CIBC CAPITAL MARKETS

US MIDDLE MARKET MONITOR

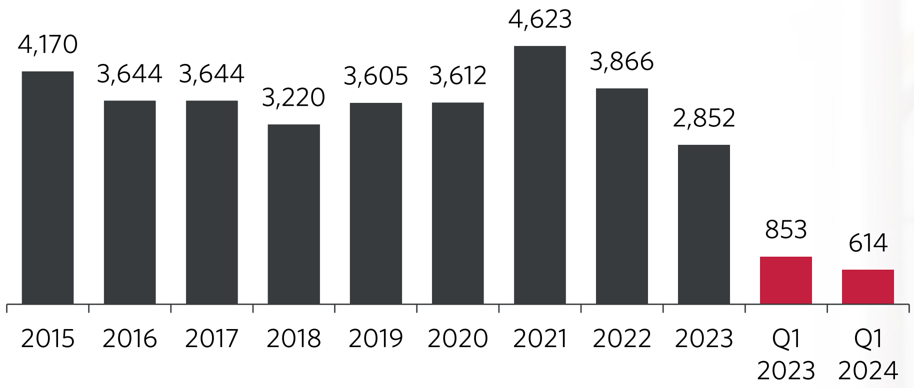
M&A and financing update

Q2 2024

CONFIDENTIAL

Deal volume declines

US M&A transactions under $500M



During Q1 2024, US lower middle market deal volume (under $500 million of enterprise value) declined 28% compared to the same period in 2023, according to Robert W. Baird. Deal volume was suppressed due to higher interest rates, persistent global conflicts, and inflation, collectively causing targets to experience poor financial performance and dealmakers to be more cautious, leading to valuation gaps between buyers and sellers, delayed processes, and broken auctions.

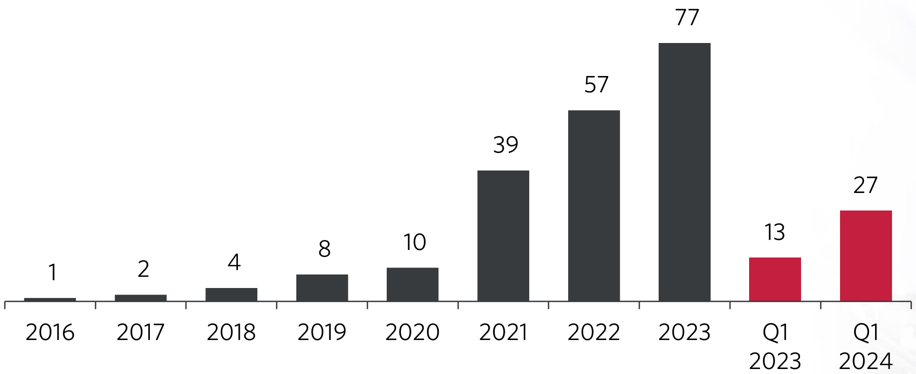
Looking ahead to the balance of 2024, the sentiment in the lower middle market appears cautiously optimistic. The potential decrease in interest rates later this year could make it easier for buyers to finance acquisitions and there are already signs debts markets are becoming more favorable.

Historically, although the data shows no consistent pattern of deal activity or valuation trends shortly before or after elections, election years have influenced owners' stated desire to consider selling their businesses due to potential changes in tax or economic policies. However, this time may be different: we are not observing business owners using the 2024 Presidential election as a catalyst to sell, possibly because both candidates have already held the office, and with some exceptions, the election result is not expected to have a material impact on business decisions or the economic health of potential sellers.

Source: Robert W. Baird & Co.

Continuation funds provide capital returns to aid private equity fundraising

US PE continuation-fund-related exit count



Due to a challenging exit environment, continuation vehicles have seen a significant rise in popularity as an alternative path to provide cash returns to limited partners ("LPs") for private equity ("PE") firms. These vehicles allow a PE fund to transfer one or more assets from an existing fund that is nearing the end of its term into a new vehicle, providing existing LPs the option to cash out of their investment or roll their interest into the continuation vehicle. New investors are also often brought in to provide additional capital for the continuation vehicle.

