



# LOWER MIDDLE MARKET UPDATE

## M&A Insights | SUMMER 2023



**DIAMOND CAPITAL ADVISORS**  
1875 Century Park East, Suite 1220  
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## LOWER MIDDLE MARKET COMMENTARY

**Signs of Thawing in the LMM M&A Market** - after a rough first half of 2023, LMM M&A appears poised for a rebound

The combination of an uncertain economic environment, rising interest rates and a near banking crisis drove overall M&A activity in the first half of 2023 to its lowest levels since the Great Recession. Although the Fed paused interest rates hikes at its June meeting, the strength of the economy and the labor market as well as hints from the Fed make it likely that rate hikes are going to continue. What this means for the U.S. economy moving forward is uncertain. With mixed signals coming from the upward revision in Q1 2023 GDP to 2% and a recent stock market rally, many economic experts still have hope that the U.S. economy will avoid a recession.

In the lower middle-market (LMM) M&A activity has declined, but not to the extent seen in the broader M&A market. An interesting trend we are seeing is buyers increasingly pursuing smaller deals that don't require leverage because of the elevated cost of debt.

The market dynamics in the LMM create an optimistic scenario for increased LMM M&A activity in the second half of 2023.

- Private Equity has record levels of uninvested capital that need to be put to work. According to Preqin Pro, PEGs and VCs have amassed a record amount of dry powder which surpassed \$2.5 trillion for the first time in 2023.
- More and more buyers, both financial and strategic, are doing smaller LMM M&A deals. Valuation mismatches between buyers and sellers and the higher interest rate environment have had a stifling impact on doing mega deals.

*"Blackstone, KKR and other buyout giants are using their record war chests to snap up smaller companies in deals that are easier to accomplish in an era of soaring borrowing costs and economic uncertainty"*

*"Private-Equity Giants Settle for Bite-Size Deals" Wall Street Journal (Jun 27, 2023)*

- While valuations in the broader M&A market have been impacted by higher interest rates and inflation, LMM valuations have remained resilient. According to GF Data, valuations paid by private equity firms for middle market companies between \$10-\$500 million in enterprise value improved in Q1 2023 compared

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### Firm Overview

Diamond Capital Advisors is an independent investment banking firm that provides M&A, capital raising, corporate valuations and related strategic advisory services to lower middle-market companies in North America.

Our transaction experience covers a broad range of industries, end markets and business models. We have domain expertise in working with companies serving the consumer products, industrials, healthcare, wellness, business services and technology markets.

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## LOWER MIDDLE MARKET COMMENTARY (cont.)

to Q4 2022, rising to 8.0x EV/EBITDA from 6.8x EV/EBITDA.

- More and more LMM companies may need to rethink organic growth strategies as access to growth capital becomes more difficult. Regional banks, the typical lenders of choice for LMM companies, have pulled back, and in some cases have put a hold on new customers and at the very least have lowered their leverage levels and tightened their covenants.

### Key Considerations and Takeaways for LMM Sellers

- **Abundant capital available for deal making.** PE firms have enormous reserves of dry powder to invest in platform and add-on acquisitions. Failure of PE firms to put this capital to work can lead to undesirable outcomes for these firms, such as lower investment returns, decreased management fees, and the prospect of having to return of capital to LPs.
- **Increasing investor focus on LMM companies.** Market uncertainty and the increased cost of debt has caused a significant pullback in large leveraged M&A transactions. Reluctant to conduct larger transactions that require leverage, investors have turned their attention to LMM companies. The presence of more investors vying for LMM companies may provide select LMM sellers with a competitive edge in an organized M&A process.
- **Significant opportunities for high performing LMM companies.** With more investor focus on LMM companies, there has been increased competition for superior operating companies, creating a ripe environment for high-quality LMM companies to command premium multiples. Notably, targets with above average financials achieved a 44% premium compared to other buyouts. This premium is nearly double the 2022 level, which amounted to 23%.
- **Stabilizing valuations in LMM M&A.** Although valuations have compressed for larger M&A transactions, valuations in the LMM have seen an increase in Q1 2023 over Q4 2022 levels. This could provide momentum for sellers sitting on the sidelines waiting for M&A conditions to improve to enter the market.
- **Signs point to a strong recovery in M&A activity.** It is likely interest rates will peak within the next several months with a consensus of economists predicting rate cuts early next year. The recent increase in the stock market seems to suggest that many investors have already priced this in. Moreover, there is a large backlog of PE backed companies that have not come to market because of the cloudy economic environment. These factors create a ripe environment for a strong rebound in M&A activity in the near future.

