Pursant

INSPIRED PURSUIT

M&A Transactions
What To Expect And How To Prepare

Presented by Mark Herbick – Founder & CEO of Pursant, LLC

My Background

- Serial entrepreneur since childhood
- Started first “real” business at 19 years old (Fitness Center)
- Acquired first business at 20 (another Fitness Center)
- Bought first non-sexy company at 27 (Building Maintenance)
- Bought, operated and sold over a dozen of my own businesses ranging in size from 5 to 1400 employees
- Started advising on growing enterprise value (EV) and strategic transactions (M&A, raising capital) in 2004.
- Sold last portfolio company in 2007
- Founded Pursant in 2010

Pursant, LLC Overview

- **What Pursant Does:**

Pursant helps business owners grow the value of their companies and maximize that value when they exit.

- **Investment Banking**
  - M&A Advisory (Buyers & Sellers)
  - Private Capital Markets (Raising Debt & Equity)

- **Strategic Transaction Support**
  - Business Valuation
  - Due Diligence Support
  - Post Transaction Financial Integration

- **Business Value Enhancement**
  - Strategic Planning for Enterprise Value Growth
  - Business Optimization
  - Talent Solutions (Interim CFO & Executive Search)

State of M&A and Strategic Transactions

- Scope of this discussion:
  - Review 2018 Macroeconomic Conditions and how they related to M&A
  - Provide M&A and Strategic Transaction insight specific to the lower middle market (<$250M in TEV)
  - Discuss why preparing now for a sale at any point in the future is critical
  - Discuss drivers of valuation and deal structure
  - What to expect in terms of deal structure, timelines, etc.
  - Provide insights into what to expect in 2019

Reflecting on Strategic Transactions in 2018

1. Overall 2018 US M&A deal volume up 10-50% (tough to track) from 2017
2. ***Lower Middle Market*** ($10M-$250M TEV) M&A volume similar to 2017
3. 10,000 baby boomers retiring a day are driving smaller business M&A
4. Deal friendly administration, policy clarity and tax reform helped M&A
5. Limited Organic growth options and cheap capital helped M&A
6. Valuation multiples peaked and softening is starting to be felt
7. With higher multiples, due diligence was rigorous
8. More companies Stress-Testing, Optimizing and Exit Planning
9. Private Equity's capital abundance and limited deal flow motivated them to do smaller deals
10. "Acquihires" starting to appear with low unemployment rates

Pursant
INSPIRED PURSUIT

Macroeconomic Conditions

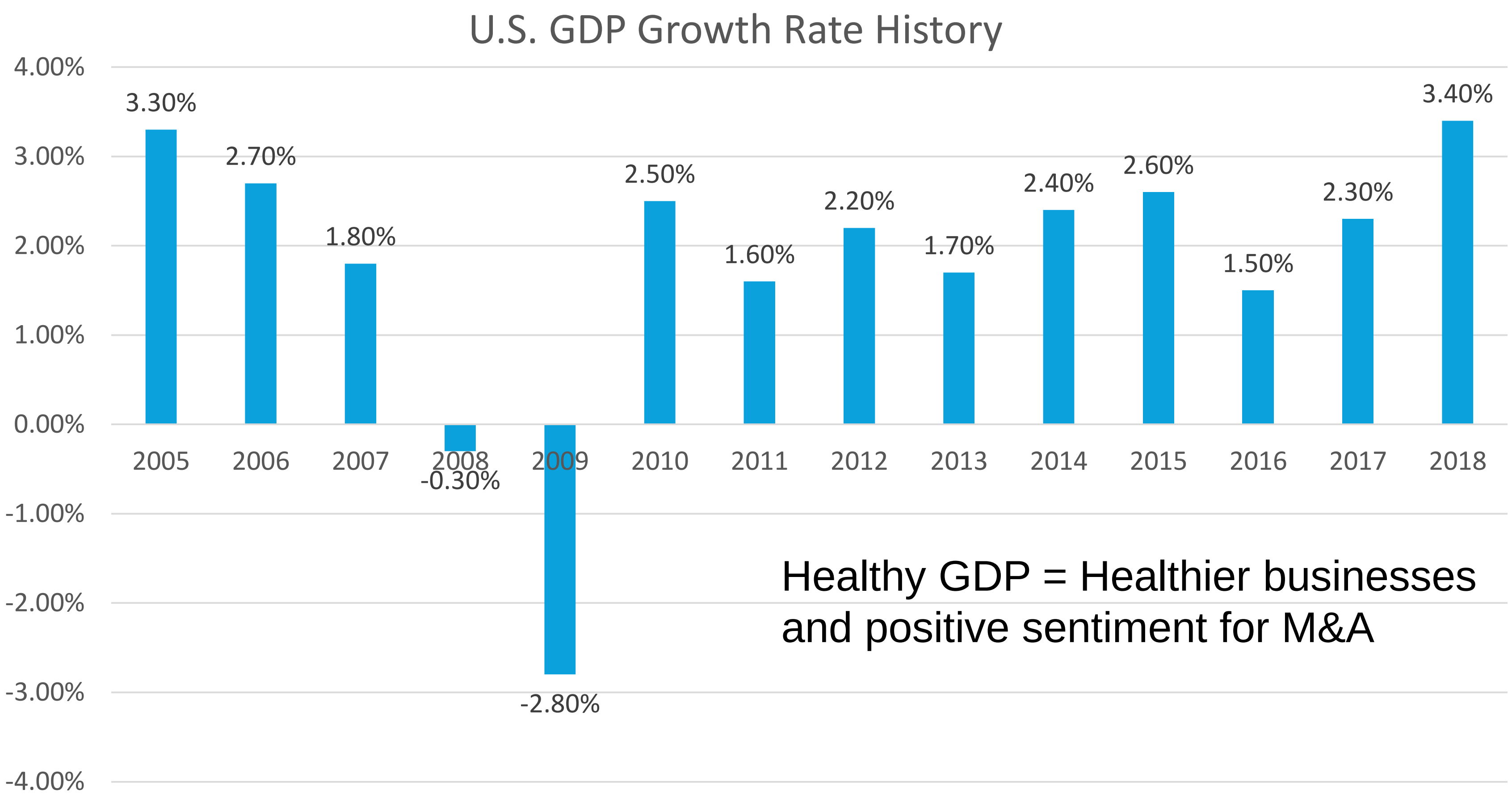
- 5 Deal-Impacting Macroeconomic indicators we will review:

