



**M&A Update**  
**U.S. Micro Middle Market**  
**2H 2023**



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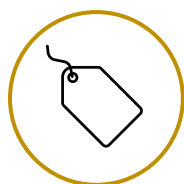
# 1 Executive Summary

## Key Takeaways



### M&A Activity

*Activity in Q4 2023 fell to lowest point since 2017, cautious optimism for a rebound in 2024*



### Valuation Multiples

*Multiples trend upward as interest rates stabilize*



### Sector Activity

*Reduced activity across the board. Valuations climb in tech and healthcare services, drop in manufacturing and retail*



### Leverage

*Lenders remain cautious and selective as senior debt pricing continues to rise*

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#### Who we are:

Houlihan Capital is a boutique valuation and investment banking firm committed to delivering superior client value and thought leadership in an ever-changing landscape.

#### Micro Middle Market Overview:

Houlihan's Investment Banking group specializes in providing sell-side M&A advisory services to owners of privately-held businesses within the Micro Middle Market ("MMM"), defined as those with total enterprise value ("TEV") below \$250M.

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#### Data Source:

The data used in this report was primarily sourced from GF Data, using information provided by 400+ private equity firms on their recent transaction activity.

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## M&A Overview

*Fewer Closings, Rebounding Multiples*

2023 was an underwhelming year for M&A activity in the MMM. After an encouraging uptick in Q1, deal activity declined each of the subsequent three (3) quarters, finishing the year with 57 closings in Q4, the lowest since 2017.

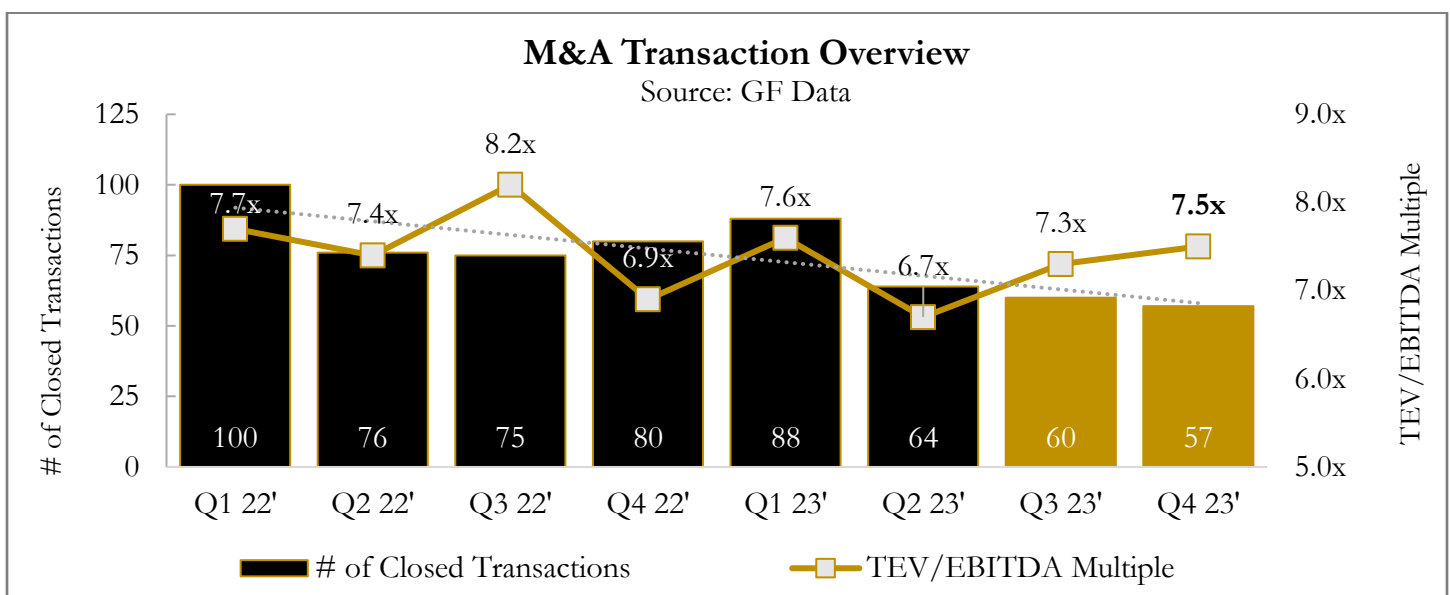
### M&A in the Early-COVID Economy (20'/21') – Navigating the Unknown

2020 marked the beginning of the pandemic, causing many investors to pause their M&A initiatives as they awaited direction on the government’s economic response. This COVID-related backlog of deals, coupled with near-zero interest rates, substantial government stimulus, and an abundance of committed capital to private equity, created a unique convergence of bullish M&A trends that materialized in a red hot 2021.