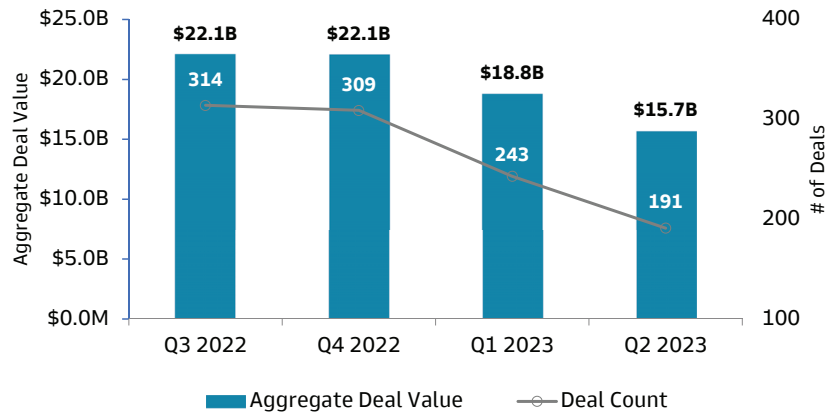




## LOWER MIDDLE MARKET M&A STATISTICS

LMM M&A aggregate deal value declined 16% and deal count declined 21% in Q2 2023 versus Q1 2023 as economic headwinds and rising interest rates continue to encourage caution among buyers and sellers. However, LMM M&A activity continues to outperform the broader M&A market in deal volume.

### LMM M&A Activity (Last 4 Qtrs.)

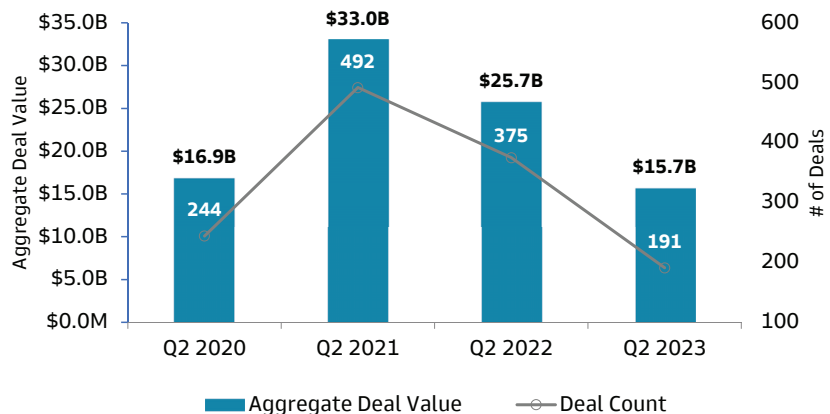


Source: Pitchbook  
Enterprise Value: \$5M-\$250M

LMM M&A aggregate deal value declined 39% and deal count declined 49% in Q2 2023 versus Q2 2022.

This represents the lowest level of Q2 LMM deal activity since the pandemic. Hopefully this represents the bottoming of a market poised for a rebound.

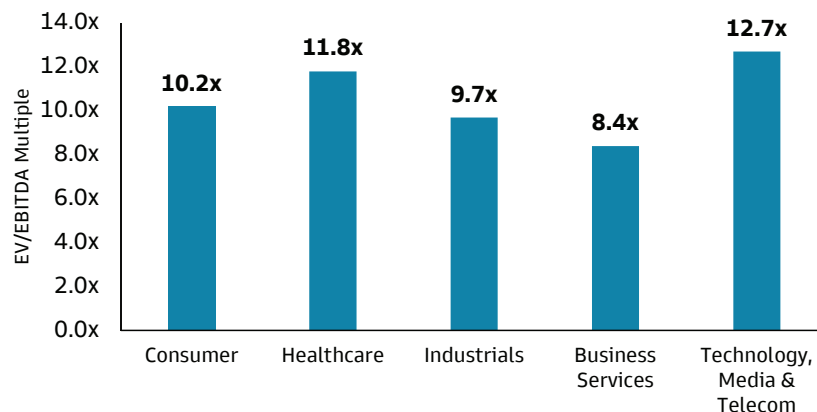
### LMM M&A Activity (Q2 2020 - Q2 2023)



Source: Pitchbook  
Enterprise Value: \$5M-\$250M

Middle-market M&A valuations are holding steady. Technology, Media & Telecom and Healthcare are the leading industries from an M&A multiple standpoint.