1. GDP
2. Unemployment
3. Inflation
4. Interest Rates
5. Debt Loads and Debt Quality impacts on M&A

Bottom-line – Macro Market all rolls down to the Middle Market and Main Street

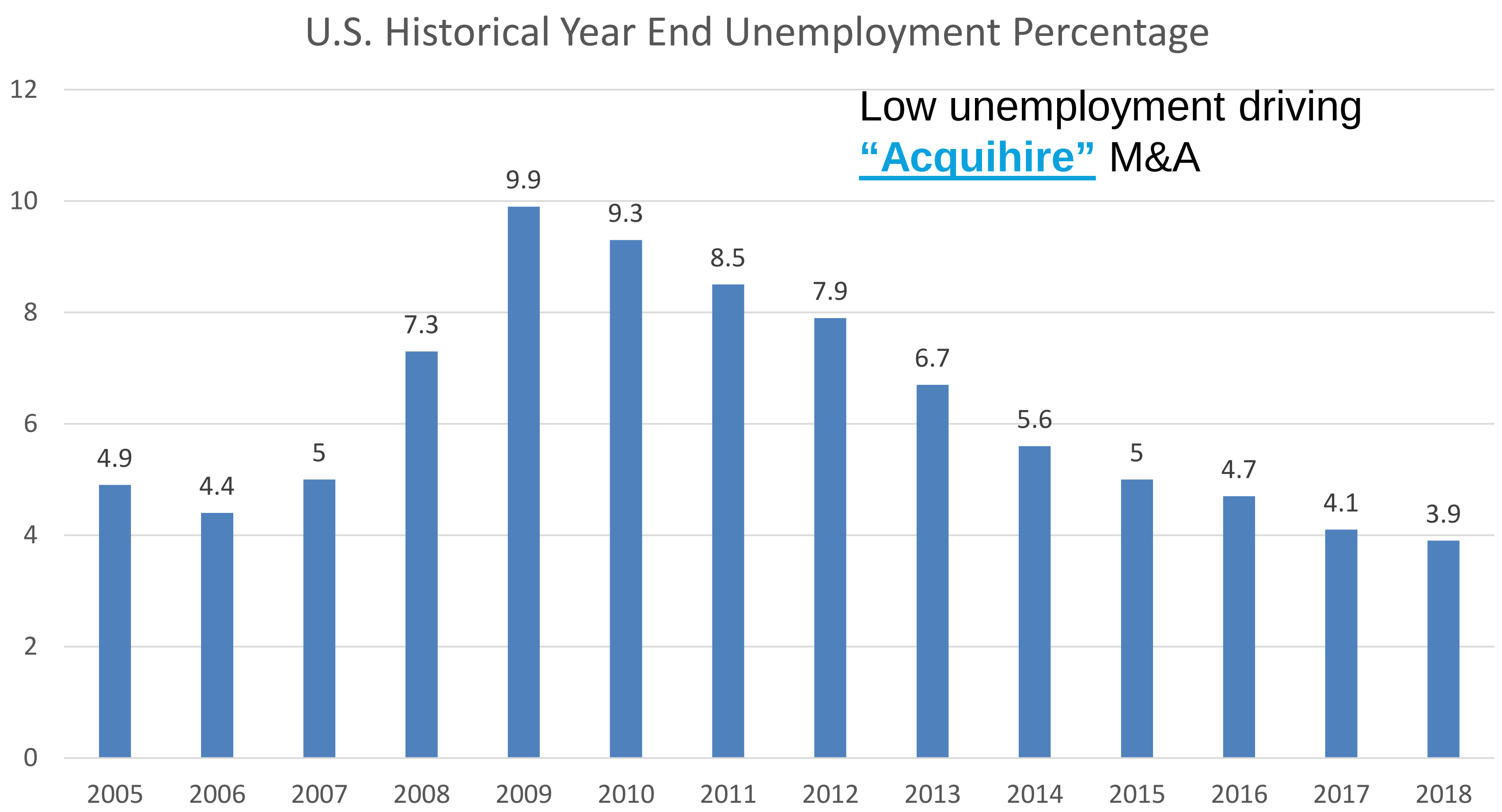
Pursant
INSPIRED PURSUIT

Macroeconomic Conditions



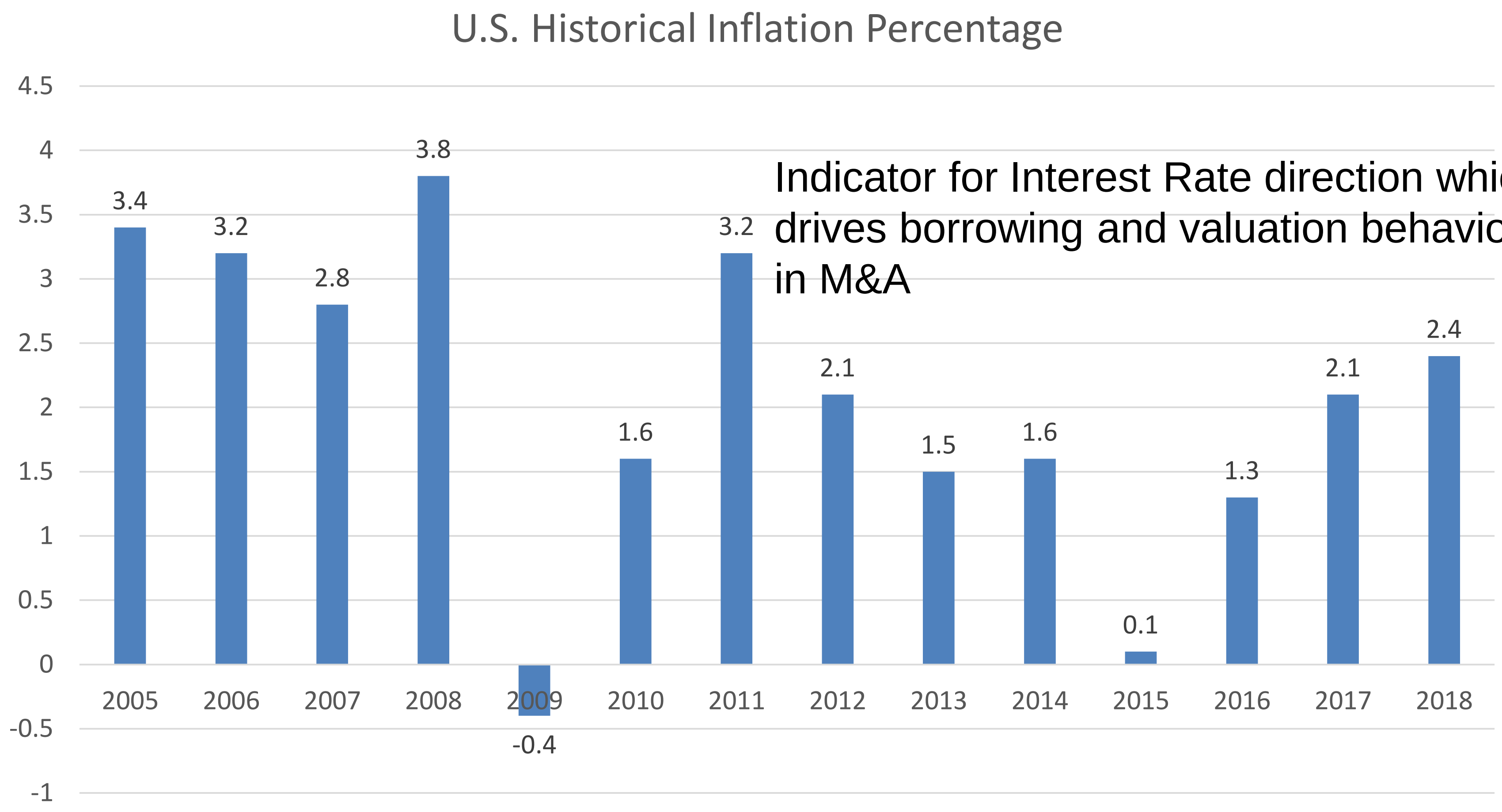
Pursant
INSPIRED PURSUIT

Macroeconomic Conditions



Pursant
INSPIRED PURSUIT

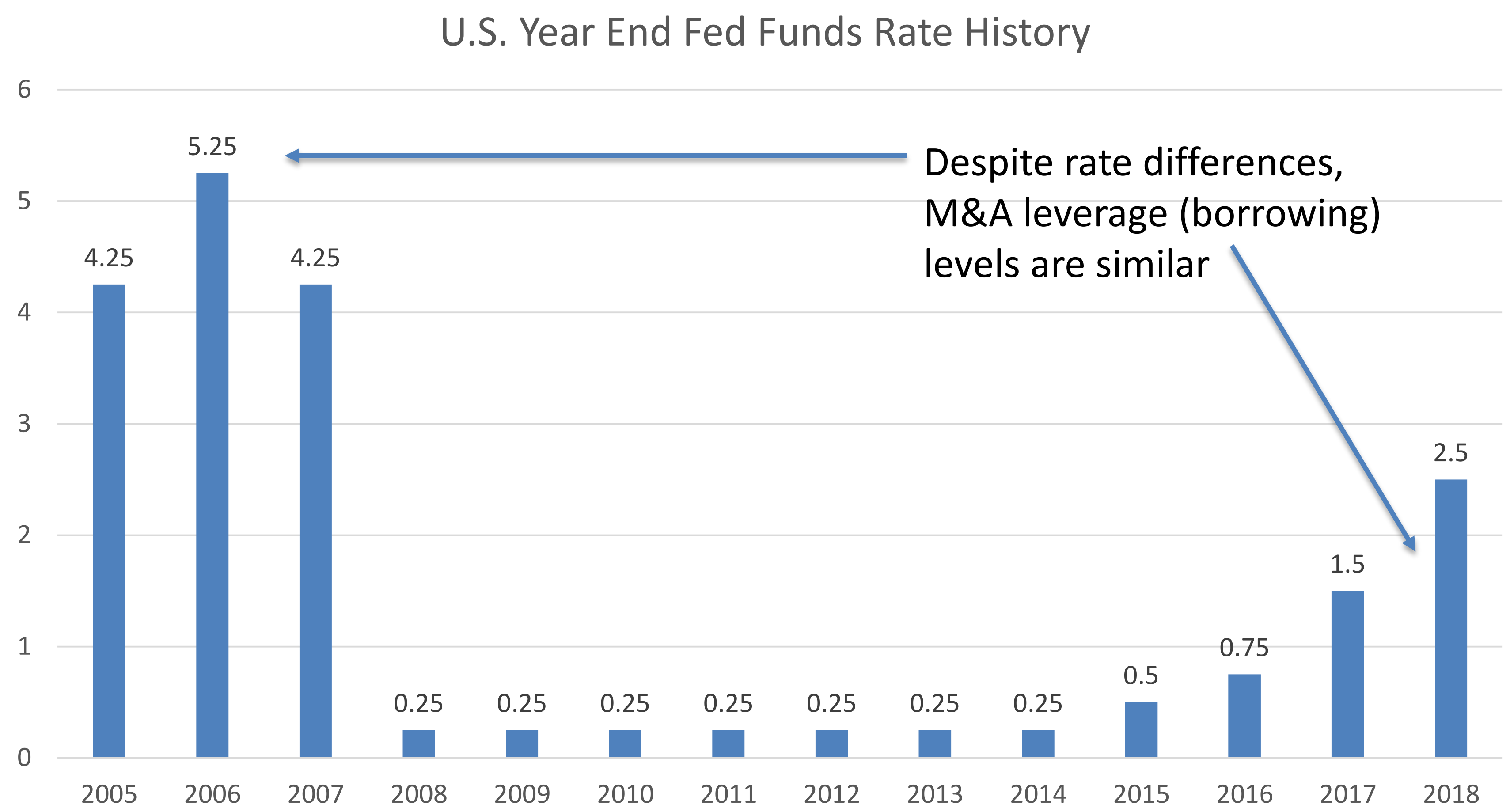
Macroeconomic Conditions



Indicator for Interest Rate direction which drives borrowing and valuation behaviors in M&A