### Post-COVID Normalization (22'/23') – Adapting to Uncertainty, Forging New Paths

Since the M&A high of 2021, the economy has faced major headwinds, causing activity to stall and valuations to soften. Key economic factors affecting the M&A market include:

- **Tightening Monetary Policy:** Interest rate hikes have made borrowing more expensive for buyers, causing a drag on both M&A activity and valuation multiples. Rates have remained steady since July 2023, and the Fed is currently forecasting three (3) rate cuts in 2024, although this remains uncertain.
- **Geopolitical Tensions:** International wars and trade disputes create uncertainty for companies with foreign exposure. Tensions between NATO and BRICS countries remains high and will be a key trend to watch in the coming year.
- **Strategic Focus:** Some financial buyers (ie. private equity, family offices) have prioritized organic growth over M&A initiatives in recent years, evidenced by very few sponsor-to-sponsor deals. This trend is expected to change in 2024 as economic factors stabilize and investors look to deploy their dry powder.



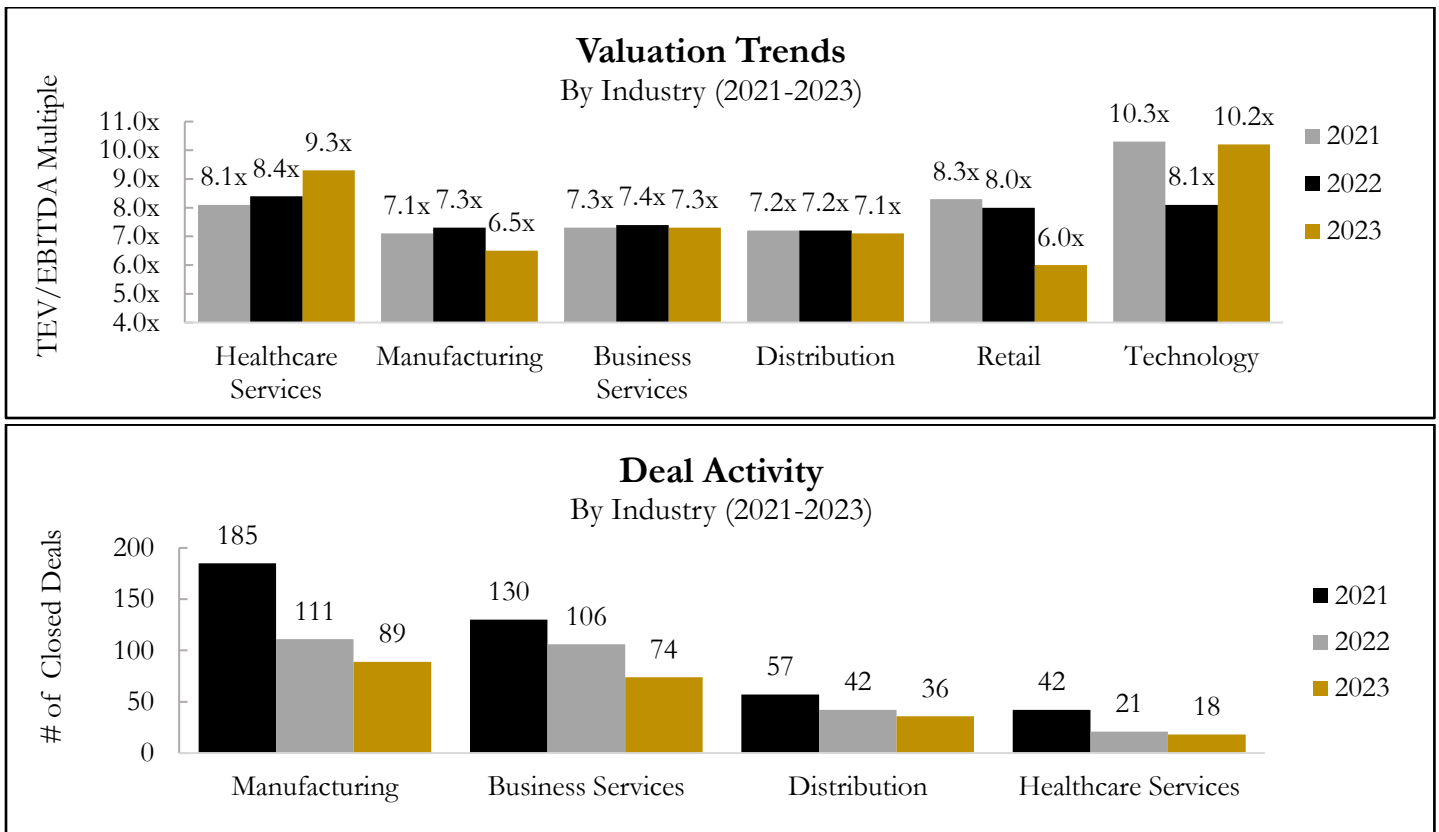
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## Sector Breakdown