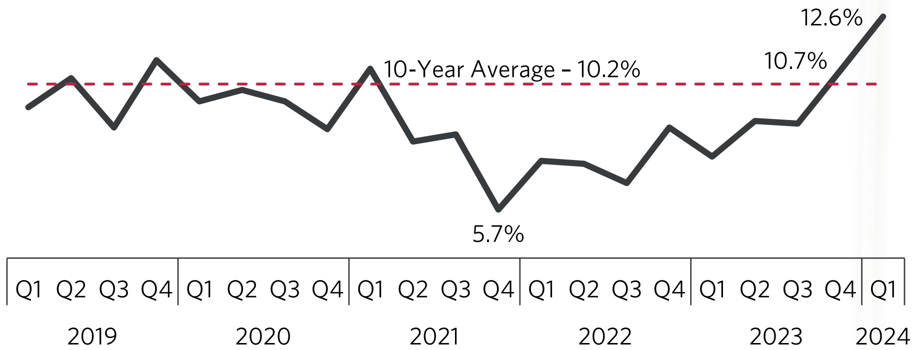
The growth in continuation funds has been driven by several factors. On the PE fund side, they provide a way to extend the life of high-performing assets and reset economics. For LPs, they offer the opportunity to gain liquidity without a traditional exit like a sale or IPO, which have proven challenging due to rising interest rates and pockets of economic uncertainty.

For the balance of 2024, the outlook for continuation vehicles appears robust. With a record amount of dry powder raised by secondary funds, an increasing number of PE-backed companies held longer than 5 years, and a challenging traditional exit environment, the conditions are ideal for liquidity or an extended hold period via a continuation vehicle.

Source: Pitchbook.

Corporations are narrowing their strategic "core," which is driving carve-outs

Carve-outs as a percentage of US PE buyouts



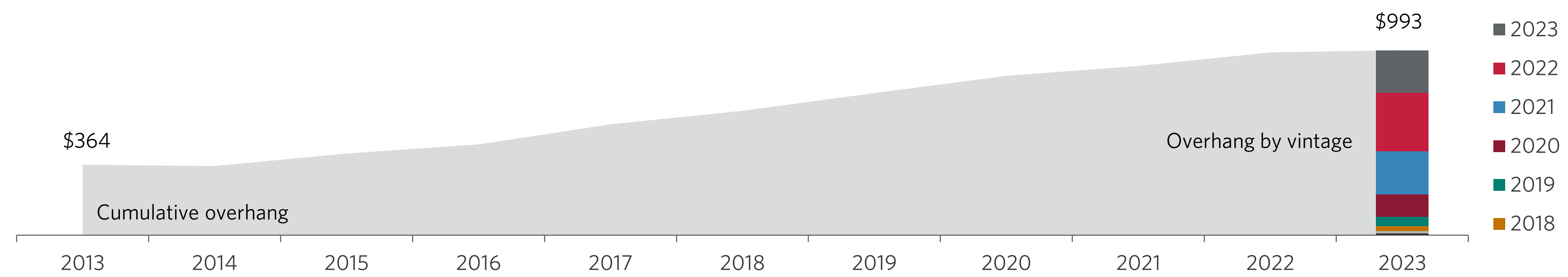
In Q1 2024, carve-outs amounted to 12.6% of all US PE buyout deals, marking a full recovery from the low of 5.7% in Q4 2021 and the highest share since Q2 2016 when carve-outs accounted for 13.4%. There are several factors compelling parent companies to divest non-core assets, including underperformance, regulatory pressures, enhanced management focus on higher return on investment ("ROI") divisions, the pursuit of higher stock market valuations by unbundling dissimilar businesses, and PE firms with expertise in executing complex carve-out transactions to unlock value.

