CBIZ
PRIVATE EQUITY
ADVISORY

Q1
2024

M&A MARKET UPDATE

CONTENTS:

Deals Closed (#): 1,382 (QoQ ↓ 25%) Deals Closed Value: $145.4B (QoQ ↓ 15%) PE Fundraising: $76.8B (QoQ ↓ 42%)

M&A MARKET PERSPECTIVE

M&A in 2024: Let's Wait and See

Deal activity appears to have leveled off, and while current levels are nowhere near the highs of 2021, quarterly results still exceed pre-pandemic levels. However, the same cannot be said for exits. Holding periods are expected to continue growing as firms are forced to keep waiting for desired exit values. To stave off the disruption to industry growth (and satiate LPs pressuring for a return of capital), market players continue to find ways to extract and utilize investment dollars to keep the M&A engine turning through its interdependent life cycles.

Secondaries Fundraising Paves the Way for Exits: Secondaries continue to be a well-accessed vehicle to secure liquidity without force-selling on unfavorable terms. Q1 2024 saw almost 30 continuation fund exits, a 108% increase over Q1 2023. The primary driver of that growth has been LP-led deals (compared to GP-led secondary activity, which remained flat). For LPs, secondaries provide access to their capital and an opportunity to rebalance portfolios. For GPs, secondaries provide access to an extended exit timeline on current portfolios and an avenue to deploy the $78B in secondaries fundraising from 2023. As the popularity of secondaries grows, the next evolution is specialization to better align the interests between GPs and LPs.

The M&A Market is Poised for Recovery, but not Showing Results Yet: Q1 2024 resulted in a 25% decline in deal count compared to the prior quarter, excluding unconfirmed deals. Of the deals that were completed so far in 2024, those in the lower middle market range, under $25M, still held the majority. Healthcare add-ons continue to plummet, hitting their lowest deal count since 2020, while other industry sectors remained proportionally stable. Challenges with healthcare deals were expected as the industry maneuvers rising labor and debt service costs coupled with flat or declining reimbursement and large physician practice management platforms struggling for exit opportunities. Platform deals across all sectors remain scarce, given the unchanged access to leverage, which is strangling the ability to execute on larger LBOs. Despite these preliminary results, macroeconomic headwinds are diminishing as the market surmises that improved liquidity conditions are on the horizon, which should contribute to the broader M&A recovery.

Divestitures / Carveouts have Their Time in the Spotlight: As of Q1 2024, carveouts / divestitures made up 12.6% of all PE buyouts, up from an all-time low of 5.7% in Q4 2021, and the right market conditions are in place for the upward trend to continue. Carveouts / divestitures fell out of favor when PE and corporations took advantage of the low rates and rising valuations of 2021. However, when 2022 brought on increased interest payment obligations, cash flow-rich companies capable of supporting those higher borrowing costs became more desirable. Businesses carving out / divesting assets tend to have more mature business models, be less expensive than other buyout targets, and are more stable, making them more bankable in an environment where lenders are so risk-averse. Acquisitions of carveouts / divestitures also align well with PE's shift to a value-oriented investing strategy, where GPs are focusing on operating leverage and lower entry valuations to achieve a higher exit multiple compared to the popular buy-and-build strategy. Against the current market backdrop, acquisitions of divested / carved out assets provide investors an opportunity for more control over the outcome of their managed returns, rather than relying on market trends to boost value. And while platform deals are still struggling to get off the ground, carveouts are particularly attractive to those seeking platform acquisitions.

Mark Coleman
Managing Director /
National Practice Co-Leader
Deal Advisory
Private Equity Advisory

