

Investment  
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# Middle-Market M&A Update – Q3 2023

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# Introduction

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## Summary:

The Middle-Market M&A Update is a quarterly publication for the middle market deal-making community, presented by The Bonadio Group, reporting on transaction activity in the United States. This report provides information and insights on types of deals, multiples, and private equity activity.

Note: For purposes of this report, we define the “middle-market” as companies with enterprise values between \$10 and \$250 million. Some third-party data sources do not present deal data in that size range on a standalone basis, to avoid excluding deals where transaction values were not disclosed (which is often the case for transactions in this size range). We reference overall trends as a proxy for what’s happening in the middle market.

## About The Bonadio Group:

The Bonadio Group is comprised of accounting, tax, and consulting entities, including Bonadio & Co., LLP, a nationally-ranked top 50 CPA firm founded in 1978.

Our Investment Banking and Transaction Advisory (IBTA) team is supported by a unique blend of investment bankers, transaction professionals, accounting and tax experts, and business advisors that bring almost 50 years of M&A expertise to each transaction. Our full-service team has worked on hundreds of merger and acquisition transactions, providing sell-side investment banking, due diligence, quality of earnings, and other ancillary transaction support to various clients across the country. Our sell-side investment banking process assists business owners looking to sell and exit their businesses. We generally serve companies with annual revenues from \$10 million to \$100 million and enterprise values from \$5 million to well over \$100 million.

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Over the last 10 years, our Investment Banking Team has closed more than

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# \$900M

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in M&A Transactions

# Q3 2023 M&A Insights

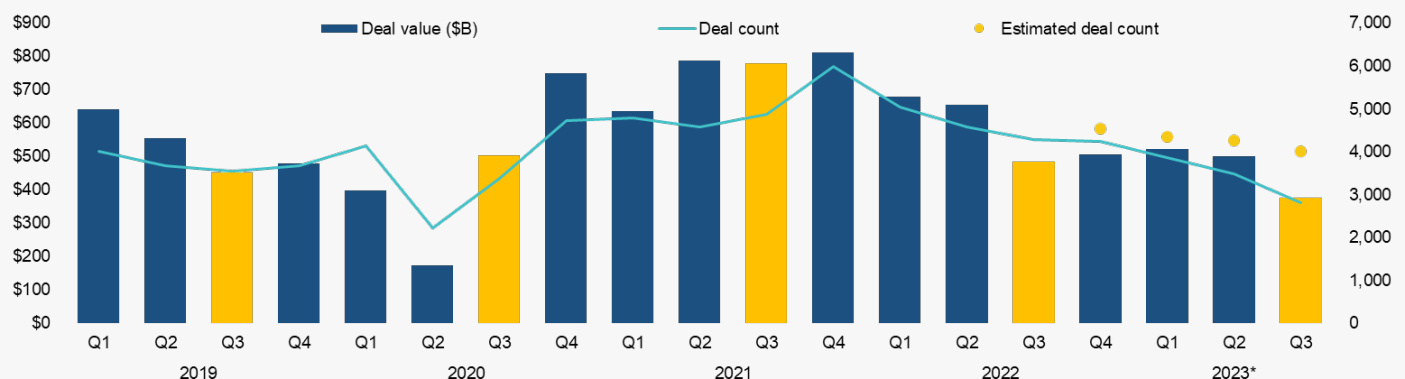
## Overview:

Q3 M&A activity in North America experienced its second consecutive decline in both deal value and deal count, with an estimated 4,022 deals closed or announced for a combined value of \$375.2 billion. Quarter-over-quarter, deal count declined by 5.8%, while deal value experienced a more severe 25.1% drop as dealmakers continued to turn toward smaller deals in the face of higher financing costs, reduced lending, and lingering buyer-seller valuation disconnect. On an annualized basis, M&A activity is expected to fall short of that seen in 2022 by a similar magnitude—deal count is on track to fall 7.9% below 2022 levels, while deal value is expected to fall by 19.3%.

In the US, the federal funds rate held steady at its 22-year high in September as officials paused their rate hikes to assess inflation data. A halt in interest rate hikes would put less upward pressure on borrowing costs, which have been a major headwind for dealmaking. However, the Federal Reserve has signaled the bank could be due for another rate increase above the current 5.25% to 5.5% range before the end of the year.