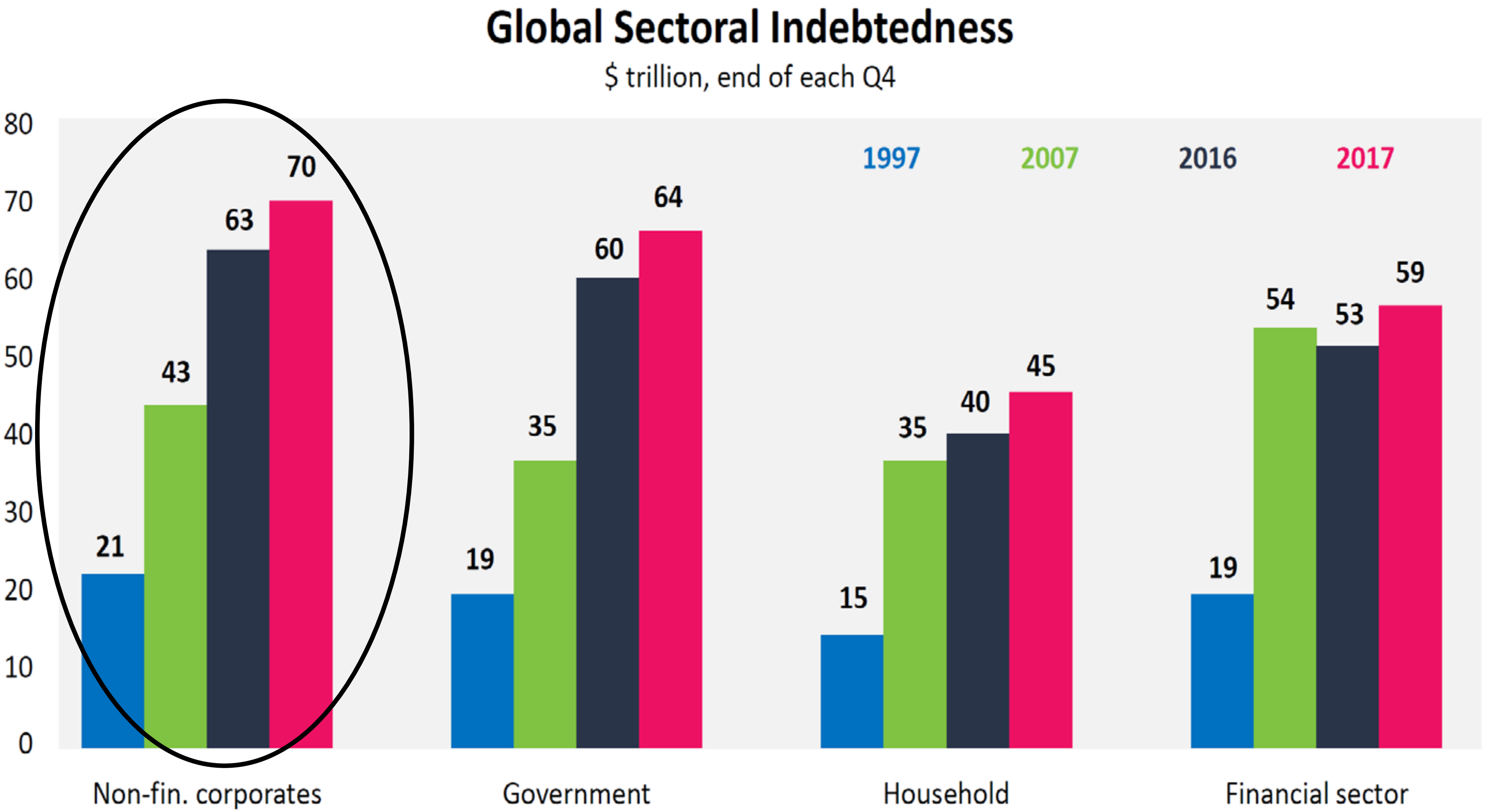
Pursant
INSPIRED PURSUIT

Macroeconomic Conditions



Pursant
INSPIRED PURSUIT

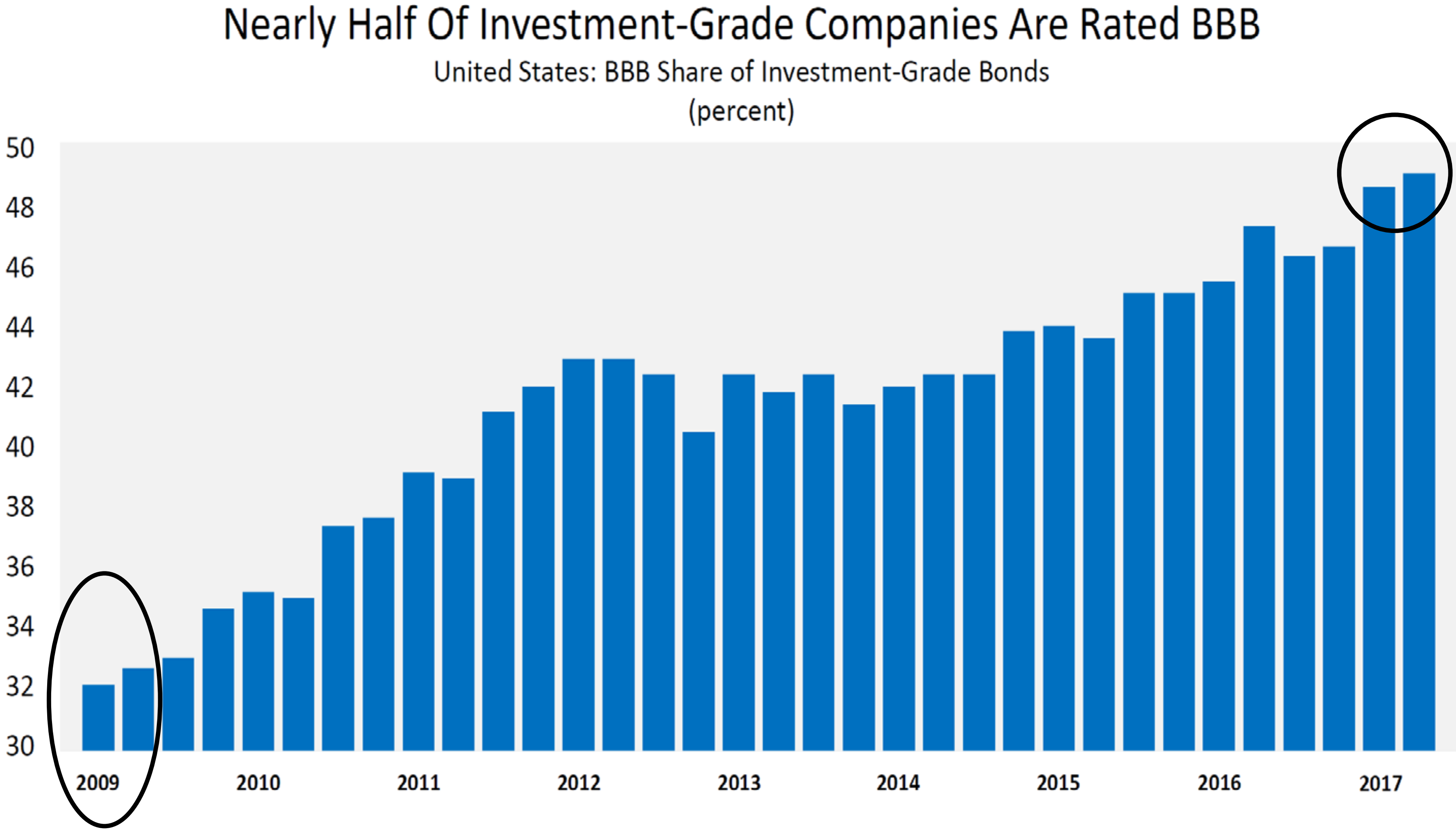
Debt Volume Implications on M&A



Source: Institute of International Finance

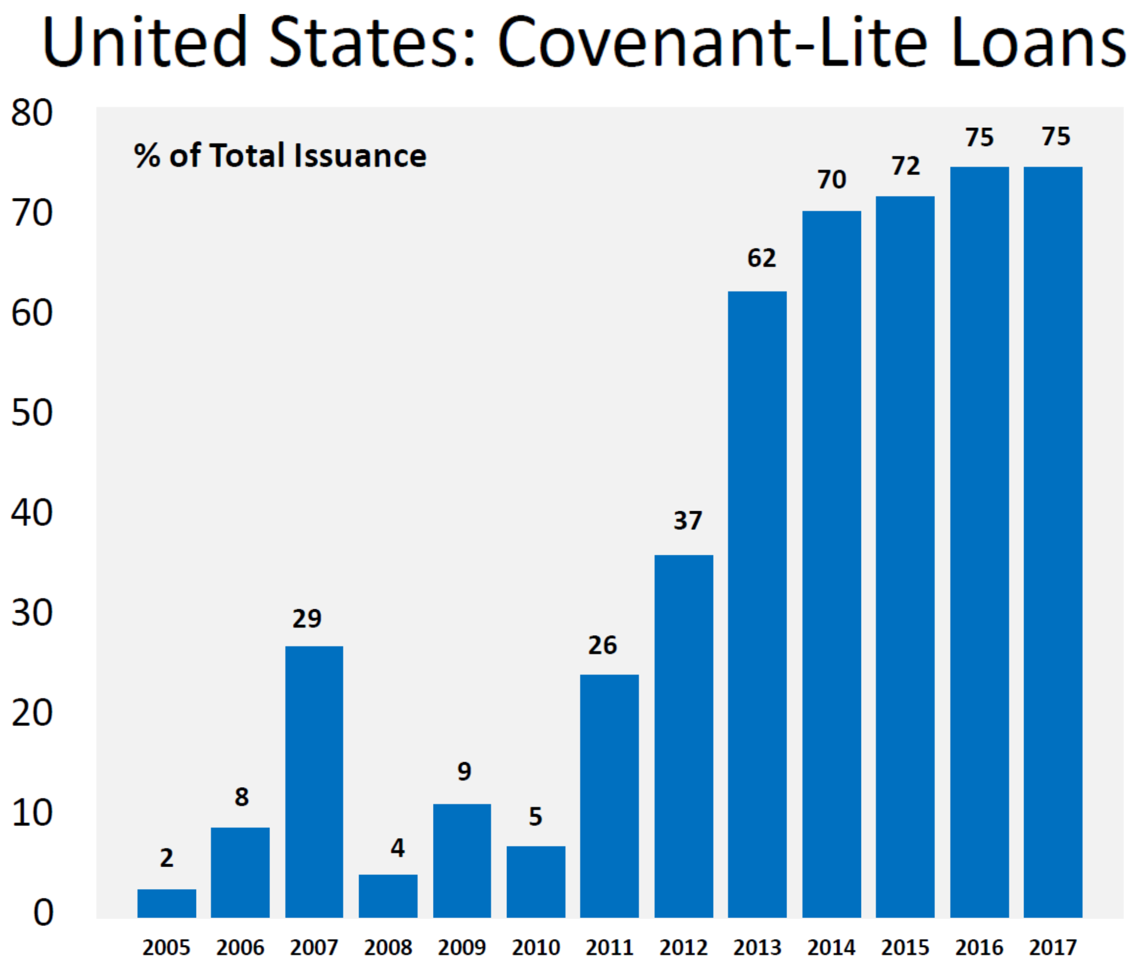
Pursant
INSPIRED PURSUIT

Debt Grade Implications on M&A



Source: Bloomberg, Glusken Sheff

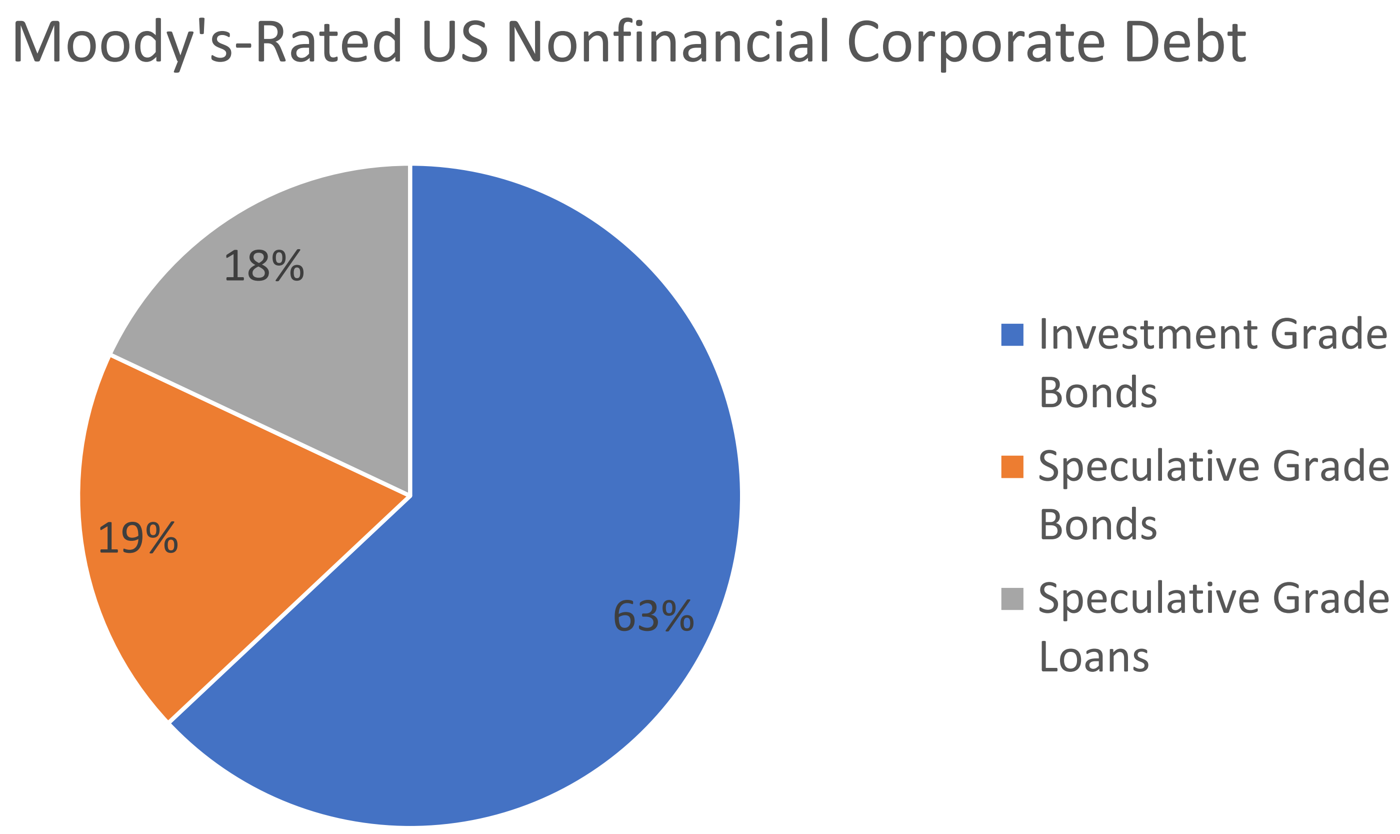