### Q1 2023 Middle Market M&A Avg. EV/EBITDA Multiples

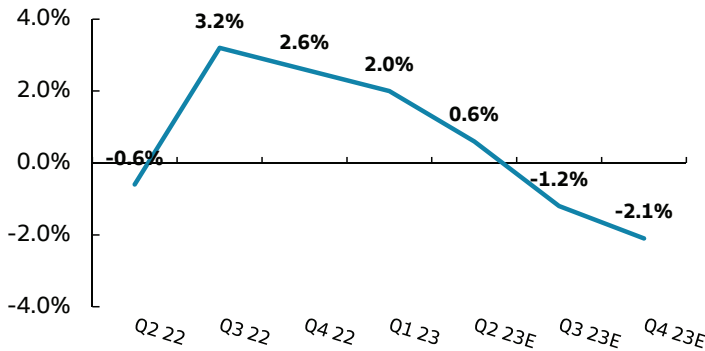


Source: Pitchbook; CapIQ  
Enterprise Value: <\$500M

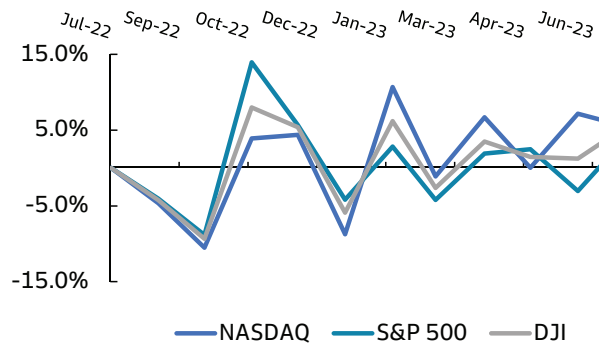


### U.S. ECONOMICS STATISTICS

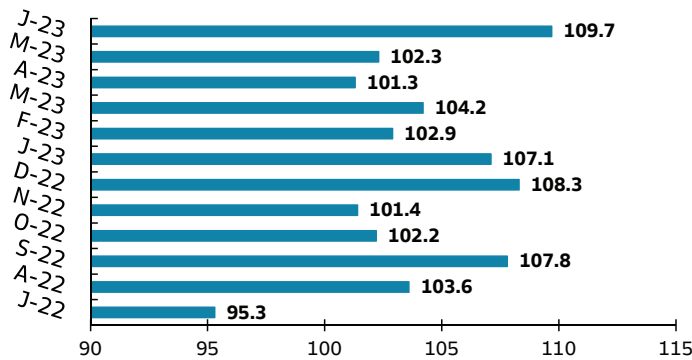
Real GDP Growth



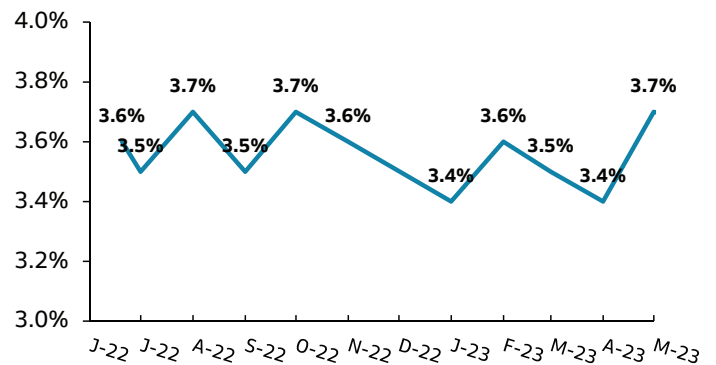
Stock Index Performance (TTM)