Because of this, potential buyers in the middle market have turned to different deal structures to bridge the gap between the financing that is available, and the transaction value sought. The reliance on “creative” deal structures helps to push deal flow onward. Mezzanine debt, seller financing, rollover equity, and earnouts are all examples of creative deal structures that are being utilized on middle-market deals.

Middle-market deal activity moves onward, despite the macroeconomic challenges it's currently facing. There continues to be near-record high levels of dry powder on hand amongst private equity firms. As such, these firms are hungry to do deals. Additionally, corporate (strategic) buyers continue to have an interest in the M&A markets given their opportunities for synergies and expanded capabilities. Buyers with an appetite to get deals done, paired with the continued aging population of business owners in the middle market, are keeping the market competitive and holding multiples relatively steady.



Source: Pitchbook

## Q3 2023 M&A Insights (Continued)

### Multiples:

EBITDA multiples on smaller deals in the middle market (\$100M or less) have decreased slightly in 2023, while larger deals (greater than \$100M) experienced a small uptick. Smaller companies with less EBITDA have more perceived risk in the marketplace. This risk, paired with the increased costs to finance transactions, has resulted in a downtick of EBITDA multiples on smaller deals, specifically under \$25M.

| TOTAL ENTERPRISE VALUE (TEV)/EBITDA |               |      |      |      |      |             |       |      |
|-------------------------------------|---------------|------|------|------|------|-------------|-------|------|
| TEV                                 | 2003<br>-2018 | 2019 | 2020 | 2021 | 2022 | YTD<br>2023 | Total | N =  |
| 10-25                               | 5.8           | 6.1  | 5.9  | 6.1  | 6.5  | 5.7         | 5.9   | 1848 |
| 25-50                               | 6.5           | 7.0  | 6.7  | 7.2  | 7.1  | 7.1         | 6.7   | 1446 |
| 50-100                              | 7.5           | 7.5  | 8.0  | 8.3  | 8.5  | 7.7         | 7.7   | 997  |
| 100-250                             | 8.1           | 9.2  | 8.7  | 9.3  | 9.1  | 9.6         | 8.5   | 549  |
| 250 - 500                           | 8.9           | 11.0 | 11.6 | 10.9 | 10.1 | 10.3        | 10.0  | 74   |
| Total                               | 6.6           | 7.1  | 7.0  | 7.6  | 7.6  | 7.2         | 6.8   |      |
| N =                                 | 3276          | 335  | 341  | 499  | 328  | 135         |       | 4914 |

Please note that N for 2003-18 encompasses 16 years of activity..

**GF** SOURCE: GF DATA® an ACG Company

As shown in the TEV/EBITDA-By Industry table below, “old school” industries including manufacturing, retail, and distribution have all seen multiples decline, while business services and health care services saw an uptick. We are seeing that buyers in the marketplace are favoring recurring revenue businesses in a more challenged lending environment, which is having a direct impact on the industry metrics.

| TEV/EBITDA—BY INDUSTRY (\$10-250M TEV) |               |      |      |      |      |             |       |      |
|----------------------------------------|---------------|------|------|------|------|-------------|-------|------|
| INDUSTRY                               | 2003<br>-2018 | 2019 | 2020 | 2021 | 2022 | YTD<br>2023 | Total | N =  |
| Manufacturing                          | 6.2           | 6.5  | 6.7  | 7.1  | 7.3  | 6.4         | 6.4   | 1963 |
| Business services                      | 6.6           | 7.2  | 7.1  | 7.3  | 7.5  | 7.8         | 6.9   | 1081 |
| Health care services                   | 7.4           | 8.0  | 7.6  | 8.1  | 8.4  | 8.7         | 7.6   | 439  |
| Retail                                 | 6.9           | 9.3  | 6.5  | 8.3  | 8.0  | 5.7         | 7.1   | 138  |
| Distribution                           | 6.5           | 7.0  | 7.5  | 7.2  | 7.2  | 6.5         | 6.8   | 519  |
| Media & Telecom                        | 7.4           | 9.4  | 8.3  | 6.3  | 9.1  | NA          | 7.6   | 74   |
| Technology                             | 8.3           | 10.0 | 7.6  | 10.3 | 8.1  | 7.8         | 8.5   | 166  |
| Other                                  | 6.3           | 6.5  | 6.2  | 7.3  | 6.7  | 7.0         | 6.4   | 460  |
| N=                                     |               |      |      |      |      |             |       | 4840 |

