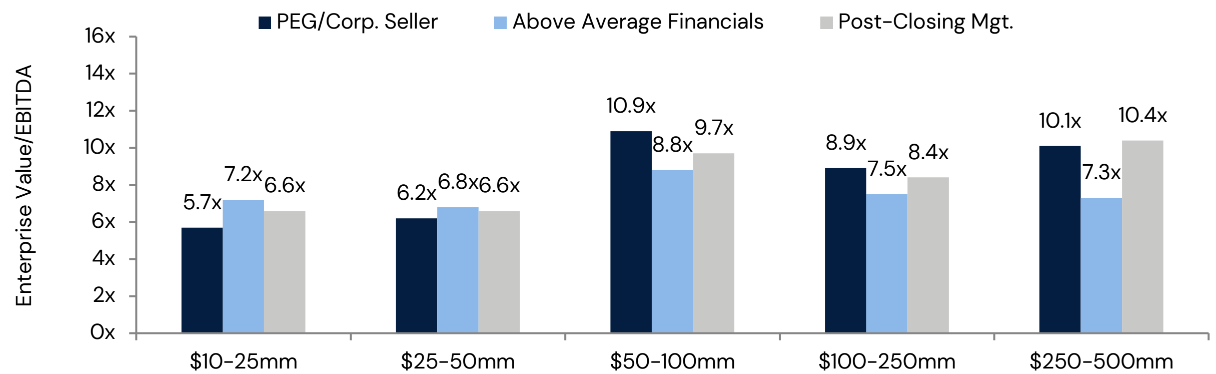
CAPSTONE PARTNERS

# PRIVATE EQUITY VALUATIONS

## VALUATIONS PAID BY FAMILY OFFICES LEAD MIDDLE MARKET

- Private equity firms and family offices have continued to pay the highest multiples out of the financial buyer universe at the top end of the market ($250-$500 million) to better compete for scalable platform businesses.
- Family office buyers have been the most competitive acquirers for businesses in the $10-$25 million and $25-$50 million range, while also offering double-digit multiples in the highest enterprise value range of the middle market.
- An above average financial profile has been a key determinant of pricing in the lower middle market. However, this has had little impact on upper middle market valuations.



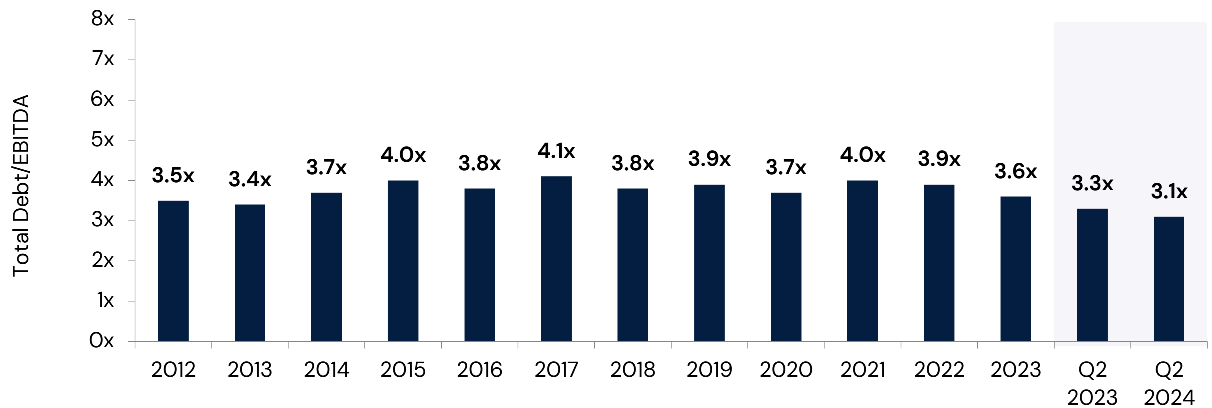

*Source: GF Data® and Capstone Partners*
*GF Data® defines Above Average Financial Performers as businesses with TTM EBITDA margins and revenue growth above 10%, or one above 12% and the other metric at least 8%*
*Includes multiples 3x-15x; Enterprise Value $10mm-$500mm*