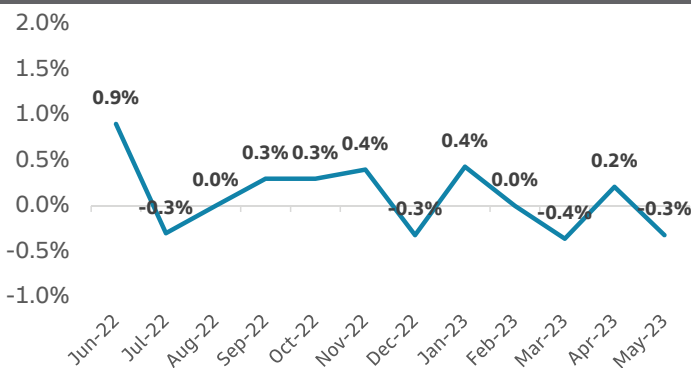
Consumer Confidence Index



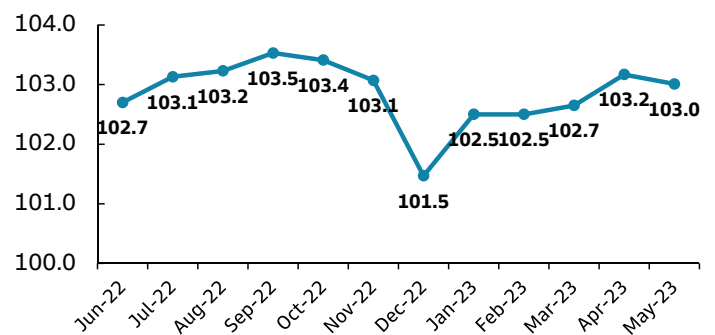
Unemployment Rate



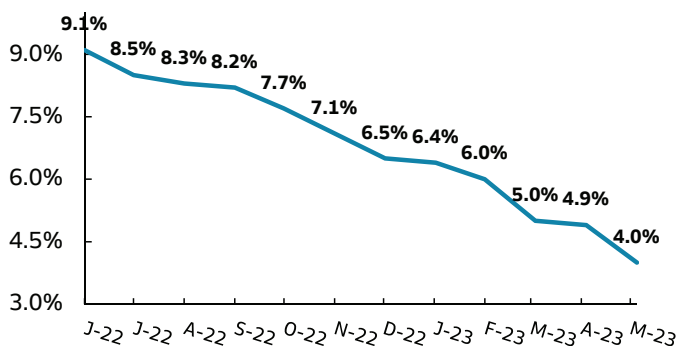
Producer Price Index (1 mo. change)



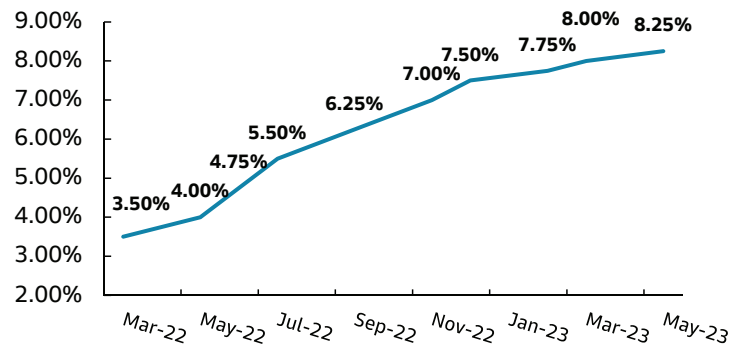
Industrial Production Index



Consumer Price Index (YoY% change)



Prime Rate




## DIAMOND CAPITAL'S TRACK RECORD

Diamond Capital has represented numerous companies in various industry verticals. Our advisory work has included multiple industries and involved companies of diverse specialties, many of which sell in both the public- and private-sector markets.

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Clinical Research

has been acquired by



ERG  
Evolution Research Group

Advisor to Seller

**GIDA  
MAX**  
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Industries

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**SPIDELL**  
THE ANALYZED EDUCATION

has been acquired by



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OF HAWAII**

has been acquired by

Individual Labs

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Modern Homecare  
Services and  
Pharmacy, Inc.

has been acquired by




BEVERLY  
ENTERPRISES

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PIZZA  
COLLECTION**

has licensed certain  
assets to



ancestry.com

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**audacity**

has been acquired by



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Advisor to Seller

**AXIOM  
MOBILE IMAGING**

has been acquired by



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Advisor to Seller

The Weekend  
Exercise Company

has been acquired by

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Group

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**sera+care**

has been acquired by

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Inc.

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