Seth Goldblum
Senior Managing Director
Private Equity Advisory

DEAL METRICS UPDATE
Q1 2024 By the Numbers

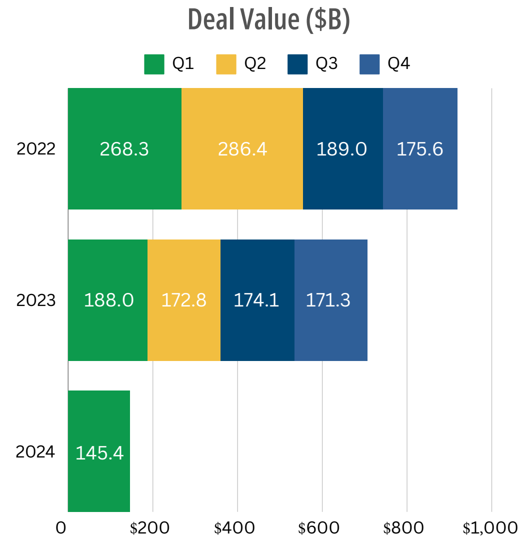
Steady as We Go

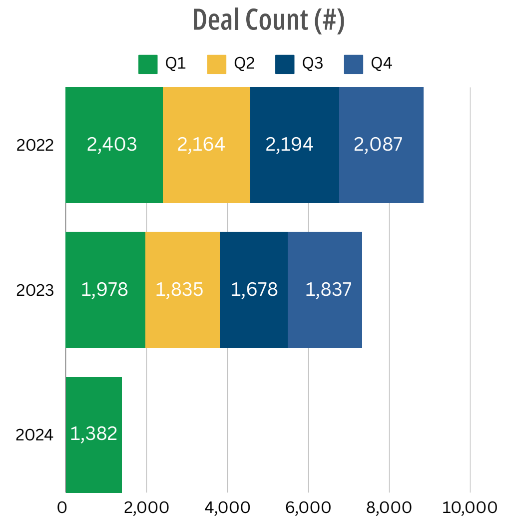
While not expected to return to the highs of 2021, Q1 2024 is the 7th quarter that, in hindsight, shows a trend of stabilization in deal activity. After revised Q4 2023 estimates, deal activity appears to be moving largely sideways. By comparison, QoQ deal value is down 15%. These results are not surprising given the larger portion of deal activity attributable to characteristically smaller deal types (i.e., growth equity and add-ons). Larger platform acquisitions continue to wait in the wings for their resurgence, bolstered by the anticipation (or, dare we say, "hope") of lower interest rates.

2023 discussions centered around sunsetting debt terms and the strain on company cash flows resulting from refinanced debt vehicles at debilitating interest rates. While the bank-led Broadly Syndicated Loan (BSL) market rebounded in Q1 2024 with new loan issuances to PE-backed companies (from $9.8B in Q4 2023 to $23.4B in Q1 2024), the turnaround pales in comparison to the BSL-funded loan values in refinancing, totaling $51B. This shift is noteworthy given that new loans have historically outnumbered refinance activity at least four-to-one. The surge comes as PE borrowers are motivated to improve leverage ratios and the demand for collateralized loan obligations increases.

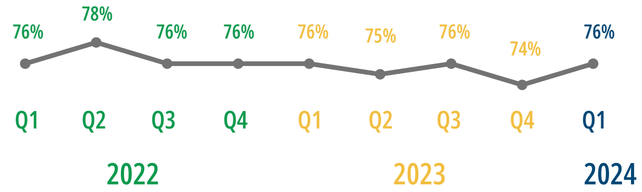
Add-on activity, as a percentage of total deal count, held firm in Q1 2024, in line with historical quarters of the last two years. The dominant deal type is a testament to the strategic focus on consolidation and operational synergies across Private Equity, a pivot widely adopted when platform and LBO deals were unattainable. However, if interest rate reductions materialize, an upswing in larger platform transactions would be naturally expected.

Quarterly PE Deal Activity





Quarterly PE Add-On Activity (% of Deal Count)

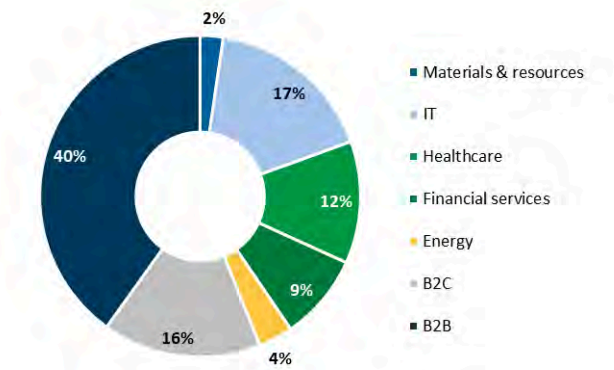


Source: PitchBook Data, Inc. US PE Breakdown

DEAL METRICS UPDATE
Q1 2024 By the Numbers

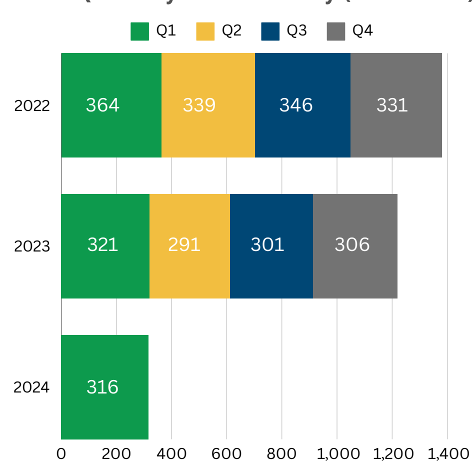
Quarterly Deal Activity Breakdown

PE Deals by Sector (#)



