Middle Market M&A:

Private Equity investor Sentiment

KPMG Corporate Finance LLC

Fall 2024

Moving | Forward...

KPMG Corporate Finance LLC is the middle market investment banking arm of KPMG LLP. Our practice combines the focus of an elite boutique investment bank with the resources of a 200,000-person professional services firm

In October 2024, six of our seasoned industry bankers attended the Association for Corporate Growth's M&A East event in Philadelphia, PA to engage with middle-market private equity firms to discuss market conditions, share investment strategies and forge new connections

Leveraging the benefit of a captive audience of active deal makers we surveyed 126 sponsors with a business services focus to better understand i.) the expected factors having most impacted sponsor exits over the past year, ii.) expectations for future platform exit activity, iii.) and the primary drivers of deal flow over the coming months and quarters

We are pleased to share the results of our informal survey

KPMG Corporate Finance LLC is committed to providing the insights and guidance necessary to navigate the current market effectively. Feel free to reach out to discuss these insights further

Trust KPMG Corporate Finance with your next transaction!

KPMG CF Value proposition

Our Business Services team of seasoned M&A advisors specialize in helping privately held, founder and family-owned businesses navigate the complexities of an M&A process

We are expert in assisting corporations as they adjust their strategic priorities through targeted acquisitions and related carveouts

US Business Services Investment Banking

Stephen W. Guy
Managing Director
sguy@kpmg.com

W. Christopher Weber
Director
wchristopherweber@kpmg.com

David W. Lazarek
Vice President
dlazarek@kpmg.com

Parker C. Knott
Senior Associate
pknott@kpmg.com

Proprietary KPMG Corporate Finance LLC investor sentiment survey

October 2024

How do leading middle market private equity firms think about M&A activity today?

Dealmakers believe we are poised for a rebound…

Financial sponsors are broadly optimistic about the anticipated increase in M&A activity, primarily driven by the recent easing of interest rates. These interest rates play a crucial role in shaping M&A activity by affecting financing costs and valuations

Key Survey Findings:
Optimism for increased exit activity is driven by improving economic conditions and lower interest rates, though pockets of uncertainty do remain

Value Expectations

Nearly 40% of sponsors have identified "value expectations" as the main factor hindering exits in the past year, compounded by elevated inflation levels affecting portfolio performance. Meeting desired valuation expectations has posed significant challenges for deal flow

Optimism for Exits

Amid improving economic conditions and lower interest rates, dealmakers are growing more optimistic about a rebound in M&A activity. Despite some uncertainty, there is anticipation of increased deal flow

Declining Rates Will drive volumes

Over 60% of survey respondents believe that interest rates and macroeconomic improvements will have the most significant impacts on deal flow

Key Survey Insights - Factors Suppressing Sponsor Exits...

[Q] Which factors have been most impactful in suppressing sponsor exists over the past 12 months

	Responses % Total
Value Expectations	**38.0%**
Revenue Growth	22.0%
Margin Compression	16.0%
Interest Rates	16.0%
Other	8.0%
Total	**100.0%**

Key Survey Findings:
Over the past twelve months, inflated value expectations and the impacts of inflation on portfolio performance have created a challenging environment for deal makers. Sponsors needed to strategically manage these expectations to align with market realities

Value Expectations

Nearly 40% of sponsors identified value expectations as the primary factor suppressing exits over the past year

Elevated asset prices and high valuation expectations have created a challenging exit environment, as sellers aim for high returns in an uncertain economic climate

Portfolio Performance

Elevated inflation and economic uncertainty have impacted portfolio company performance. This makes it harder for these companies to achieve the growth necessary for successful exits

Limited partners (LPs) are increasingly cautious, reflecting concerns over inflation's impact on investment returns

Strategic Implications

To overcome these challenges, sponsors had to manage valuation expectations and focus on strategic initiatives to improve portfolio company performance

Enhancing operational efficiencies and driving organic growth can align valuation expectations with market realities, creating better exit opportunities