# PRIVATE EQUITY VALUATIONS

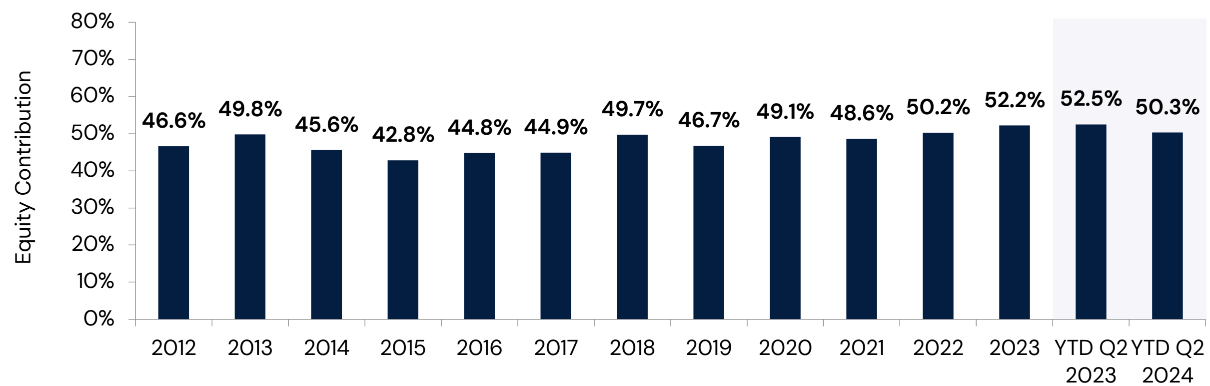
## AVERAGE DEBT MULTIPLE MODERATES IN Q2 2024

- The average debt multiple fell slightly to 3.1x compared to the prior year period. This is due to price increases for Junior and Unitranche debt, while Senior debt pricing improved QoQ.
- Although the average debt multiple across the middle market declines compared to the previous year, the average multiple in the $25-$50 million enterprise value range improved to 2.9x compared to the prior year period.
- Financial buyers executing platform transactions have eased their equity contributions through YTD Q2 2024. This is largely due to a softening Syndicated Loan market and a greater availability of debt capital.

### Average Debt Multiples of Middle Market LBO Transactions




### Average Middle Market LBO Equity Contribution




*Source: GF Data® and Capstone Partners*
*Includes multiples 3x-15x; Enterprise Value $10mm-$250mm*

CAPSTONE PARTNERS


# CAPSTONE BAROMETERS

# CAPSTONE PARTNERS' FULLY INTEGRATED EXPERTISE

We have developed a service delivery model that can address the needs of any client situation, supported by vast internal resources. These capabilities are delivered together with deep domain expertise across 12 dedicated industry groups with an established, real-time access to the private equity community.

### Mergers & Acquisitions
- Sell-side Advisory
- Buy-side Advisory
- Recapitalizations
- Mergers & Joint Ventures

### Capital Advisory
- Equity Advisory
- Debt Advisory
- Infrastructure Finance

### Financial Advisory
- Transaction Advisory
- Interim Management
- Performance Improvement
- Valuation Advisory
- Litigation Support

### Special Situations & Restructuring
- Special Situations
- Turnaround
- Restructuring
- Bankruptcy
- Insolvency

### ESOP Advisory
- Preliminary Analysis
- Feasibility Study
- ESOP Implementation
- Liability Study
- IRC § 1042 Design

## Industry Groups

- Aerospace, Defense, Government & Security
- Building Products & Construction Services
- Business Services
- Consumer
- Agriculture
- Energy, Power, & Infrastructure
- FinTech & Services
- Healthcare
- Industrials
- Industrial Technology
- Technology, Media, & Telecom
- Transportation & Logistics