Quarterly PE Middle Market Fundraising ($B)

Quarterly PE Exit Activity (Deal Count)



Source: PitchBook Data, Inc. US PE Breakdown

The Exit Linchpin holds Firmly in Place

Q1 2024 saw a decline in exit value (almost 23% below the pre-pandemic average) and a nominal 0.9% increase in QoQ exit count. Corporate strategic buyers accounted for nearly 69% of total Q1 2024 PE exits (a 15%+ increase over the two-year average) and 48% of exit value. Sponsor-to-sponsor exits accounted for 52% of exit activity and 31% of exit value. The sponsor-to-sponsor exit value represents a 10-year low, excluding one pandemic quarter in 2020. The continued deterioration of the quarterly two-year average demonstrates the ongoing challenges of exiting to other GPs. While market pressures do not lend themselves to improved exit conditions near term, increased usage of continuation funds continue to provide alternatives to traditional exit routes. Trends suggest we haven't seen the bottom for exits or are closer to an environment of force-selling, which has the potential itself to drive additional M&A activity in the latter part of the year.

Despite a Liquidity Lockup, Fundraising Continues

$76.8B was raised in Q1 2024, a nominal 4% decline compared to Q1 2023. While these results are solid and consistent, the effort to yield them is greater – funds are averaging 16.8 months to close, compared to 11 months in 2022, and the time between fund raises is lengthening, 2.9 years through Q1 2024, up from 2.7 years in 2022. Ironically, when considering all other PE activity market trends, firms continue to see success via higher step-ups from their predecessor funds. As highlighted last quarter, fundraising is often a lagging indicator, and we expect the slump impacting other data points to be felt here eventually. For now, Q1 2024 fundraising is not indicative of the challenges plaguing other market corners.

STATE OF THE ECONOMY
Inflation, Yields, and Jobs, Oh My!

Through the first part of this year, the American economy continued the pattern of a tight labor market and elevated prices. As is the case in life, not everything in the economy goes as planned. This year, again, is also giving us its share of unforeseen and unintended consequences, from policy to investor behavior to geopolitical complexities.

- **The market has repriced its rate expectations:** In an about-face, the fed funds futures market revised its views from six cuts in January to under two cuts in mid-April. Driving the revision were stubbornly high inflation prints and a resilient labor market. Since the Fed is "data dependent," the latest numbers imply a higher-for-longer policy.

- **A Tale of Two Surveys:** The unemployment rate remains strong, hovering near all-time lows. However, there is a divergence in the two surveys taken by the Bureau of Labor Statistics. The widely followed Establishment Survey recorded a gain of 303,000 jobs in Nonfarm Payroll in March and a gain of 2.9 million jobs since March of 2023. The less-trodden Household Survey shows a loss of 1.4 million full-time jobs, a gain of 2.9 million part-time jobs, and nearly half a million Americans now hold multiple jobs to make ends meet compared to a year ago.[1]

- **Yields, yields, yields:** The benchmark 10-year U.S. Treasury yield continues to rise in 2024. As the Treasury rate rose, corporate credit spreads compressed in Q1 2024. One explanation is that investors can't seem to get enough of the attractive total yield on corporate bonds, and the unsatiated demand for income keeps the spreads narrow and the borrowing environment compelling for American corporations. Perhaps investor appetite for total income is distorting the credit spread's reading of the risks in corporate lending.

- **Is the Fed inadvertently causing inflation?** The road to the Fed's 2% inflation target has been tough. About 30% of the Consumer Price Index (CPI) calculation is housing / rent, and rent prices need to stabilize for CPI's meaningful downward progress. Unfortunately, the rapid rate hikes have kept many homeowners with low mortgage rates on the sidelines, resulting in a tight supply of existing homes for sale. High mortgage rates and high home prices have kept would-be homeowners off the market, increasing the current demand for apartment rentals. As such, upward pressure remains on rents, which, in full circle, keeps CPI sticky.

- **Public market price check:** Fueled by the promise of artificial intelligence and the "soft landing" narrative, equity markets soared in Q1 2024. Markets can sustain high valuations for a long time, and momentum is your friend until there is a catalyst for a reversal. Almost on cue, Q2 2024 ushered in market volatility as tensions in the Middle East escalated. The ongoing conflict continues to be a source of uncertainty for investors.