*Declining Volume Across the Board, Multiples Hold Strong in Service-Based Businesses*

While M&A activity continued to slow in the second half of 2023, valuation multiples rebounded to 7.5x TEV/EBITDA, more consistent with historical levels. The broader rise in multiples was driven by healthcare services (+0.9x) and technology (+2.1x). Meanwhile, valuations remained steady for business services (-0.1x) and distribution (-0.1x) companies, while experiencing notable drops in retail (-2.0x) and manufacturing (-0.8x).

These trends signal a broader shift in investor preference towards asset-light, service-based businesses. Our investment banking team has seen evidence of this in recent **healthcare and facility services** transactions – two areas where M&A processes have been highly competitive with motivated buyers.



As shown in the graph above, the declining trend in M&A closings has been spread across all major industries. Nonetheless, many deal professionals have expressed optimism for an uptick in 2024 deal activity, despite the typical hesitancy that accompanies an election year. Through the first quarter of 2024, this trend appears to be playing out, as some buyers and brokers have noted an increasing number of deals/leads coming across their desk.

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## Leverage

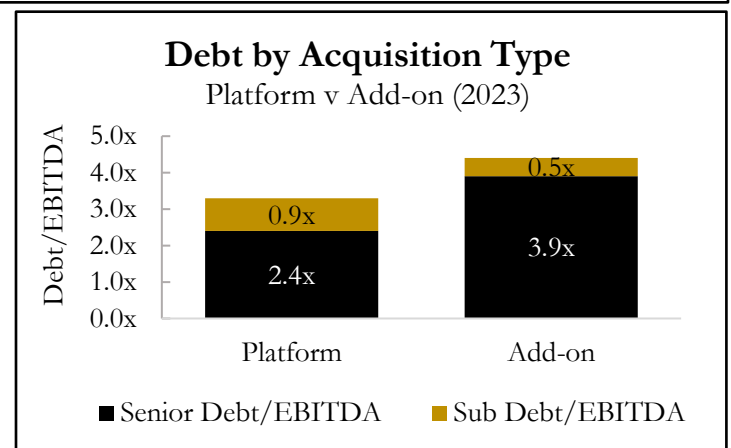
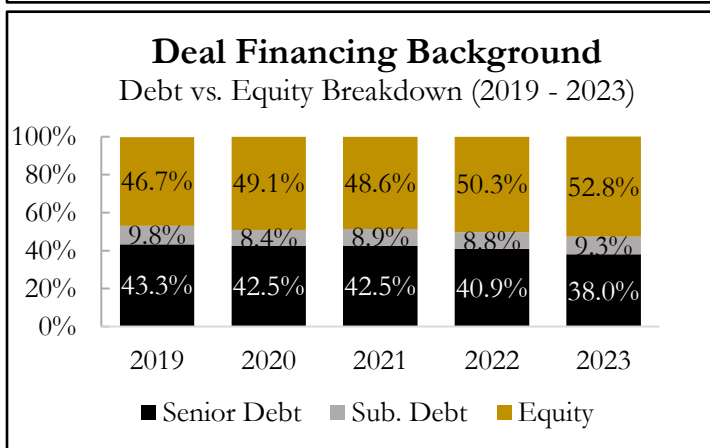
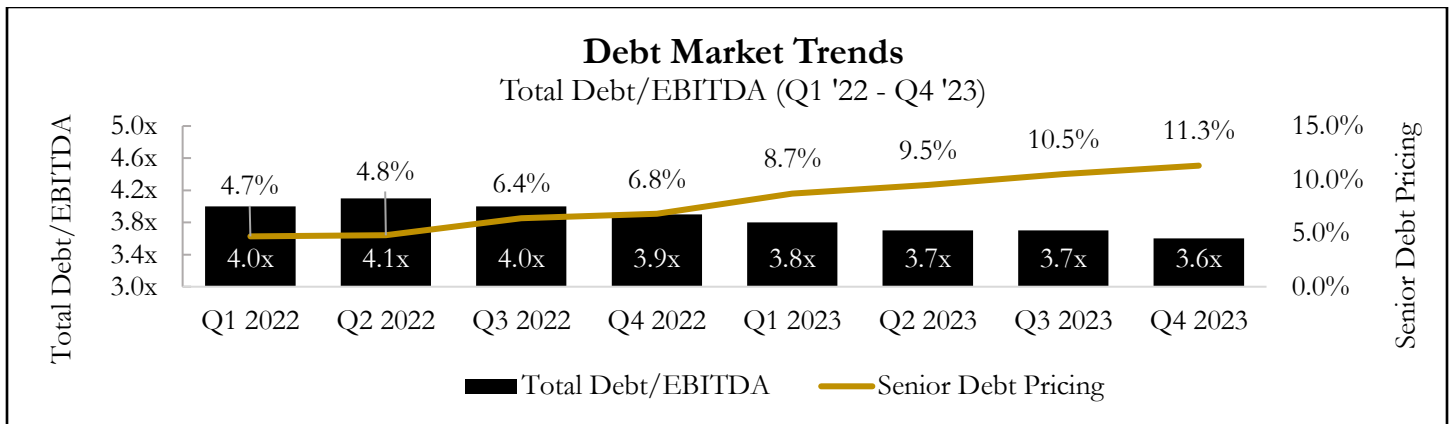
*Rates Continue to Rise, Lenders Remain Cautious and Selective*

M&A debt markets have continued to tighten in recent periods due to rising interest rates and persistent inflation. Banks have become more selective in their lending practices while requiring a more rigorous evaluation process. This has made it essential for companies to demonstrate strong financial health and a clear strategic rationale for their proposed transactions.

The charts below provide overviews of several key M&A debt market trends – i) rolling average of total debt/EBITDA and average senior debt pricing, ii) equity and debt contributions, and iii) breakdown of senior and subordinated debt based on transaction type (platform vs. add-on).