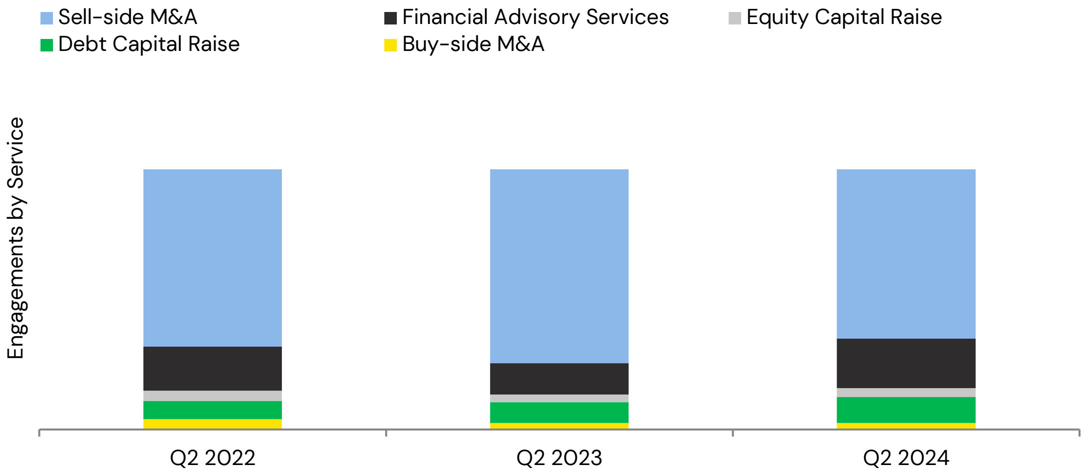
Sponsor Coverage Group

# FIRM DATA

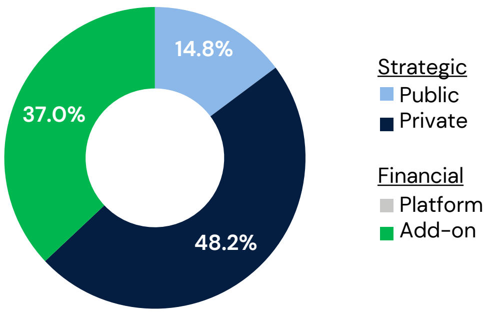
## MIDDLE MARKET ACTIVITY PERSISTS AMID HEADWINDS

- While middle market dealmaking has been challenged by economic headwinds, the backlog of transaction inventory has remained robust. Increased visibility in near-term market conditions may provide momentum for dealmaking throughout 2024.
- Strategic buyers have accounted for 63% of trailing twelve-month transactions (TTM), with private strategic deals comprising 48.2%.
- Financial buyers have maintained their presence in the middle market, primarily through add-on transactions. Transactions by sponsor-owned businesses accounted for 37% of Capstone's TTM deals.

### Capstone Engagements By Service




### Capstone TTM Buyer Breakdown




*Source: Capstone proprietary data based on live engagements and closed sell-side engagements*

CAPSTONE PARTNERS

# RECENT DEAL CLOSINGS

Capstone is an active leader in middle market M&A advisory, serving many clients and their needs, despite the unprecedented disruptions to the economy. Select our recent tombstones below to read the full press release.

Sam Ash Music Stores HAS BEEN ACQUIRED UNDER CHAPTER 11 §363 BY gonher distribuidora

cp medical Theragenics HAS BEEN ACQUIRED BY RIVERPOINT a portfolio company of ACP Arlington

Safe Haven Defense HAS BEEN ACQUIRED BY Dominus Capital

zrg a portfolio company of RFE HAS SECURED $120M IN DEBT FINANCING FROM MAIN ST Capital Corporation

Mays HAS BEEN ACQUIRED BY Ravago

STP HAS RECEIVED AN INVESTMENT FROM Gallagher Bassett a subsidiary of Gallagher

Nyman Associates HAS BEEN ACQUIRED BY Point Quest a portfolio company of Avesi Partners

Supreme Auto Transport HAS BEEN ACQUIRED BY NIKKON Holdings Co., Ltd.