Loan Quality Implications on M&A



Source: Bloomberg, Bank of America Merrill Lynch, S&P LCD, Guggenhein Investments

Pursant
INSPIRED PURSUIT

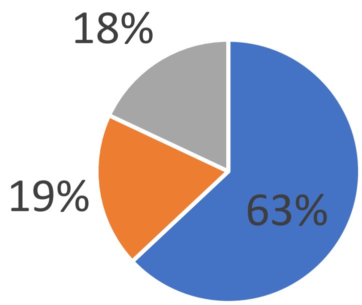
Debt and Loan Quality Implications on M&A

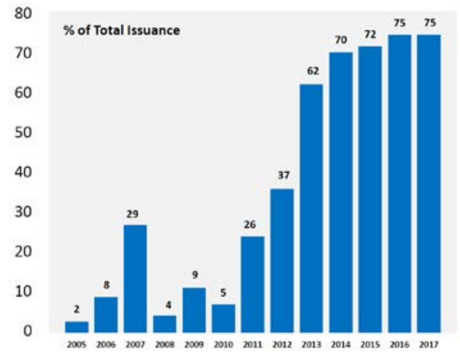


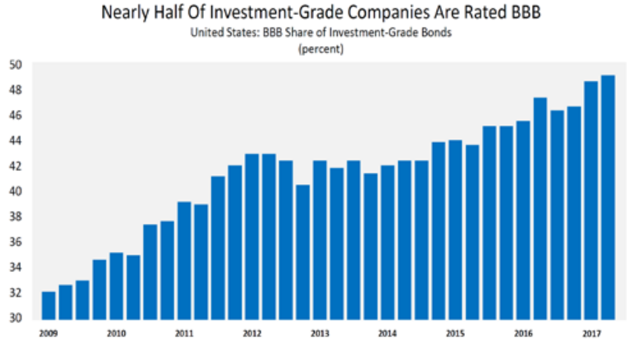
Source: Bloomberg, Bank of America Merrill Lynch, S&P LCD, Guggenhein Investments