Notable observations:

- **Senior debt pricing continues to surge:** Rates have climbed from 4.7% at the start of 2022 to 11.3% at the end of 2023, an average increase of nearly 100 basis points each of the past seven (7) quarters.
- **More equity in deals:** As senior debt becomes more expensive, buyers are financing deals with an increasing amount of equity. This is often in the form of rollover equity, especially when sellers plan to stay in the business.
- **Preference for add-ons:** Add-on acquisitions have received 3.9x turns of senior debt compared to 2.4x for platform deals. This highlights the importance for buyers to demonstrate a proven track record and strategic rationale for deals.





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# 5 | Houlihan Capital

*Investment Banking team*

Houlihan Capital’s Investment Banking group offers an integrated advisory approach that draws upon our strategic and technical expertise, industry knowledge, transactional and financing experience, and expansive network of institutional and private investors to guide shareholders and management teams. We understand the time sensitivity of many of our assignments and work diligently to meet these demands while minimizing operational disruption, allowing clients to focus on their business.

Our team works with businesses across all major industries with an enterprise value greater than \$5.0 million and EBITDA between \$1.0 million and \$20.0 million. Many businesses of this size have a unique story to tell, and we are committed to structuring a tailored approach to assist clients in achieving their strategic, financial, and risk-management objectives.

Our investment banking professionals function as an extension of our client’s management team, providing specialized transaction advisory support derived from years of hands-on experience. Our clients can stay focused on running their business while Houlihan runs a successful sale process.

**To find out more about how Houlihan can assist in the deal process, please contact one of the following members from our team:**



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