While carve-out activity has grown, the proportion of carve-out deals within the broader PE buyout landscape is expected to stabilize rather than increase further. We expect carve-outs to stabilize as a percentage of the overall market as deal volume increases during the second half of 2024, driven by potential interest rate cuts and improved asset pricing. Nonetheless, carve-outs will likely remain an important tool for PE firms to deploy capital, especially in the middle market, as they navigate a challenging economic environment and seek to drive growth through operational improvements in carved-out entities.

Source: Pitchbook.

Record levels of “dry powder” available for private equity firms to deploy

PE dry powder by vintage



The cumulative difference between the amount of commitments PE sponsors have from their investors and the amount of funds deployed, referred to as “dry powder”, has reached record levels in recent years. As of Q1 2024, $993 billion is available across all fund vintages, driven by robust fundraising of over $800 billion between 2021 and 2023. The growth in dry powder reflects strong investor confidence in PE as an asset class, as well as a challenging deal-making environment that has left funds with ample capital to deploy.

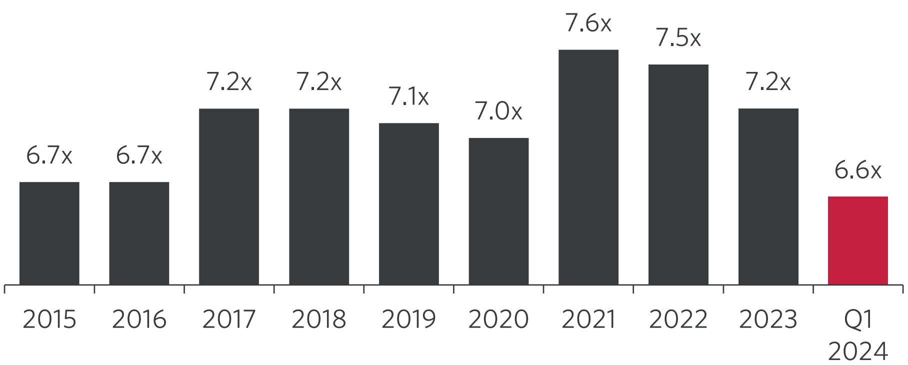
However, the effect of available funds across vintages is not equal. Older vintages are under increasing pressure to invest their capital, with 26% of dry powder now four years old or older, up from 22% in 2022, creating a strong incentive for PE funds to accelerate their deal-making activities even if market conditions are not ideal. Newer vintages, particularly those raised at the peak of the market in 2021 and 2022, may face challenges in deploying their capital at attractive valuations, potentially leading to longer holding periods and slower return of capital to investors.

Looking ahead, record levels of dry powder suggest the potential for a rebound in private equity deal activity in 2024, particularly if interest rates stabilize and economic uncertainty eases. Much will depend on the ability of PE firms to find attractive investment opportunities and generate strong returns in a more challenging environment. Firms that can adapt their strategies, focus on operational value creation, and take advantage of dislocations in the market may be best positioned to deploy their dry powder effectively and deliver strong returns to their investors.

Source: Pitchbook.

Valuation multiples mixed

Average EBITDA multiples for $10M – $250M LBOs



Average EBITDA multiples for LBOs by industry

Industry	2003 – 2019	2020	2021	2022	2023	Q1 2024
Manufacturing	6.2x	6.7x	7.1x	7.3x	6.5x	6.1x
Business services	6.7x	7.1x	7.3x	7.4x	7.2x	6.9x
Healthcare services	7.4x	7.6x	8.1x	8.4x	9.0	6.4x
Retail	7.0x	6.5x	8.3x	8.0x	6.0x	6.4x
Distribution	6.6x	7.5x	7.2x	7.2x	7.1x	7.1x
Media & Telecom	7.6x	8.3x	7.0x	9.1x	7.8x	8.8x
Technology	8.5x	7.6x	10.3x	8.1x	10.2x	7.2x

During Q1 2024, lower middle market valuation multiples experienced a notable decline, although this trend was far from consistent among sectors. The average valuation for PE-backed leveraged buyouts (LBOs) dropped to 6.6x EBITDA, down from 7.2x in the fourth quarter of 2023, according to GF Data®. This decline was particularly pronounced in deals valued between $250 million and $500 million which decreased from 8.7x in Q4 2023 to 6.8x in Q1 2024 and less noteworthy for deals under $250 million which, on average, remained flat.