UltraPET HAS BEEN ACQUIRED BY Oil-Dri Corporation of America

AstreaX HAS BEEN ACQUIRED BY DC Capital Partners

TripShot HAS BEEN ACQUIRED BY Transit Technologies a portfolio company of GSV PSG

acclaro HAS MERGED WITH Jonckers a portfolio company of Mayfair Equity Partners

TPC The Partner Companies WAS ADVISED BY CAPSTONE PARTNERS ON RAISING $35 MILLION IN JUNIOR DEBT

Ohio Art HAS RECEIVED DEBT FINANCING FROM Huntington

Ohio Art ENGAGED CAPSTONE PARTNERS TO PROVIDE BUY-SIDE TRANSACTION ADVISORY SERVICES

Continental Adjusters, Inc. HAS BEEN ACQUIRED BY AN UNDISCLOSED STRATEGIC BUYER

AVT Simulation HAS RECEIVED DEBT FINANCING FROM FVCbank

A LEADING FUEL DISTRIBUTOR HAS SECURED $160 M IN DEBT FINANCING FROM SELECT SENIOR LENDERS

Grupo PiSA HAS ENTERED AN EXCLUSIVE DISTRIBUTION AGREEMENT WITH Keurig Dr Pepper

DOBBS Tire & Auto Centers HAS BEEN ACQUIRED BY Audax Private Equity

ops Consulting HAS BEEN ACQUIRED BY The Swift Group

# LEADERSHIP TEAM

**JOHN FERRARA, FOUNDER AND PRESIDENT**
jferrara@capstonepartners.com | 617-619-3325
John has dedicated 30+ years to serving as a trusted advisor to privately held businesses. Representative of over 200 engagements, he has acted as investment banker, management consultant, interim executive, investor, founder and board member. John has been recognized as one of the Top 50 M&A advisors in the U.S. and honored as an M&A Advisor Hall of Fame inductee. Under his leadership, Capstone has expanded to 19 offices in the U.S., U.K., and Brazil with an international platform that spans over 450 professionals in 40 countries worldwide. John graduated from Wesleyan University with an MBA from UCLA and The London School of Economics.

**OLIVIA FERRIS, COO**
oferris@capstonepartners.com | 303-962-5772
Olivia Ferris has over 10 years of investment banking experience with Capstone Partners and currently serves as Chief Operating Officer on the firm's executive team. In this role, Olivia is responsible for overall firm strategy, corporate development, partnerships, strategic initiatives, and investments. She is central to communicating, executing, and sustaining Capstone's priorities and translating them into a comprehensive strategic plan. Olivia earned a BSBA in Finance from Daniels College of Business, University of Denver.

**PAUL JANSON, CO-HEAD OF INVESTMENT BANKING**
pjanson@capstonepartners.com | 303-887-0174
With 25 years of executive experience, Paul manages all investment banking operations for the firm. On the M&A Advisory side, he is active in telecommunications services, manufacturing and infrastructure. Previously, Paul served as President & CEO of Camiant, a Packet Cable Multimedia broadband company. Paul was also CEO of Worldbridge Broadband Services Inc, a broadband and telecommunications company that was later acquired by C-Cor. Paul then became President of C-Cor's Global Services Division. He earned a BA in Business from Saint Anselm College.

**PETER ASIAF, HEAD OF BUSINESS DEVELOPMENT**
pasiaf@capstonepartners.com | 617-619-3368
Peter has more than 20 years of experience as a senior business development executive across the professional and financial services industries. He has been a growth-oriented leader in early-stage, middle-market and Fortune 500 enterprises, helping them to design and execute strategic expansion plans, optimize brand positioning and strengthen key market relationships. Peter is a Certified Exit Planning Advisor (CEPA) designated by the Exit Planning Institute.

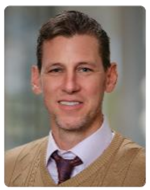
**BRENDAN BURKE, HEAD OF SPONSOR COVERAGE**
bburke@capstonepartners.com | 303-531-4603
Brendan has 16 years in investment banking experience. He oversees the firm's outreach to private equity sponsors and recruitment of senior investment bankers. Since joining Headwaters MB (now Capstone) in 2004, he has held roles in transaction execution, business development, recruiting and marketing. In 2012, he was awarded 40 UNDER 40 by the M&A Advisor. He received a BA in Politics, Philosophy, Economics from Pomona College.