Looking ahead, all eyes are on the Fed. The three rate cuts communicated after the March FOMC meeting seem to be obsolete for the data-driven Fed, and some investors are whispering about the possibility of another hike. With large banks feeling the pinch of high rates and an inverted yield curve, an increasingly hawkish Fed stands in the path of a soft landing of the American economy.

---

[1] Bureau of Labor Statistics, The Employment Situation, released April 5, 2024

Anna Rathbun
Chief Investment Officer
Retirement & Investment Solutions
CBIZ Investment Advisory Services, LLC

WHAT'S TRENDING

Mind the Gap: Renewed Strategies for Addressing Valuation Differences Between Buyers and Sellers

As of the end of Q1 2024, many of us watched as the major stock market indices continued to reach record highs. But are private businesses keeping pace? On a micro-level, we're continuing to hear from many business owners, often second/third/fourth generation companies, that they are receiving unsolicited offers of interest, which in turn piques owners' curiosity about where their company valuations lie.

Their curiosity is well placed, given the recent market conditions. Starting in the second half of 2022, there was much speculation that valuations would be adjusted downward as costs to acquire (i.e., increased interest rates) were suddenly much higher, and both buyers and sellers would need to recalibrate their expectations. Despite this rise in acquisition costs, the public markets have helped keep sellers' expectations elevated while the cost of capital has remained high, albeit stable. Buyers continue leveraging more creative deal structures to bridge valuation gaps. Amongst this backdrop, we're continuing to see, more and more, the use of non-cash forms of purchase consideration to bridge the expectations of buyers and sellers.

This has been especially evident in acquisitions involving financial sponsors and includes vehicles such as earnouts / contingent consideration, rollover equity, and seller notes. While used as a tool to bring a buyer and seller closer to agreement, these instruments have the beneficial side effect of aligning post-close financial motivations of both buyers and sellers, making these non-cash tools even more desirable to the acquirer.

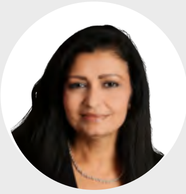
- **Earnouts / contingent considerations** are the most commonly seen value-bridging mechanism in the marketplace, as business owners put forward significant growth targets for revenue and cash flow, and buyers challenge owners to "prove it." This mitigates risk for the buyer and defers payments to the seller.

- **Rollover equity,** more often seen in private equity-backed platform acquisition situations, is most impactful when there is a transition period during which the seller continues to run the business. In these instances, the seller receives partial liquidity from the initial sale and a "second bite at the apple" when the acquirer looks to exit a few years later.

- **Seller notes,** which are less commonly seen, are more often used by conservative sellers who want to generate additional return on their investment post-sale. These promissory notes usually have below-market interest rates and are typically subordinated to the company's term debt.

Each of these non-cash forms of purchase consideration, while helpful in the dealmaking process, are also important and impactful to the post-close financial reporting of the acquiring company. Each instrument needs to be recorded at fair value as of the transaction date, which is determined as part of the post-close valuation assessment.

While non-cash consideration is not a novel concept, its renewed popularity in recent years demonstrates its effectiveness amidst current market conditions.



Deepa Menon
Senior Managing Director
CBIZ Valuation Services

Todd Mitchell
Managing Director
CBIZ Valuation Services

CBIZ PRIVATE EQUITY ADVISORY

Deal Advisory

- Transaction Due Diligence
- Tax Due Diligence
- Tax Planning & Structuring
- Merger Integration
- Preparation for Exit

Performance Enhancement

- FORWARD™ Program for Post-Transaction Finance
- Accounting & Finance Optimization
- Transaction Accounting & Valuation Services
- Budgeting & Strategic Planning
- Financial, Operational & Cash Forecasting
- Performance Reporting & BI Solutions
- Profitability Improvement
- Executive Search
- Interim Talent

Mark Coleman
Managing Director / National Practice Co-Leader
Deal Advisory
mark.coleman@cbiz.com

Clare Yuritch
Managing Director / National Practice Co-Leader
Performance Enhancement
cyuritch@CBIZ.com

Patrick Martin
Managing Director / National Practice Co-Leader
Deal Advisory
patrick.martin@cbiz.com

Kyle Ludwig
Managing Director / National Practice Co-Leader
Performance Enhancement
kludwig@CBIZ.com

Seth Goldblum
Senior Managing Director
sgoldblum@cbiz.com

Dave Enick
Lead Managing Director, Operations
denick@cbiz.com

Tim Vieira
Lead Managing Director, Sponsor Coverage
tvieira@cbiz.com

CBIZ Private Equity Advisory By The Numbers

400+
PRIVATE EQUITY CLIENTS

2,000+
PORTFOLIO COMPANIES SERVED

110+
PROFESSIONALS