Several factors contributed to this downward trend in valuation multiples. The primary driver was the broader economic environment, characterized by high borrowing costs, macroeconomic concerns, and uncertainty over projected cash flows which led to a shift in buyer behavior, with increased discipline, a focus on lower levels of the middle market, and more conservative valuations.

While there was an overall decline in lower middle market valuation multiples, there was considerable variability among sectors. Valuations for manufacturing companies declined from 6.5x in 2023 to 6.1x in Q1 2024, down from 6.5x in 2023 but approximately in line with long term averages driven by ongoing economic uncertainties, supply chain disruptions, and high borrowing costs, which affected output and profitability.

Healthcare services saw a more pronounced drop, with valuation multiples declining from 9.0x in 2023 to 6.4x in Q1 2024. This decline reflects the challenges that facility-based care has faced with rising labor costs and the impact of higher interest rates.

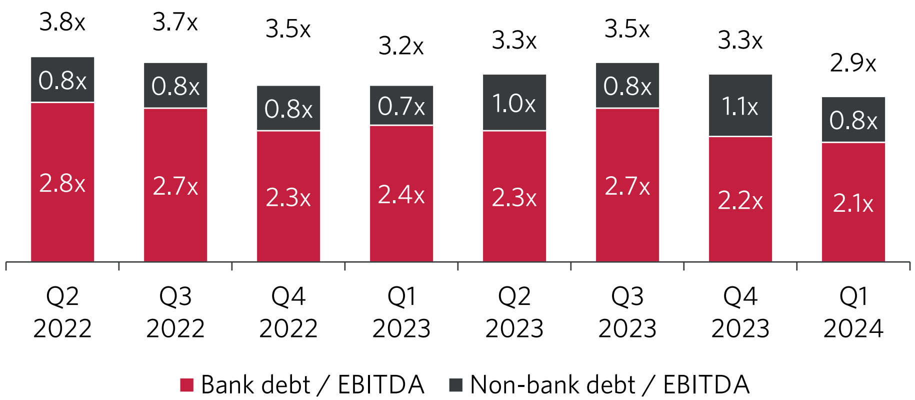
The technology sector saw a decline in valuation multiples from 10.2x 2023 to 7.2x in Q1 2024, reflecting performance in the public markets, which without the returns from a handful of stocks, would be down meaningfully. Since most of the value of technology stocks is derived from their terminal value, they are particularly impacted by higher interest rates.

In Q1 2024, the business services, retail, distribution, and media & telecom sectors remained relatively flat or increased compared to 2023.

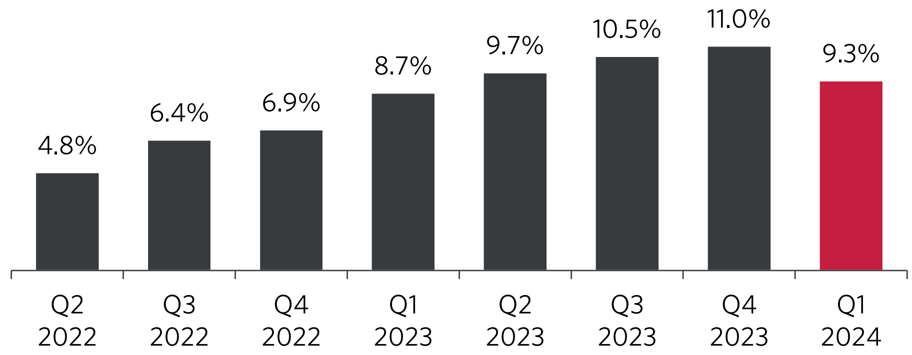
Source: GF Data®.

For borrowers, debt market shows signs of improvement despite decline in available debt

Quarterly average LBO debt multiples for $10M – $250M LBOs



Senior debt pricing



According to GF Data®, average PE-backed LBO debt multiples in the lower middle market (under $250 million of enterprise value) decreased from 3.3x in Q4 2023 to 2.9x in Q1 2024. This decline was observed across most size tiers, with the exception of deals valued between $50 million and $100 million, which saw a slight improvement.