# LEADERSHIP TEAM (CONTINUED)

**DANIEL MCBROOM, HEAD OF PRIVATE CAPITAL MARKETS**

dmcbroom@capstonepartners.com | 303-951-7128

Daniel has 15 years of private and investment banking experience and is responsible for sourcing and analyzing hundreds of companies a year introduced by the firm's institutional clients and partners. Select companies are engaged and his team will stay involved until the transaction is closed. Before his financial career, Daniel spent seven years as a pilot in the United States Air Force. He earned an MBA from the University of Notre Dame and a BS from the United States Air Force Academy.



**MARK CASPER, CHIEF FINANCIAL OFFICER, SUPERVISING PRINCIPAL**

mcasper@capstonepartners.com | 303-531-4604

Mark joined Capstone in 2016 and currently serves as the CFO and the Supervising Principal. In that capacity, Mark manages the FPA, oversees tax, financial, and regulatory reporting, and heads the firm's corporate development. Mark works in tandem with the President and COO ensuring financial feasibility for strategic initiatives as well as current business lines. In addition, he works closely with each banker to assist them in client management, regulatory efforts, and provides guidance around finance, accounting, and taxation. Prior to his current role, Mark spent over 11 years in public accounting. During his career, he has specialized in assurance, taxation, and business valuation consulting.

**SARAH DOHERTY, DIRECTOR OF MARKET INTELLIGENCE**

sdoherty@capstonepartners.com | 617-619-3310

Sarah has more than 10 years of professional research, writing, and data visualization experience and leads the strategic coverage and development of Capstone's middle market insights. She manages the firm's Market Intelligence Team, which produces 150+ reports, articles, white papers, surveys, and capital markets updates each year. Her team's award-winning M&A commentary and analysis has been featured in more than 50 of the nation's top news outlets. Sarah received a BA from Biola University and was recognized in 2021 with the "Emerging Leader Award" by the M&A Advisor.

**BRIAN DAVIES, MANAGING PARTNER, FINANCIAL ADVISORY SERVICES GROUP**

bdavies@capstonepartners.com | 617-619-3328

Brian has 20+ years of experience working in the fields of corporate recovery, business reorganization and interim management services. He has provided financial advisory services to lenders, debtors, creditors' committees, trustees and equity holders in bankruptcy matters and out-of-court restructurings. Brian has provided assistance to under-performing businesses and acquirers of distressed companies. He has worked with companies to develop cost containment and asset rationalization plans, improve liquidity, re-engineer financial and other back-office functions. He received a MS from Bentley University and MSF from The McCallum School, Bentley University.

**JIM CALANDRA, HEAD OF FINANCIAL ADVISORY SERVICES GROUP**

jcalandra@capstonepartners.com | 617-619-3395

Jim has more than 25 years of experience in turnaround management consulting, interim management, fraud and forensic accounting, mergers and acquisitions, and recapitalizations. He has advised more than 50 companies through significant strategic transitions involving both public and private middle market companies with varying situations. Jim received a BS in Accountancy from Bentley University and an MS in Accountancy from The McCallum Graduate School of Business, Bentley University.

**Capstone Partners,** a subsidiary of Huntington Bancshares Incorporated (NASDAQ:HBAN), has been a trusted advisor to leading middle market companies for over 20 years, offering a fully integrated range of investment banking and financial advisory services uniquely tailored to help owners, investors, and creditors through each stage of the company's lifecycle. Capstone's services include M&A advisory, debt and equity placement, corporate restructuring, special situations, valuation and fairness opinions, and financial advisory services. Headquartered in Boston, the firm has 175+ professionals in multiple offices across the U.S. With 12 dedicated industry groups, Capstone delivers sector-specific expertise through large, cross-functional teams. For more information, visit www.capstonepartners.com.

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