KPMG

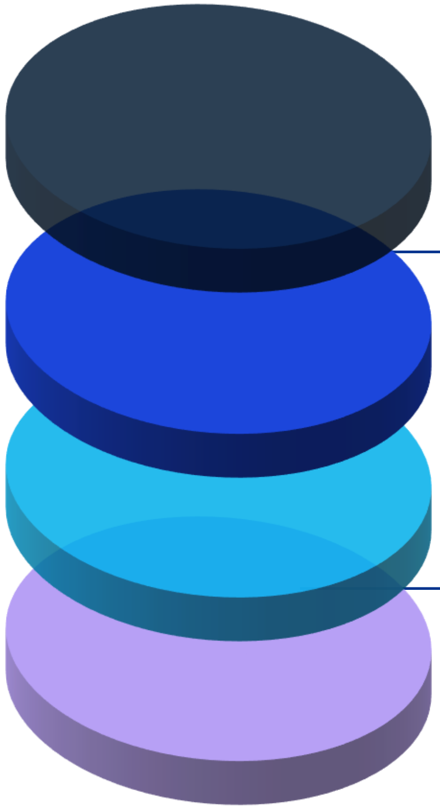
Anticipated Exit Activity & Drivers of Deal Flow

Expected Trajectory of Sponsor Exits

[Q] How would you characterize the trajectory of expected sponsor exits over the next 12 months

		Responses % Total
01	**Increase**	**54.8%**
02	Still too Uncertain	35.7%
	No Change	7.1%
	Decline	2.4%
	Other	-
	Total	**100.0%**

Key Survey Findings:
The majority of respondents expect a rise in platform exit activity within the next year due to portfolio maturation and anticipated economic improvements, while a fair portion nonetheless remains uncertain and cautious due to economic unpredictability and geopolitical factor



01 Optimism

Over 50% of respondents foresee an increase in platform exit activity within the next 12 months, driven by portfolio maturation and anticipated economic improvements

02 Uncertainty

Around 35% remain uncertain about the direction of exits. This reflects cautious optimism amidst economic unpredictability and geopolitical factors, leading to hesitance about committing to exit plans without clearer economic signals

KPMG

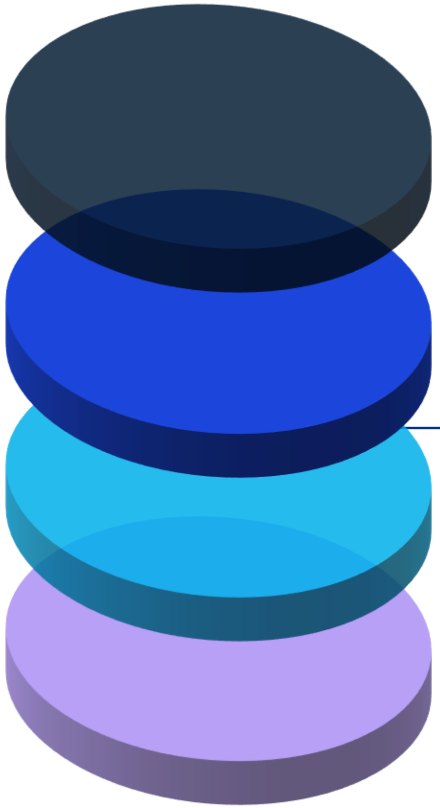
Anticipated Exit Activity & Drivers of Deal Flow

Primary Drivers of Deal Flow

[Q] What would you attribute to as having the strongest likely impact (positive or negative) on the direction of deal flow over the next 12 months

		Responses % Total
03	**Interest Rates**	**36.7%**
	Improving Macro	24.5%
	Uncertain Macro	18.4%
	Industry Specific	14.3%
	Presidential Election	6.1%
	Total	**100.0%**

Key Survey Findings:
A more stable economy provides a better environment for strategic acquisitions and exits, as predictability improves investor confidence



03

Interest Rate Environment

According to over 60% of survey respondents, the most critical factors anticipated to shape future deal flow are interest rates and improving macroeconomic conditions. The respondents believe that favorable interest rates could lower the cost of borrowing, thus potentially increasing investment activity

Additionally, improved macroeconomic conditions might boost business performance and investor confidence, leading to a higher volume of deals. As companies seek to capitalize on a more robust economic environment, these combined elements are expected to drive significant changes in the market dynamics and opportunities for transactions in the foreseeable future

Dealmakers believe we are poised for a rebound…

Private Equity Conference Feedback Summary

Operational Performance

- Emphasizing operational performance is crucial for boosting valuations
- Mixed results among portfolio companies indicate a need for strategic improvements to make them more attractive to prospective buyers

Geopolitical Risks

- Increased geopolitical risks could impact transaction volumes and valuations by creating uncertainty around the future performance of target companies
- Despite these risks, the recent focus on the U.S. Presidential election has had minimal direct impact on M&A decisions

Selective Bidding

- While sponsors report seeing more opportunities, they are becoming more selective in their bids due to aggressive valuations
- This selectiveness is driven by the supply-demand imbalance for quality assets, particularly in the mid-market ($5 to $10 million EBITDA)
- Sponsors are focusing on deploying capital smartly and strategically

Our take…

Sponsors will continue to be drawn to Business Services companies as the sector is generally seen as highly fragmented where many services subsectors continue to present opportunities for consolidation and economies of scale

KPMG Corporate Finance LLC – our take....