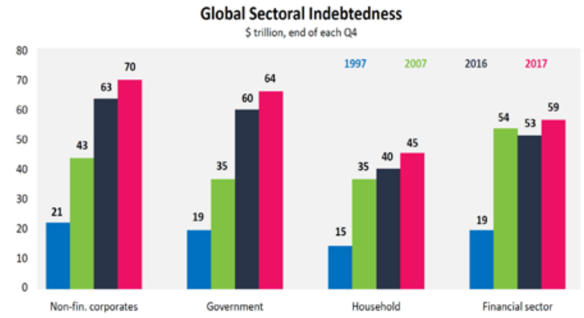
Pursant
INSPIRED PURSUIT

Debt and Loan Quality Implications on M&A







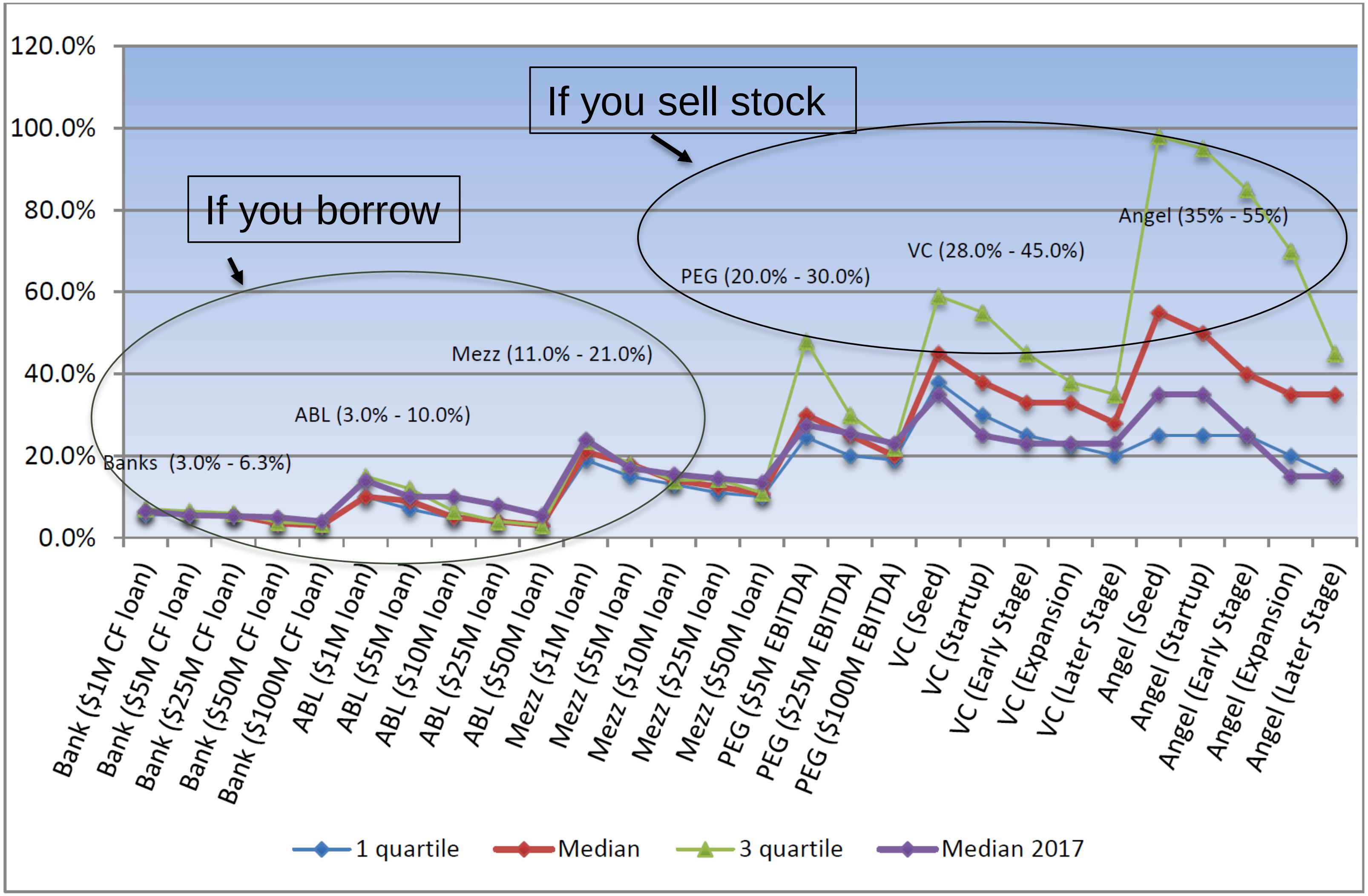


What does all of this mean?

The stage is set for the next major recession driver, a commercial credit bomb, which will completely change the M&A environment.

Pursant
INSPIRED PURSUIT

The Cost to do a Partial Cashout on Your Business



Source: Pepperdine Private Capital Markets Report

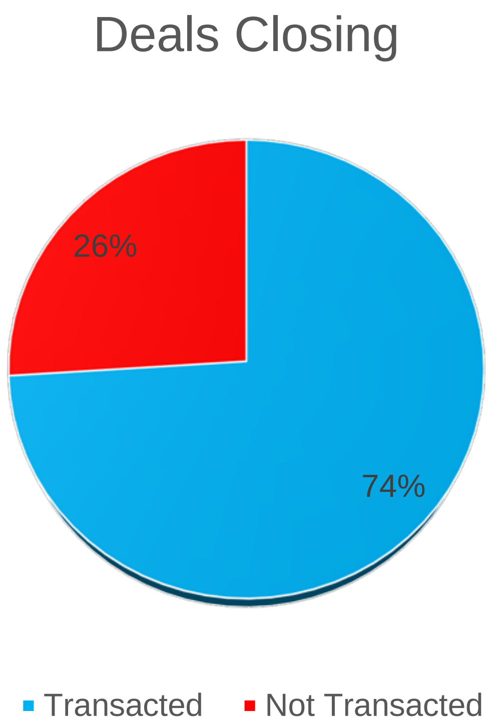
Pursant
INSPIRED PURSUIT

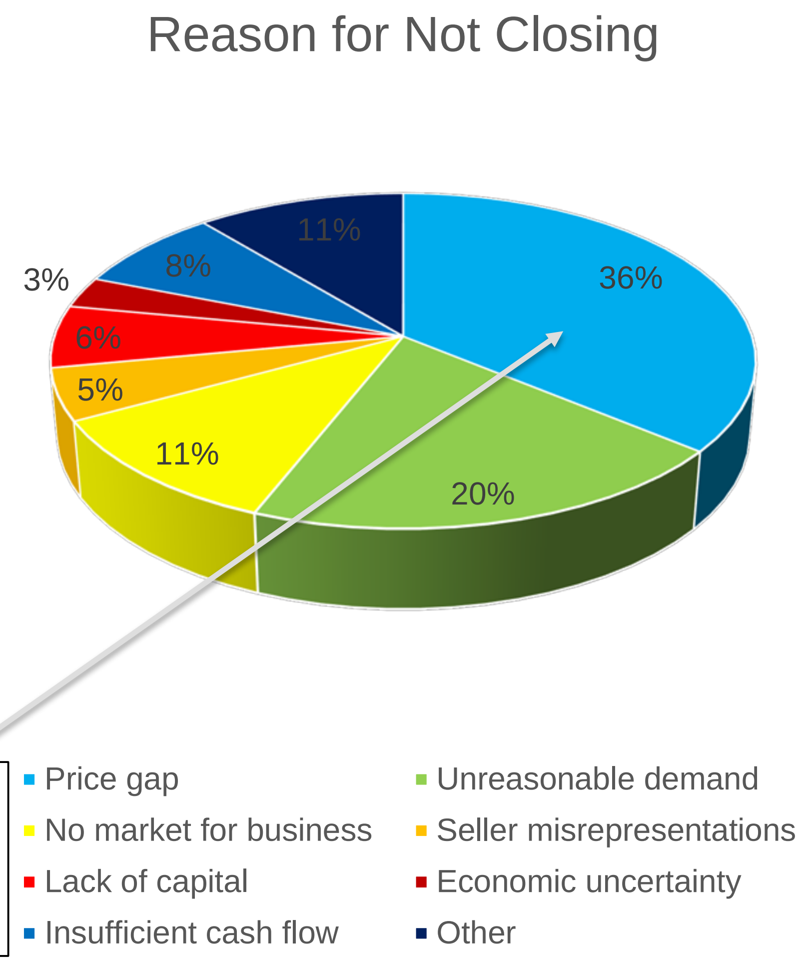
How Many Months To Complete a Deal

Deal Size	Months To Close	LOI To Close
<$500k	6	2
$500k-$1m	7	3
$1m - $2m	9	3
$2m - $5m	10	4
$5m - $50m	11.5	5.5

Source: Pepperdine Private Capital Markets Report

Will the deal close?



