CAPITAL MARKETS UPDATE

Middle Market M&A

Q2 2020

Capstone Headwaters

CEO CORNER: MARKET COMMENTARY

"… the anticipated carnage in the M&A markets showed up quickly in Q2 … deal makers are against the ropes taking a beating but are showing remarkable adaptability and resiliency."

In some ways, this economy is difficult to make sense of. It is dislocated and full of mixed messages. Amidst global health concerns, trade tensions and geopolitical unrest, the U.S. public equity markets posted a sharp recovery in Q2. Pumping liquidity rallies large-cap equity markets, but today's stock prices do not reflect the realities of grass roots business.

The M&A market rolled into 2020 off one of the top four performances in history, but COVID-19 hit early in the year (January 9), was declared a pandemic in Q1 (March 11), and approached 200k+ cases per day globally by the end of Q2 (June 28). Carnage in the M&A markets showed up quickly in Q2.

Deal makers are against the ropes taking a beating but are showing remarkable adaptability and resiliency. The numbers in this report clearly tell the story for Q2. To kick it off, I would like to share experiences, point out emerging trends and risk some crystal ball thoughts.

Q2 represented existential challenges for many businesses, so our collective focus shifted internally to protecting clients and employees while ensuring liquidity, cutting costs and rethinking business models. These efforts were largely completed in Q2. Now settled into remote work, the big question in the M&A market remains: "Can transactions that were not already in process pre-COVID be closed?" The answer is: "Yes, but the market is not open for everyone." As we shared in the last update, we are expecting the M&A markets to recalibrate by Q4 with a new wave of transactions.

We are officially in "test market" mode now in Q3 and Q4, closely watching closing rates. In the meantime, our Top-10 emerging trends are:

- ↓ Restricted leverage pushing valuations down ~1x to 1.5x
- ↑ Increase in restructurings and distressed M&A
- ↓ Sluggish activity with strategic acquirers
- ↑ Increase in spin-offs and carve-out activity from large strategics
- → Shift from PE platform acquisitions to portfolio add-ons
- ↓ Dramatic slowdown in PE exits and fundraising activities
- ↑ Rise of the SPAC for larger middle market transactions
- ↑ Strength in Technology, Consumer, Education, and Healthcare sectors
- ↑ Sharp increase in deal pipeline preparing for Q3/Q4 launch
- → Talent on the move from firm-to-firm across all levels

Looking ahead, I am certain of two things: (1) deal making (and in general, the world) will remain constrained until scientists develop a pharmaceutical solution to COVID, and (2) we will continue to see new forms of adaptability and innovation across the deal market ecosystem (and in general, the world) as we adapt to a new normal. I also think the COVID era will accelerate the shift from long-term value investing to IP-related investing.

As a CEO and business owner myself, I am managing to a longer horizon – more towards the end of 2021. Once this market turns with COVID behind us and tremendous pent-up demand, the pace will be fierce. By then, the world will have hopefully worked through other issues beyond the pandemic and the economy. We are playing to that window.

My best,

John Ferrara

MIDDLE MARKET OUTLOOK

Q2 2020 TAKEAWAYS & THEMES

We are pleased to present our Q2 2020 Capital Markets Mergers & Acquisitions Update with a look into key trends and statistics for the recently closed quarter.

Middle market M&A activity has declined significantly through Q2 as COVID-19 severely impacted the number of acquisitions.

- Buyers focused internally to mitigate operational and financial disruptions due to COVID-19
- Lenders concentrated on protecting their loan portfolios
- Private equity focused on the health of platform investments while primarily pursuing smaller add-on acquisitions
- Capstone has maintained a healthy deal pipeline of quality targets through Q2 despite seller and buyer hesitancy due to uncertainty

M&A activity is expected to improve towards the end of 2020 and into 2021 aided by factors including:

- An arsenal of private equity dry powder that needs to be deployed
- Buyers seeking high-quality targets at lower valuations
- Forecasted imbalance of supply and demand of targets seeking to sell

Activity will be negatively affected by the following:

- Interruptions in the U.S. economy due to COVID-19 including lower levels of consumer and CEO confidence
- Instability in the domestic and global political climates

For information on the themes and trends discussed in this report, or to find out about Capstone's full suite of integrated services, please contact us.