Eight fundamental catalysts for why Business Services M&A is poised to thrive over the coming quarters /

Economic Growth and Stability

General economic growth and stability create a favorable environment for M&A activity by fostering confidence and predictable market conditions

Access to Capital and Low Interest Rates

Ample access to capital, whether through equity markets, private equity, or corporate cash reserves, along with low interest rates that reduce the cost of borrowing, fuel M&A activity by making it easier to finance acquisitions

Corporate Profitability and Strong Balance Sheets

High corporate profitability and strong balance sheets provide companies with the financial resources necessary to engage in M&A, backed by healthy cash reserves and strong earnings

Technological Advancements and Innovation

The rapid pace of technological advancements drives companies to acquire innovative capabilities, digital tools, and tech-enabled services to stay competitive and meet evolving market demands.

Sector Growth and Demand

Strong growth prospects and increasing demand attract buyers looking to capitalize on trends while industry fragmentation presents substantial consolidation opportunities, allowing buyers to fill sector white space by expanding service offerings and improving market coverage through strategic acquisitions

Regulatory and Policy Change

Changes in regulatory landscapes and government policies can create opportunities and challenges that drive M&A activity as companies seek compliance and capitalize on policy-driven market shifts

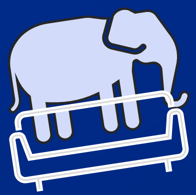
Globalization and Cross-Border Opportunities

The desire to expand internationally stimulates cross-border M&A activity as companies seek acquisitions in foreign markets to diversify their geographic presence and access new customer bases

Private Equity Activity and Strategic Realignment

Active private equity investment and strategic corporate initiatives, such as optimizing portfolios and pursuing core competencies, stimulate M&A activity by adding liquidity and competition to the market

Away from our survey… there is a new "elephant in the room…"



…how might the results of 2024's U.S. Presidential Election impact future M&A activity…

With Republican control of the white house, Senate and House of Representatives, both Wall Street and business leaders are now showing signs of optimism[(1)] over a favorable forward economic environment being more conducive to aggressive deal-making and corporate growth

- Since KPMG conducted its survey Americans took to the polls to settle a highly contested presidential election season
- The results of the election are now anticipated by industry analysts[(1)] to have the potential for marketed increases M&A activity, driven by anticipated deregulation and what is characterized a more pro-business administration

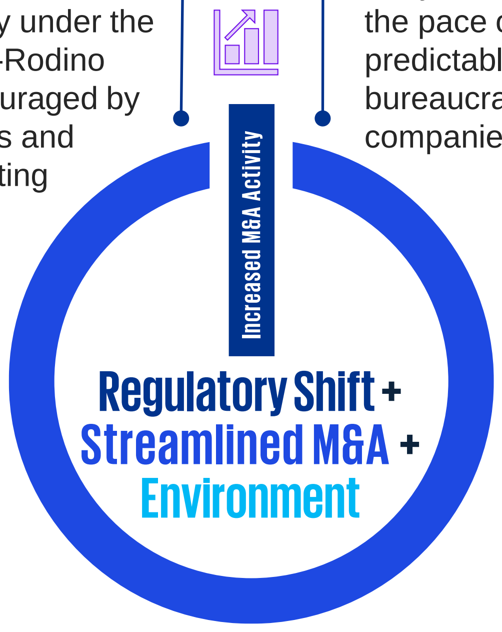
Three catalysts for anticipated improvement in M&A volume

Regulatory Shift

The new Republican administration is expected to implement lighter, more targeted regulations, shifting away from the stringent scrutiny under the previous administration and Hart-Scott-Rodino (HSR) rules. Investors are further encouraged by the prospect of decreased interest rates and corporate tax rates all of which are shifting expectations of a more favorable deal environment

Streamlined M&A Process

The expected reduction in HSR enforcement is likely to simplify approval processes, quickening the pace of mergers and acquisitions. A more predictable regulatory framework will reduce bureaucratic obstacles, making it easier for companies to pursue corporate deals



Pro-Business Environment

A pro-business regulatory stance will encourage long-term investments by minimizing bureaucratic hurdles. This environment is expected to drive economic growth and enable companies to allocate resources more strategically, fostering a dynamic M&A landscape

(1) CNBC: Published Thu, Nov 7 2024, updated Thu, Nov 7 2024 "Wall Street expects Trump presidency will unlock deal-making"

The impact of Presidential elections and on M&A activity ....a historic analytic assessment ...