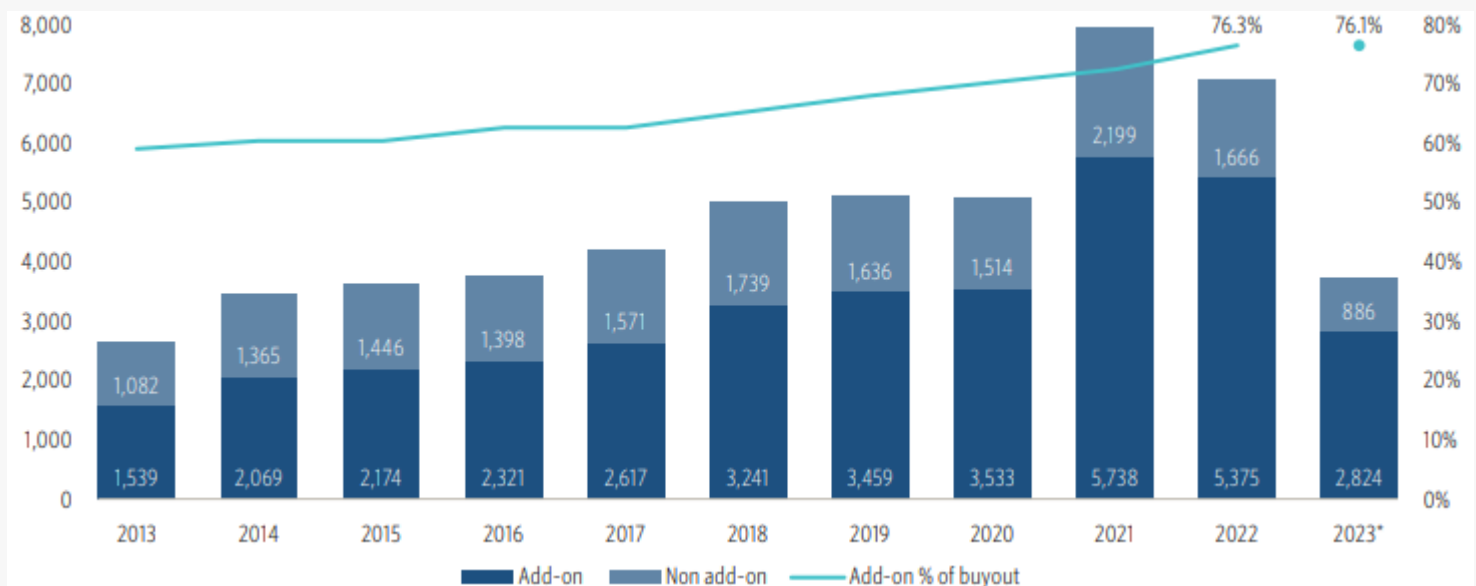
Please note that N for 2003-18 encompasses 16 years of activity.

**GF** SOURCE: GF DATA® an ACG Company

## Q3 2023 M&A Insights (Continued)

### Add-Ons:

When it comes to private equity deals, add-ons have been instrumental in propelling deal flow during a period of tight credit and market uncertainty. A well-executed add-on can provide additional revenue and cost synergies for a platform company and drive additional value to the private equity owner. Add-ons are easier to finance, given their smaller size and ability to rely on the existing credit lines of their larger platform acquirer. Because of this, the volume of add-on deals as a % of total deals has remained steady with the record highs reported in 2022.



Source: Pitchbook

# Article: “What If I Already Have a Buyer?”: The Importance of Hiring an Investment Banker

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**Author: John Rogers**

As investment bankers in the middle market, we are constantly having discussions with business owners who are contemplating the sale of their business. It's not uncommon for that business owner to already have a potential buyer at the table. In these cases, “*Do I need an investment banker if I already have a buyer?*” is one of the first questions we hear. The answer is a definite “YES”. A common misconception of business owners is that investment bankers simply bring potential buyers to the table. While certainly an important step, this only scratches the surface of the true value these professionals bring.

Selling a middle-market business is a significant event that requires careful planning, strategic decision-making, and expertise. While finding a buyer for your business is an important step, it is crucial to recognize the ongoing importance of having an investment banker during the sale process. Investment bankers bring a wide array of skills, industry knowledge, and experience to the table, ensuring that you maximize the value of your business, navigate complex negotiations, and achieve a successful transaction. In this article, we will explore the main reasons why it is vital to engage the services of an investment banker, even when you already have a potential buyer for your middle-market business.