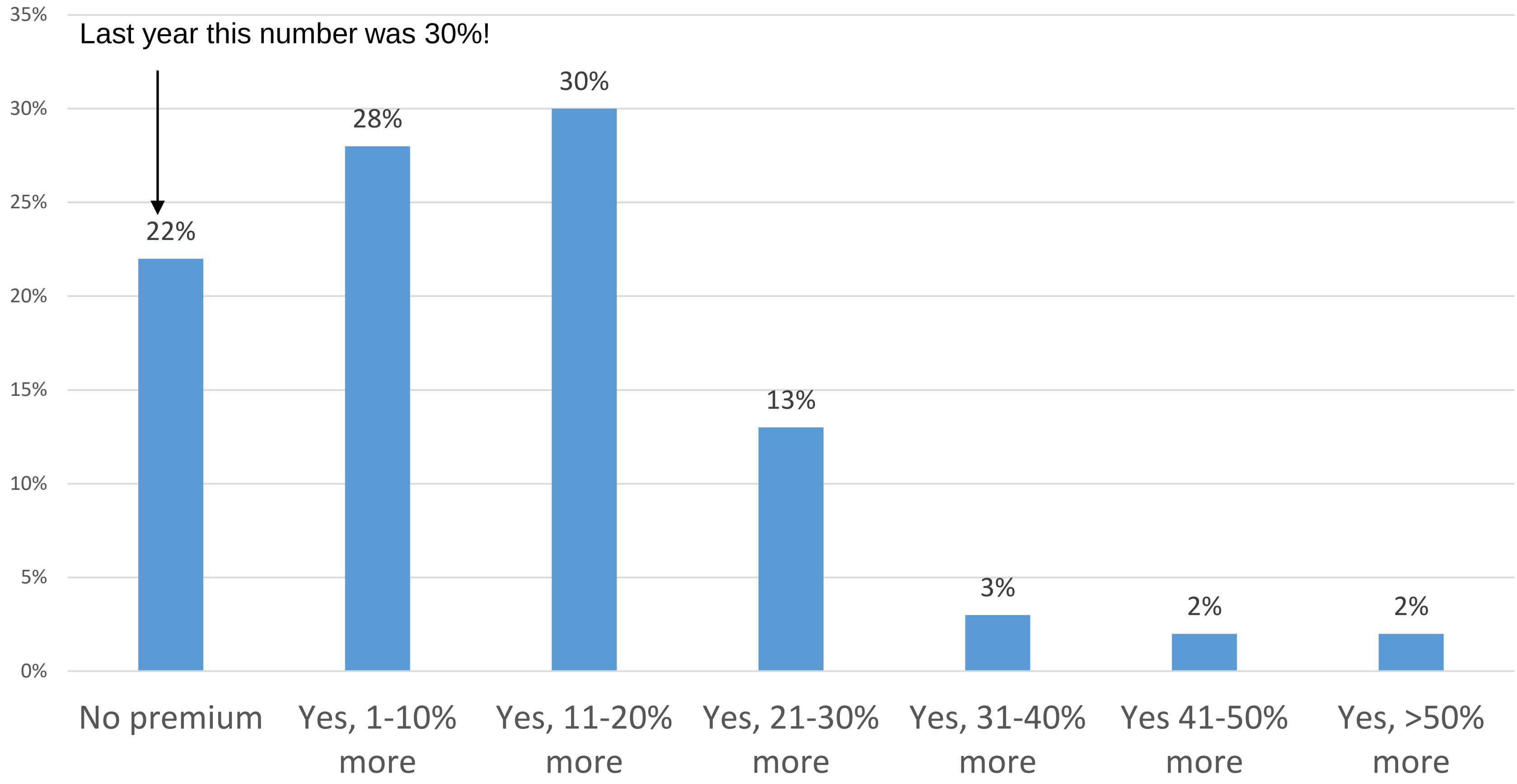


Price Gap
35% had 1-10% gap
35% had 11-20% gap

Source: Pepperdine Private Capital Markets Report

Pursant
INSPIRED PURSUIT

Premium Paid by Strategic Vs. Financial Buyers



44% of deals involved Financial buyers

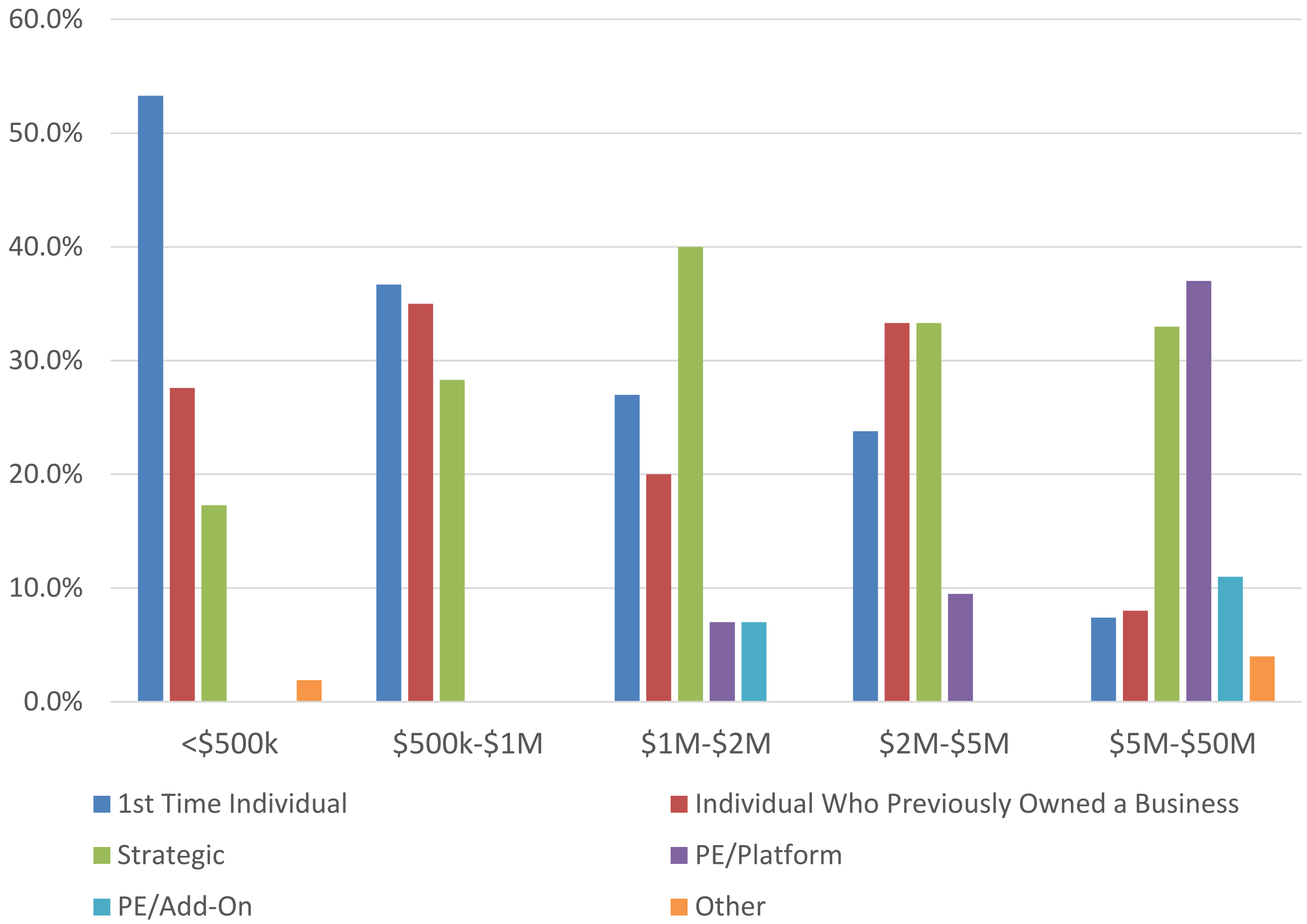
Source: Pepperdine Private Capital Markets Report

Why People are Selling

Deal Size	#1 Reason	#2 Reason	#3 Reason
<$500k	Retirement	New Opportunity	Burnout
$500k-$1m	Retirement	Burnout	New Opportunity
$1m - $2m	Retirement	New Opportunity	Health Issues
$2m - $5m	Retirement	Burnout	Family Issues
$5m - $50m	Retirement	Family Issues/Burnout	New Opportunity

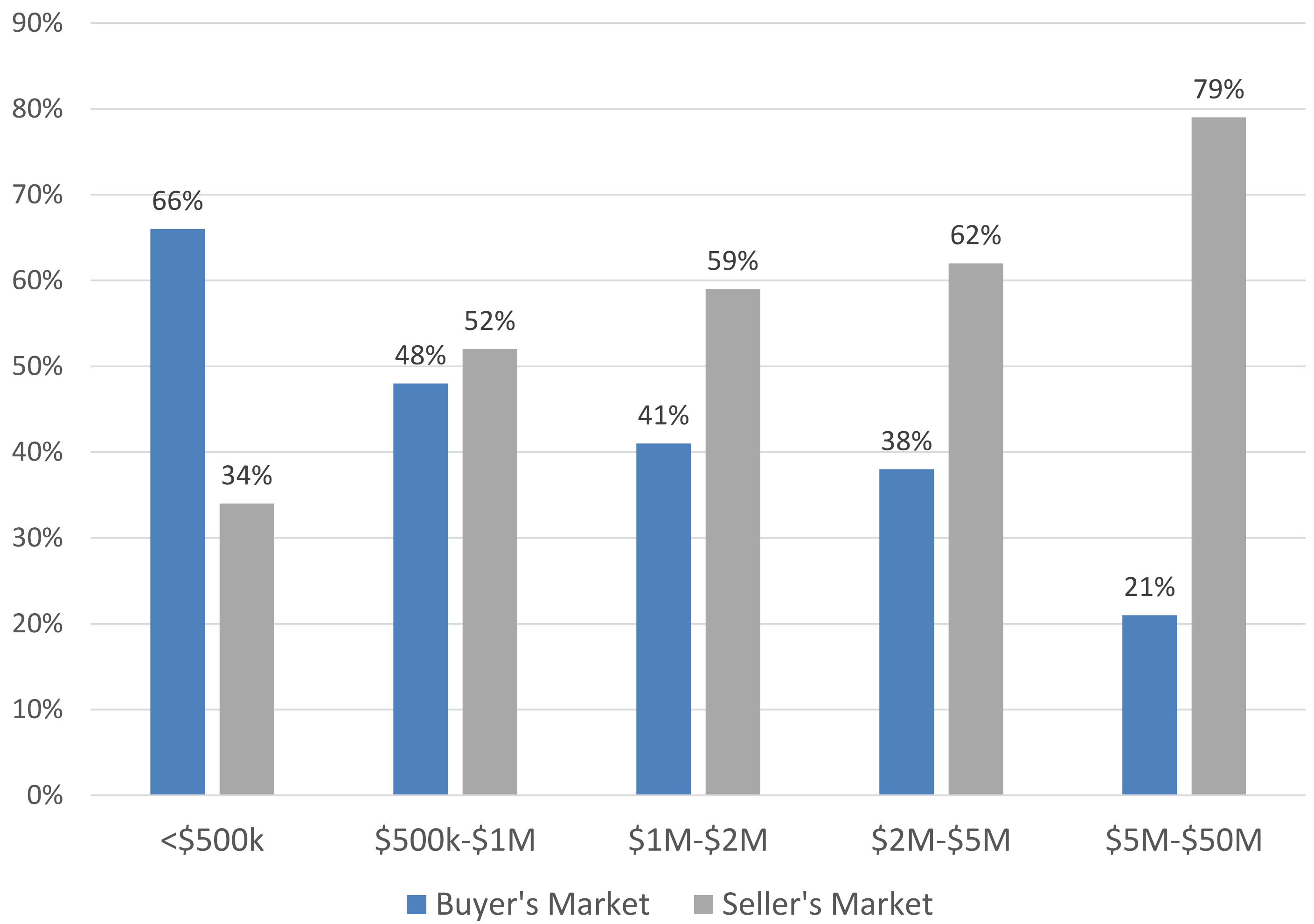
Source: Pepperdine Private Capital Markets Report