[A] Percentage Change in M&A Deals by U.S. Acquirers

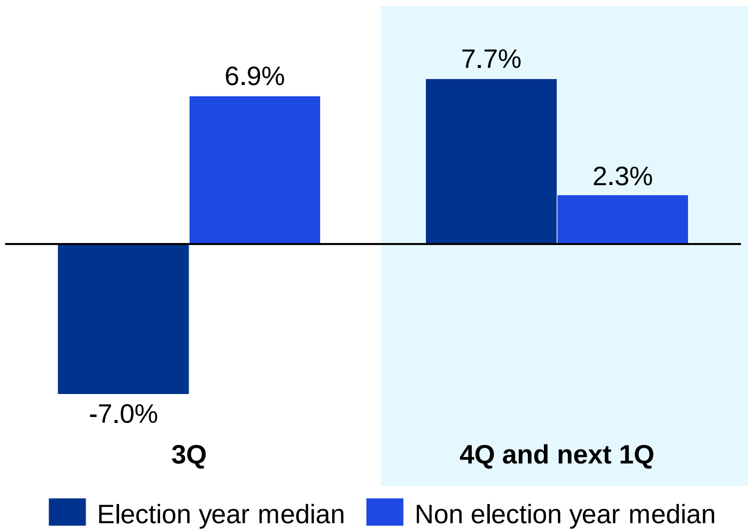
Deal volumes have been observed to generally decrease in the third quarter of an election year only to recover over the following quarters. This pattern may be attributed to the uncertainty and cautious approach adopted by investors during election periods, emphasizing the importance of strategically timing M&A activities around these election cycles

[B] Secured Overnight Financing Rate (SOFR) Trends

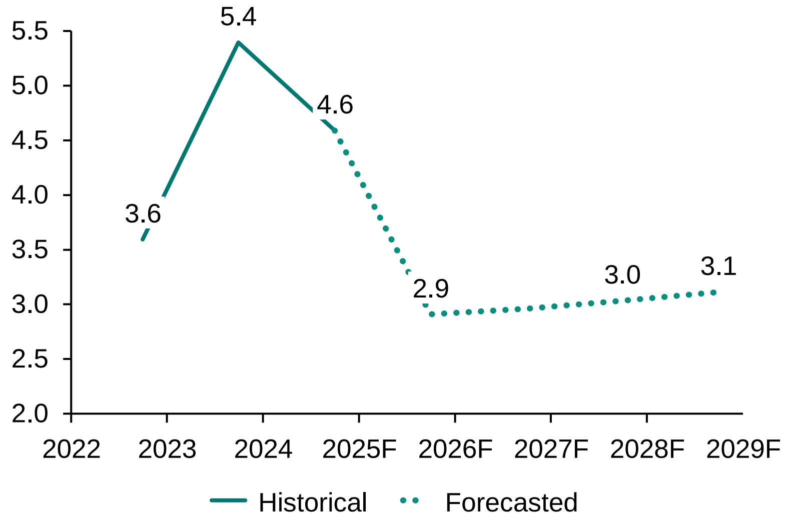
Corporate borrowing costs have begun a decline and are expected to continue to fall. The Secured Overnight Financing Rate (SOFR, benchmark interest rate which reflects the cost of borrowing cash overnight using Treasury securities as collateral) is projected to continue it fall indicating a more favorable environment for lending and borrowing over the next 12 months

A reduction in SOFR, coupled with the Federal Reserve's recent rate cuts aimed at managing inflation, are expected to enhance investor sentiment and stimulate M&A activity by lowering the cost of capital

[A] Percentage change in # of announced M&A by US acquirers: 1992 – 2022 (excluding 2008)(1)



[B] Historical and Forecasted SOFR Rates(2)