- 1) **Expert Valuation and Positioning:** Determining the accurate value of a business is a complex task that requires in-depth financial analysis, market research, and understanding what buyers are looking for. Middle-market businesses are generally valued based on a multiple of the business's recurring EBITDA (cash flow). Investment bankers possess the expertise to 1) identify and quantify credible adjustments that maximize a business's EBITDA, and in turn, transaction value; and 2) control the narrative when positioning that information to the potential buyer. Having an investment banker assist with “telling the story” to potential buyers brings instant credibility and professionalism to a potential transaction. Their knowledge of market conditions and industry dynamics allows them to position your business effectively, increasing its attractiveness and potential value.
- 2) **Negotiation and Deal Structuring:** Negotiating a business sale involves intricate discussions and deal structuring to meet the needs of both the buyer and the seller. This is where an investment banker proves their worth. Investment bankers serve as intermediaries, leveraging their negotiation skills and industry knowledge to strike a favorable deal for you. They understand the intricacies of deal terms, contractual agreements, and tax and legal considerations, ensuring that your interests are protected throughout the transaction process. Once a Letter of Intent (LOI) is executed between buyer and seller, seller generally loses a significant amount of negotiating leverage from that point forward. Having an investment banker by your side to negotiate the key terms in the LOI in advance of signing is crucial.
- 3) **Efficient and Streamlined Process:** There's a common saying in the industry that “time kills all deals”. Deal fatigue is real; and if a sale process is moving slow or is disorganized, it can quickly fall apart. Selling a business involves numerous complex tasks, including preparing materials, coordinating due diligence, managing legal documentation, and coordinating various stakeholders. An investment banker brings a structured approach to the entire process, streamlining activities, and ensuring that deadlines are met. Their project management skills and experience help minimize disruption to your day-to-day operations, allowing you to focus on running your business while they handle the specifics of the sale process. With any deal, there are always some last-minute challenges or obstacles that need to be addressed. Investment bankers are experts in closing deals and can help navigate these obstacles to get your deal across the finish line.

## Article: “What If I Already Have a Buyer?”: The Importance of Hiring an Investment Banker (Continued)

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- 4) **Confidentiality and Discretion:** Maintaining confidentiality during a sale process is crucial to preserving the goodwill, reputation, and stability of your business. Investment bankers are skilled at maintaining confidentiality, employing robust processes and protocols to safeguard sensitive information. They act as a buffer between you and your potential buyer, ensuring that sensitive information remains confidential until an appropriate stage of the transaction. They also act as “the bad guy”, when needed, by having the difficult conversations with your potential buyer so you don’t need to. Having that intermediary is a good buffer to keep emotions in check and prevent buyer and seller from potential confrontation or relationship damage.
- 4) **Access to Extensive Networks:** Having a potential buyer is great, but in no way does that mean a deal is imminent. Investment bankers possess deep-rooted connections and extensive networks within the business and financial community. These relationships offer valuable access to potential buyers, including strategic investors and private equity firms. By leveraging their networks, investment bankers can expand the pool of potential buyers, increasing the competitiveness of the sale process and potentially driving up the transaction value.
- 5) **Avoiding Potential Pitfalls:** Each M&A transaction presents a wide variety of potential pitfalls to avoid. The most common pitfalls that we see include: improper timing of a potential sale transaction, not being prepared, not being forthcoming with information, failing to continue to operate the business in the normal course, failing to be open to offers from competitors, not hiring proper legal counsel, and not appreciating that time kills all deals. Experienced investment bankers have seen and overcome these hurdles multiple times and can be worth their weight in gold as you pursue a sale transaction.

### Final Thoughts

A good investment banker does significantly more than bring potential buyers to the table. Their expertise in valuation, negotiation, and deal structure, combined with their extensive market and industry insights, can significantly impact the success and value of your transaction. No business owner should go at it alone. Having an investment banker as your trusted advisor during the process is the best way to ensure a smooth transaction and avoid potential pitfalls along the way. If you’re talking to a potential buyer, we strongly recommend that you contact an investment banker before having any discussions surrounding valuation or deal terms.

If you are thinking about selling your business and are curious about learning more about anything described in this article, feel free to contact us.

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