Who are the Buyers (sorted by TEV)?



Source: Pepperdine Private Capital Markets Report

Buyer’s or Seller’s Market? *(by Transaction Value)*



Source: Pepperdine Private Capital Markets Report

Pavement Maintenance Valuation Components

EBITDA (adjusted earnings) x Multiple (between 1 and 10) = Value

1. EBITDA (Adjusted, TTM, Run-Rate)
2. Major Risk Profile elements that effect the Multiple range

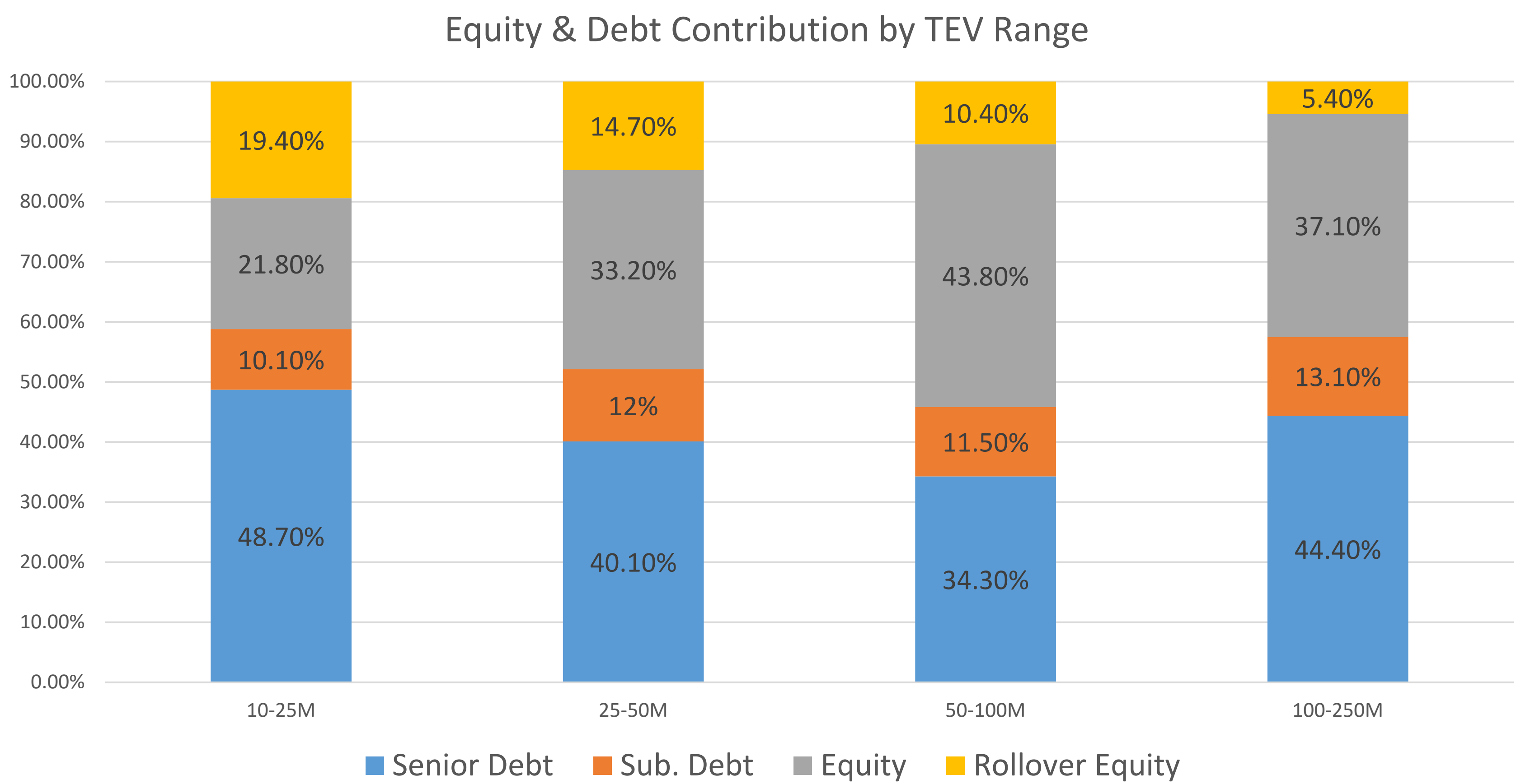
- ✓ Customer type (residential, government, developers, commercial)
- ✓ Percentage of new customers versus repeat customers
- ✓ Customer revenue concentrations above 10% of total revenue
- ✓ Revenue and Margin trends
- ✓ Talent concentrations
- ✓ Equipment quantity, type and quality
- ✓ Quality of Earnings (accuracy, format and external review of financials)

3. Size Premium
4. Quality Premium

Pavement Maintenance Deal Structure Components

1. Cash (varies widely from 0% - 100%) based on Risk Profile
2. Escrows/Holdbacks (10% is common) based on size and Risk Profile
3. Earnouts (Revenue, Gross Margin, EBITDA) based on Risk Profile
4. Seller's Note (10 - 20% common range), but less common in today's cheap/available capital market
5. Stock (1 – 20% common) on larger Private Equity (PE) deals

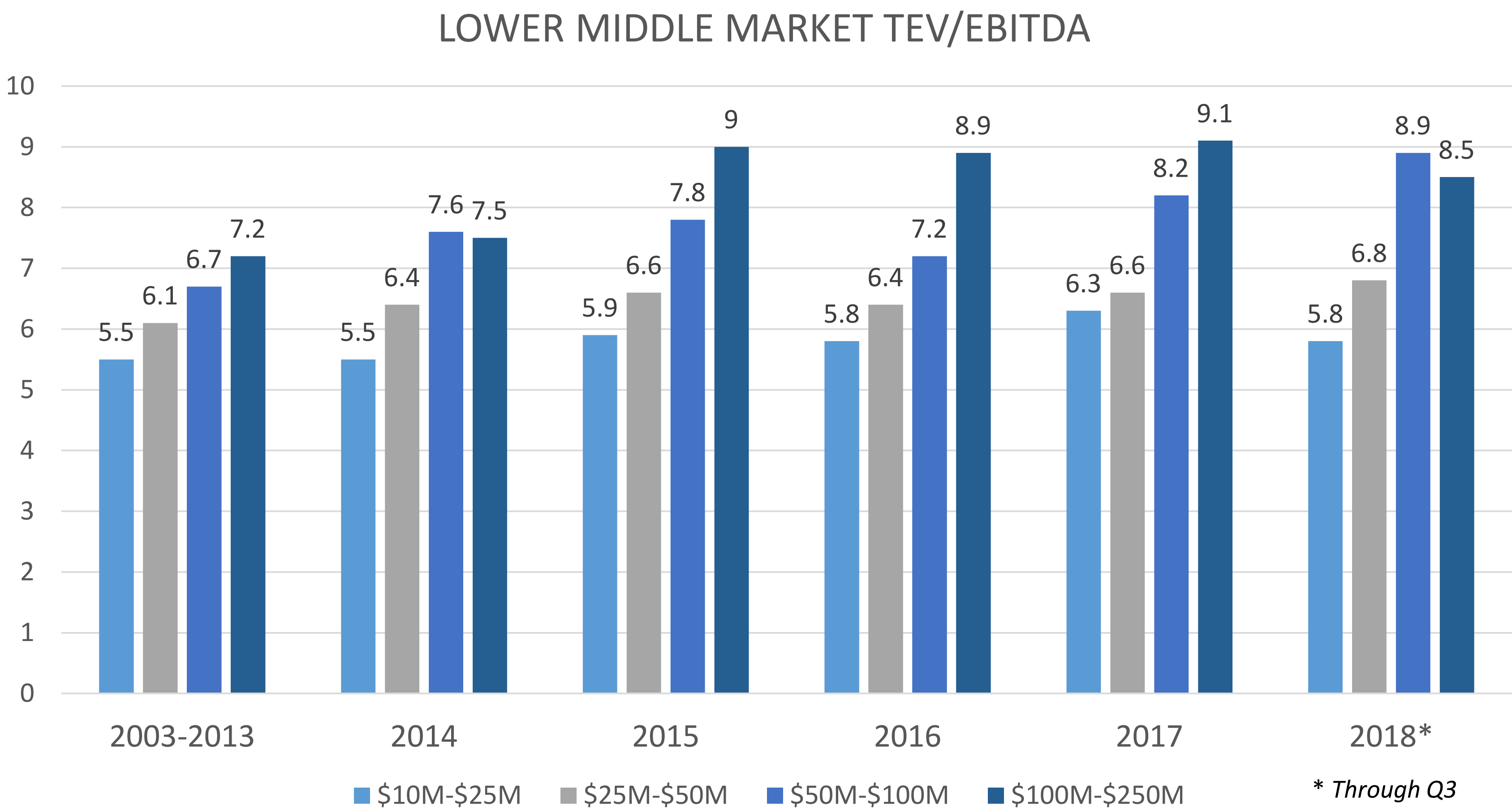
PE Deal Funding Structures for Larger Deals