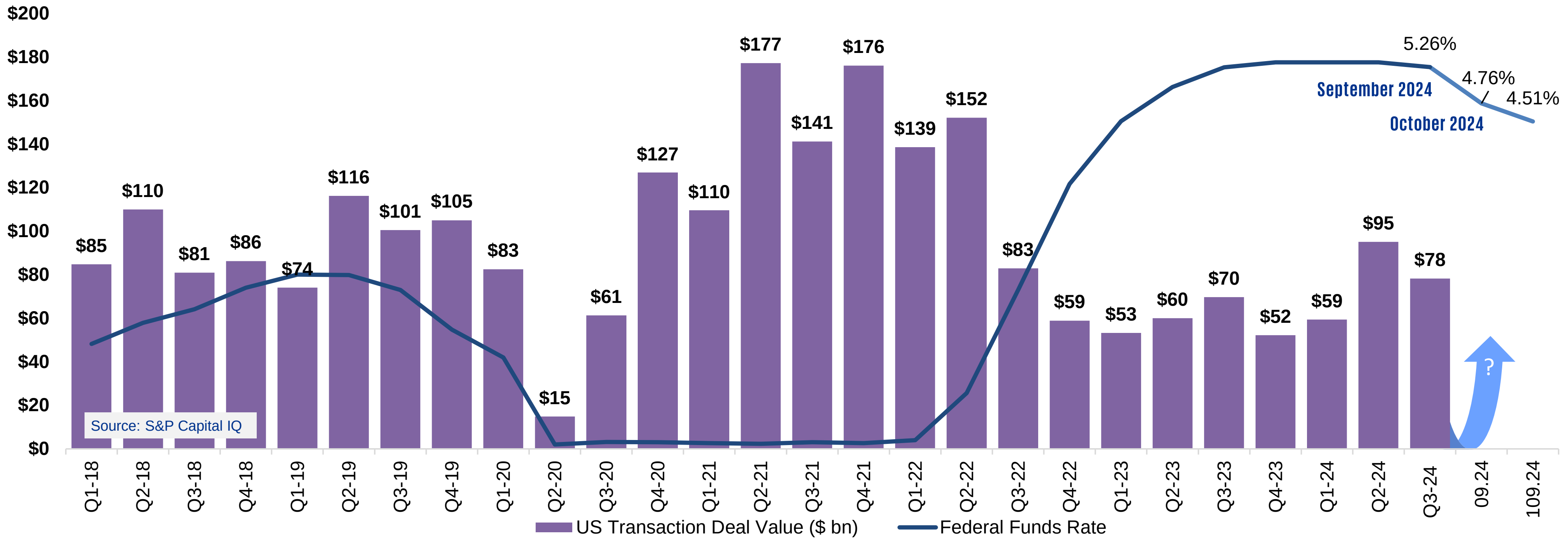
Note(s): (1) Sourced from Q3 Torys Quarterlies: 2024 US business and the 2024 election; (2) The Secured Overnight Lending Rate (SOFR) is the benchmark for interest rates on dollar-denominated loans and derivatives, the values for SOFR are much less susceptible to market fluctuations and manipulation; (3) Sourced form Pensford Financials Forward curve data as on 30 Jun 2024

Sources: Web articles and reports; all accessed in Oct 2024

Impact of Interest Rates and M&A Activity

Historical data shows that lower interest rates drive higher M&A activity by reducing the cost of capital. As borrowing becomes cheaper, companies can finance acquisitions more easily

Interest rates directly influence the cost of financing, which is crucial for M&A transactions. The recent decrease in interest rates has led to lower borrowing costs, making debt financing more attractive



Historically, deal volumes have aligned with shifts in interest rates, with lower rates typically driving higher M&A activity. The above historical data illustrates this relationship, underscoring how reducing interest rates could fuel increased deal flow

Overview of KPMG Corporate Finance

Introduction to KPMG Corporate Finance*

KPMG is a pre-eminent global M&A advisor, with leading positions across sectors & geographies*

Global Advisor Ranking*

2024		No. of deals
1	KPMG*	9,112
2	PwC	8,447
3	KPMG	6,340
4	Deloitte	5,887
5	Ernst & Young LLP	5,359
6	Rothschild & Co	5,176
7	Goldman Sachs & Co	3,747
8	Lazard	3,717
9	JP Morgan	3,684
10	Morgan Stanley	3,446