Senior debt multiples declined slightly from 2.2x in Q4 2023 to 2.1x in Q1 2024, all of which was attributed to platform deals over $100 million of enterprise value. Platform deals under $100 million of enterprise value experienced an improvement of up to 0.5x in senior debt availability for deals valued between $10 to $100 million due to the return of regional banks to the syndicated deal market. This shift led to a corresponding decline in subordinated debt multiples as borrowers preferred to secure lower cost senior debt positions. Increased activity in the first quarter has led to improved terms and lower rates that have continued into Q2 2024.

In Q1 2024, senior debt pricing decreased to 9.3% from 11.0% in Q4 2023. This decrease was observed across all size tiers tracked by GF Data®, except for the $100 million to $250 million tier, which remained stable at 10.2%. The decrease was primarily attributed to increased traditional bank activity, which helped lower the rates offered by direct lenders due to competition for strong credits.

Sources: GF Data®

For lenders, the debt market became more competitive in Q2

Month-over-month debt/EBITDA multiple comparison

Period	Debt	< $5M EBITDA	>$10M EBITDA	> $20M EBITDA
April 2024	Senior	1.5x-2.5x	2.0x - 3.5x	3.0x - 5.0x
	Subordinated	1.0x - 1.0x	1.5x - 1.0x	1.0x - 1.0x
	Total	2.5x - 3.5x	3.5x - 4.5x	4.0x - 6.0x
May 2024	Senior	1.5x - 2.5x	2.0x - 3.5x	4.0x - 5.0x
	Subordinated	1.0x - 1.5x	1.5x - 2.0x	1.0x - 1.0x
	Total	2.5x - 4.0x	3.5x - 5.5x	5.0x - 6.0x
Total YoY Difference		**NC + 0.5x**	**NC + 1.0x**	**+ 1.0x + 1.0x**

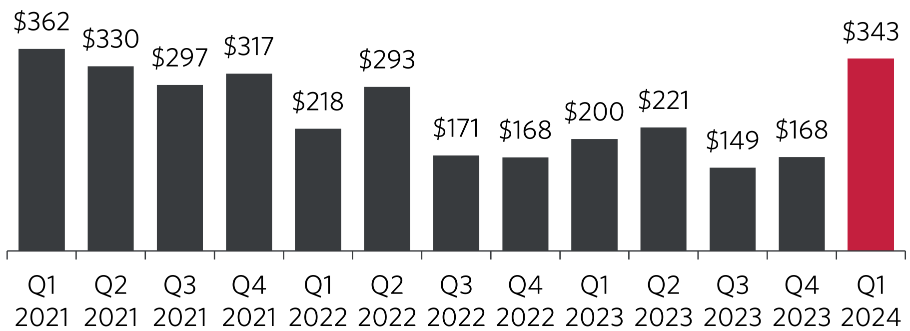
In May 2024, debt multiples exhibited what appears to be the beginning of a notable shift for companies with more than $10 million in EBITDA, the multiple increased 1.0x EBITDA from April. This increase indicates a more aggressive stance by lenders, who are becoming increasingly competitive on pricing and leverage as lenders are challenged to increase outstanding loans.

The change is primarily driven by the contrasting liquidity conditions between non-bank lenders and commercial banks. Non-bank lenders, buoyed by substantial capital inflows and a competitive market environment, are willing to offer higher leverage and more attractive covenants. Conversely, traditional banks who largely pulled back during the last year and half, have become selectively aggressive on certain credits, offering lower rates and more competitive terms, putting downward pressure on interest rates.