Source: GF Data®

Pursant
INSPIRED PURSUIT

Lower Middle Market Multiples

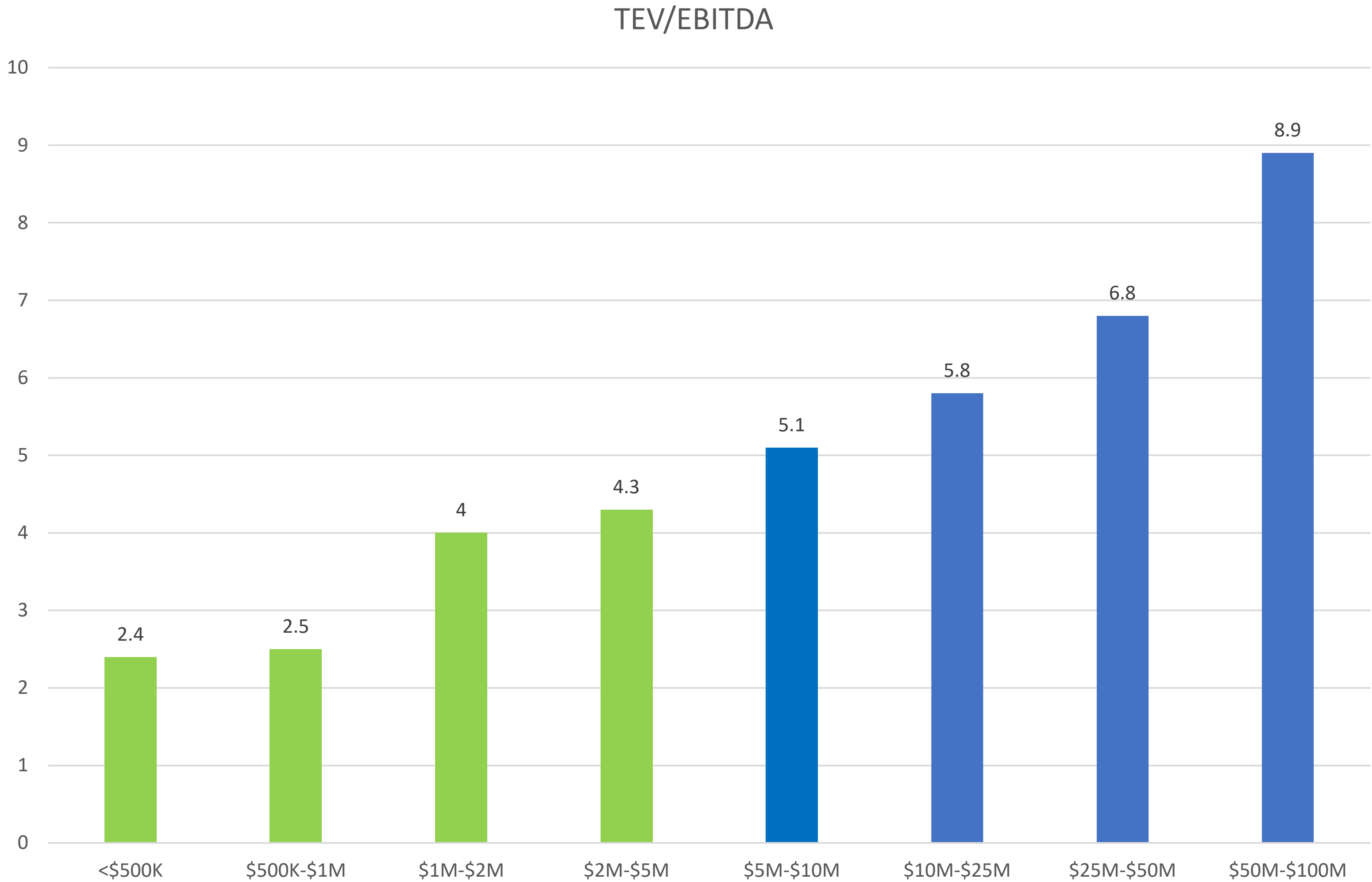


While data is across entire middle market, paving sector does not differ much

Source: GF Data

Pursant
INSPIRED PURSUIT

Lower Middle Market and Small Business Multiples

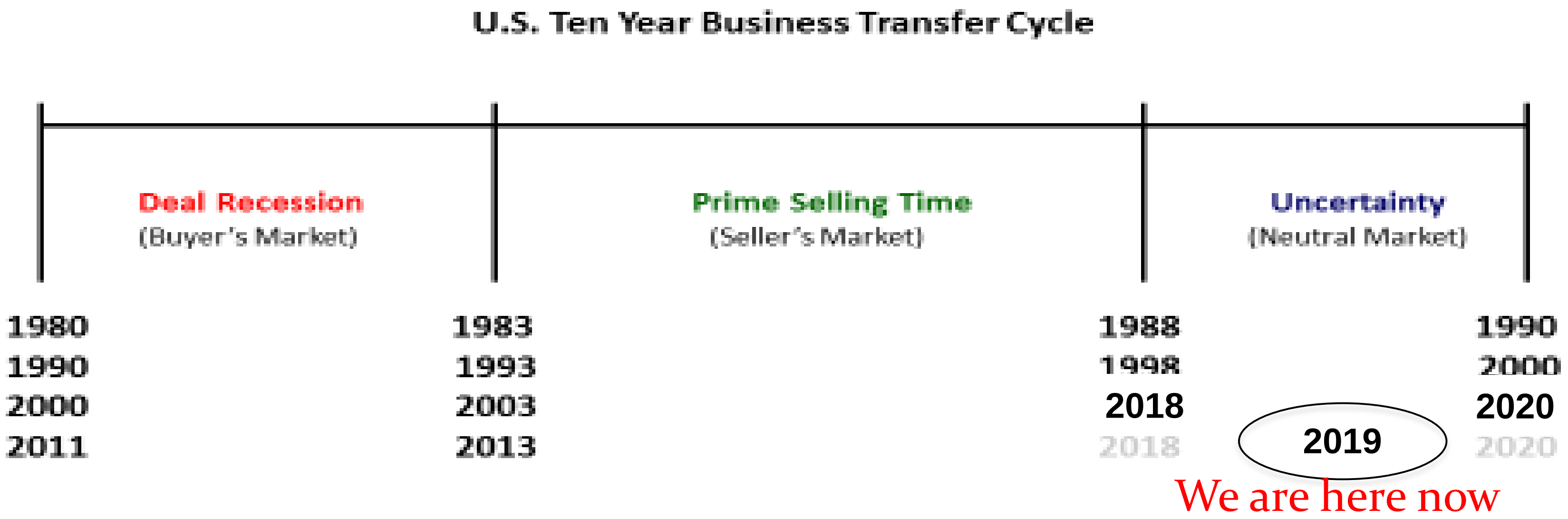


While data is across entire market, paving sector does not differ much

Source: Pepperdine Private Capital Markets Report & GF Data

Pursant
INSPIRED PURSUIT

Phases of the Business Transfer Cycle



- Cost of capital is rising again
- Debt loads are high
- Borrowing volume in slowing due to the above
- Above scenario results in multiple softening

What to expect in 2019

1. M&A activity to continue growing driven by:
   - Overall positive business environment
   - Baby Boomers continue selling
   - Favorable legislative and tax environment
   - Financial buyers still have a lot of capital to deploy
   - Strategic buyers still active - *80% of recent Deloitte CEO survey respondents plan to increase M&A in 2019*

2. Buyers doing M&A to expand product/service offerings and footprint

3. Macroeconomic M&A drivers mostly positive

4. Potential drags on M&A
   - Global economic issues
   - Rising interest rates

5. Softening multiples driven by rate increases and growing debt loads

<u>6. But, overall, a very healthy deal environment for both Buyers and Sellers</u>

Pursant
INSPIRED PURSUIT

Thank you!

Mark Herbick

mherbick@pursant.com
847-229-7000