Industry Recognition

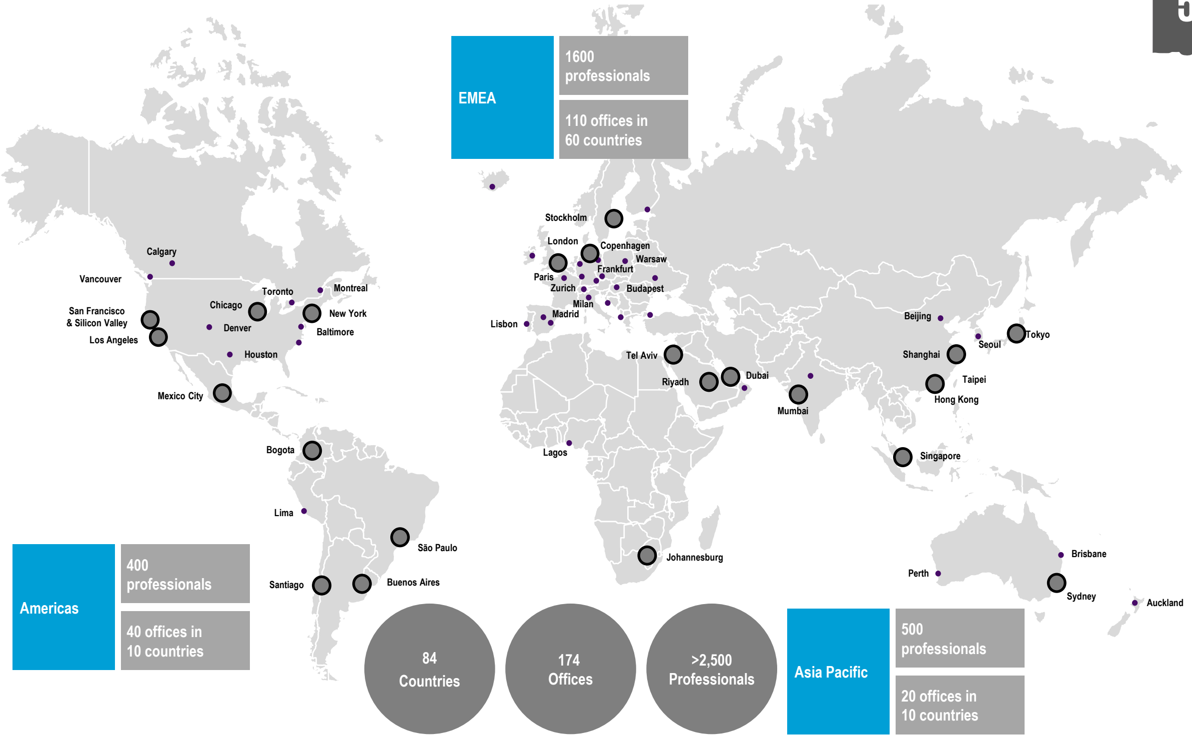
The M&A Atlas Awards – Corporate/Strategic M&A Deal Of the Year (Mid-Market) 2023

The M&A Atlas Awards – Software & IT Deal Of the Year Award (Mid-Market) 2023

The M&A Atlas Awards – Middle Market Investment Bank of the Year 2021

Middle Market Services with Deep Industry Expertise

Advisory Services	Business Services	Consumer Markets	Energy & Resources	Financial Services
Debt & Equity Financing				
M&A	Health & Life Science	Industrial Markets	Real Estate	Technology, Media & Telecom
Special Situations				
Fairness Opinions				
Private Equity Coverage				



583 global transactions in 2023

KPMG Deal Advisory Solutions
(built to solve challenges and maximize outcomes)

- **Middle Market M&A**
- **Strategic and Commercial Due Diligence**
- **M&A Planning, Integration and Separation**
- **Financial Due Diligence**
- **M&A Tax**

- We are consistently ranked as a leading global middle market M&A advisory platform by number of deals globally:
  - **8,500** closed transactions over the last 20 years
  - **2,500** M&A professionals worldwide
  - **84** Countries **174** offices globally
  - **10** dedicated industry verticals

We **solve complex transaction challenges** across the middle market with solutions designed to **maximize outcomes**

*Represents the global Corporate Finance practice of KPMG International's Network of independent member firms

KPMG

Important Notice

The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

The information contained in this newsletter is of a general nature and is not intended to address the circumstances of any particular individual or entity including their investment objectives or financial needs. In preparing this newsletter, we have relied upon and assumed, without independent verification, the accuracy and completeness of all information available from public sources. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act or rely on the information in this newsletter without appropriate professional advice after a thorough examination of the particular situation. The information contained in this newsletter may not be representative of the experience of other clients and does not constitute a recommendation, offer, or solicitation to buy, sell or hold any security of any issuer. Past performance does not guarantee future results.

Some or all of the services described herein may not be permissible for KPMG audit clients and their affiliates or related entities.

kpmg.com/socialmedia