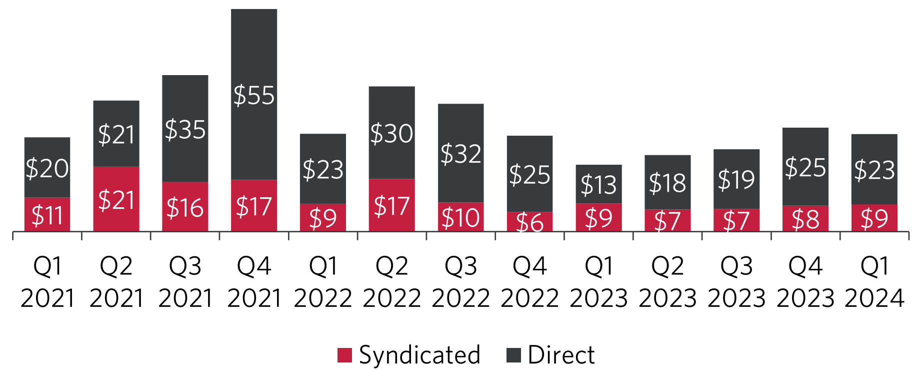
Source: GF Data®

Leveraged loan issuance surges

Quarterly leveraged loan issuance



Quarterly middle market sponsored loan volume



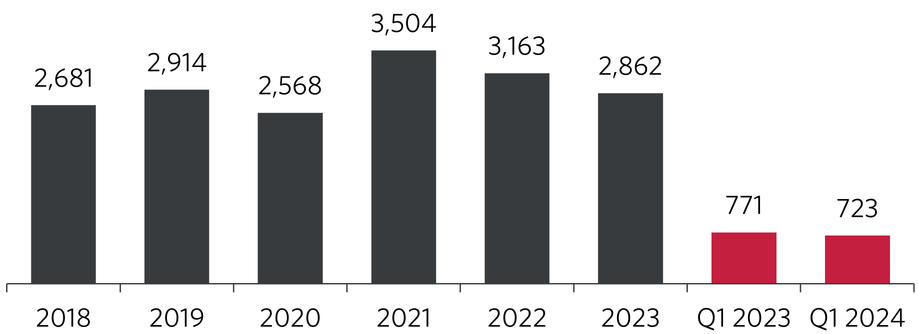
In Q1 2024, the US leveraged loan market experienced a significant uptick in activity, with new loan issuance reaching $343 billion. This marked a 104% increase from the $168 billion in new loan issuance recorded in Q4 2023, and the highest level since Q1 2021. The surge in issuance was driven by several factors, including robust investor demand, improving economic forecasts, and anticipation of potential Federal Reserve rate cuts later in the year. Although the quarter's issuance was strong by historical standards, approximately 80% of new loans were for refinancings versus LBOs or add-on M&A transactions.

During Q1 2024, sponsored middle market loan issuance totaled $33.7 million, down 6% from $31.6 million in Q4 2023. Additionally, direct lender loans declined 10% during the same time period, reflecting greater competition from traditional lenders. According to LPC Data, direct lender executions continued to outpace traditional bank syndicated loans by 2.6x as sponsors favored certainty to close. Although Q1 2024 may be perceived as a slow start, on an annualized basis 2024 would surpass 2023 if these rates of issuance are sustained through the year.

Sources: Pitchbook.

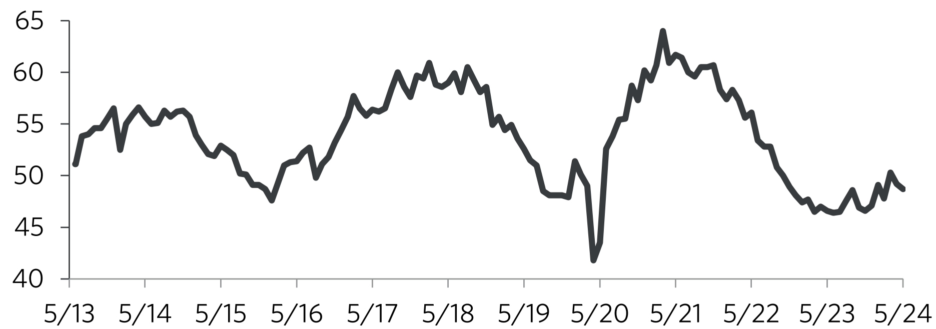
On balance, the industrials sector remains stable

US industrial M&A transactions



In Q1 2024, transaction volume declined slightly compared to Q1 2023, yet it continues to trend near historical levels. While overall volume remains consistent, there has been a shift in the end markets and business characteristics of the companies involved in M&A transactions since the 2021 deal frenzy. The consistent volume in the industrial market is unexpected when it is compared to the economic data. A key metric that has traditionally been correlated to economic health and M&A is the Manufacturing PMI index. This index has been below 50, which signals a contraction, for 18 of the last 19 months. This trend typically means that we have been in an industrial recession since October 2022, however, during this period many manufacturers serving the infrastructure, automation, or aerospace & defense markets have experienced growth and a positive outlook. The strong performance in these end markets has resulted in continued industrial M&A momentum and buyers paying premium multiples for "A" companies with proven growth strategies in these markets.

Manufacturing PMI index



Several sectors of the industrial market are experiencing a slowdown due to OEMs rationalizing inventory in late 2023 and early 2024, weather, and/or the impact of higher interest rates. A few industries that have been impacted by these negative trends are medical devices and instruments, agriculture, and lawn & garden. These markets have experienced a reduction in volume in Q1 2024 that had not been seen since the Great Recession. However, the CEOs that CIBC has talked to in these markets have experienced a normalization of orders in Q2 2024 and they remain bullish for the long-term outlook because of reshoring, local production, and local consumption trends.

We believe the outlook for industrial M&A remains strong for top performing companies for the remainder of 2024 and into 2025.

Source: S&P Capital IQ.

CIBC US Middle Market at-a-glance

Highlights

Nationally recognized middle market investment banking team with global reach.

Experienced and talented team has completed hundreds of transactions representing billions in transaction value

Clients include **private companies, private equity funds, and corporations.**

Differentiated approach to achieving client goals through disciplined and transparent transaction processes.

Investment banking services

M&A Advisory

- Execute transactions up to $500 million in enterprise value
- Specialize in sell-side transactions
- Conduct targeted buy-side advisory services

Capital Placement

- Raise up to $250 million in debt and/or equity
- Provide capital structure advice for management buyouts and recapitalizations

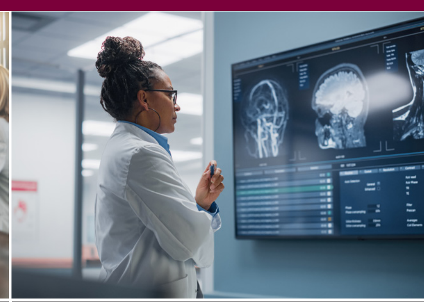
Financial Advisory

- Strategic alternative analyses
- Special situations transactions

Focus industry verticals


Consumer


Business Services


Healthcare


Industrials


Software & Technology

Recent CIBC US Middle Market transactions

Stainless Foundry & Engineering, Inc.
a portfolio company of
Guard Hill Holdings
has been acquired by
Ashland Capital Partners

Vapor Power International
a portfolio company of
Stone Pointe, LLC
Midwest Mezzanine Funds
has been acquired by
Thermon

Armor Animal Health
Detect. Defend. Deliver.
a portfolio company of
GoldnerHawn
has been acquired by
VSI

Merlot Vango Tarping Solutions
a portfolio company of
Safe Fleet
has been acquired by
Oak Hill Capital

Identiti
has partnered with
Keystone Capital

pfi InStore
a portfolio company of
CFB Capital for Business
KVCI
Mid States Capital L.P.
Diamond State Ventures
Northcreek Mezzanine
has been acquired by
Onward | Capital

Muthig Industries, Inc.
has been acquired by
LFM capital
Merit Capital Partners

Stock'd Supply
has been acquired by
Blackhawk Industrial

AAR
has acquired
Trax

Lake Air Products
has been acquired by
P4G Capital

GT Golf Supplies
a portfolio company of
Hadley
has been acquired by
Kinzie Capital Partners

Transhield
Advanced Protective Cover Technology
has been acquired by
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