Capstone Headwaters

TABLE OF CONTENTS

Q2 2020 BY THE NUMBERS

21.6% ⇩
DECREASE IN YOY DEAL VOLUME
M&A activity stalled substantially as middle market businesses combated the peak of COVID-19 disruptions in Q2

3.3x ⇩
AVERAGE DEBT MULTIPLE
Debt financing has pulled back dramatically in Q2, falling to 3.3x EBITDA, representing a significant decline from 4.0x in Q2 2019

9.5x ⇩
EBIDTA MULTIPLE, $250-$500MM
EBITDA multiples in the $250-$500mm segment fell to 9.5x but remained above other enterprise value ranges

798 ⇩
NUMBER OF PE TRANSACTIONS
Following depressed PE transaction volume in Q1, PE deal-making declined further in Q2 amounting to a YOY decrease of nearly 50%

$60.3M ⇧
AVERAGE DEAL VALUE
Average deal value for acquisitions among private companies increased modestly compared to Q2 2019, rising to $60.3 million

836 ⇧
NON-U.S. BUYER TRANSACTIONS
Foreign buyers accounted for 14.3% of total transactions, a decline from the previous quarter but an increase of 5.7% YOY

$1.2T ⇧
PE CAPITAL OVERHANG
Private equity dry powder remains at elevated levels, providing a healthy backdrop for the resumption of PE deal activity

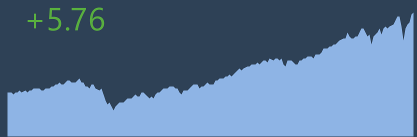
71.4% ⇧
ADD-ONS AS A PERCENT OF LBOs
PE firms continued to utilize add-on acquisitions through Q2, which have amounted to a record proportion of buyouts

56.5% ⇧
EQUITY CONTRIBUTION
Equity contributions reached historic levels in Q2 at 56.5% as buyers have accepted greater equity share to complete deals

CAPITAL MARKET DASHBOARD

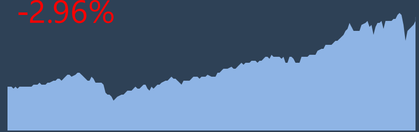
YTD EQUITIES

S&P 500
+5.76



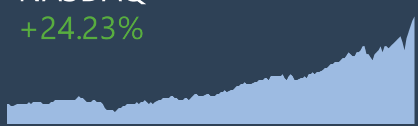
Last	1Y %	P/E LTM
3,374.9	*+17.7*	*25.2*

Dow Jones Industrial
-2.96%



Last	1Y %	P/E LTM
27,629.9	*+6.0*	*22.5*

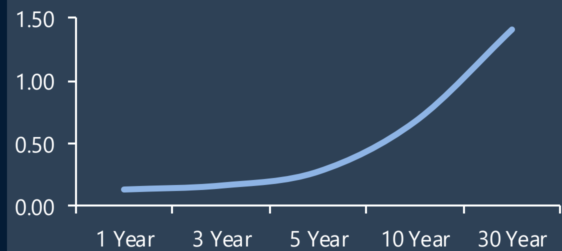
NASDAQ
+24.23%



Last	1Y %	P/E LTM
11,264.9	*+39.3*	*35.3*

FIXED INCOME

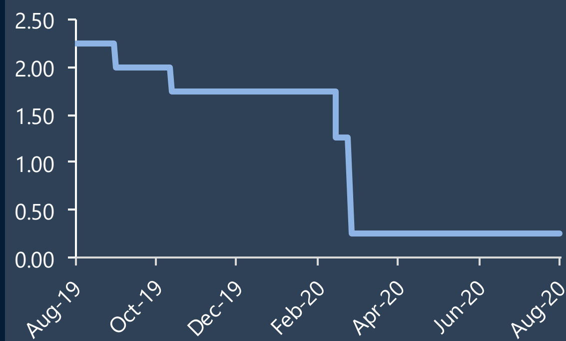
U.S. Yield Curve



1Y	3Y	5Y	10Y	30Y
0.128	*0.159*	*0.271*	*0.673*	*1.412*

POLICY RATE

Federal Funds Target Rate



ECONOMIC INDICATORS

GDP, LABOR MARKET, & INFLATION

	Last	YOY	
GDP	*-32.9%*	*-22.9%*	
Consumer Confidence	*92.6*	*-31.8%*	
Unemployment	*10.2%*	*+6.5%*	
Consumer Price Index	*267.7*	*+1.6%*	

HOUSING MARKET

Housing Starts	*1,496.0*	*+23.4%*	
Total Construction	*1,355.2*	*+0.08%*	

PMI & NMI

Purchasing Managers	*54.2%*	*+2.9%*	
Non-Manufacturing	*58.1%*	*+3.3%*	

RETAIL

Retail Sales	*$536.0*	*+2.7%*	

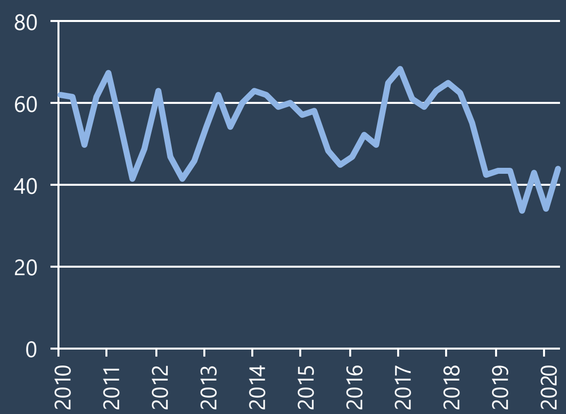
Source: FactSet as of 08/19/20

CORPORATE DASHBOARD

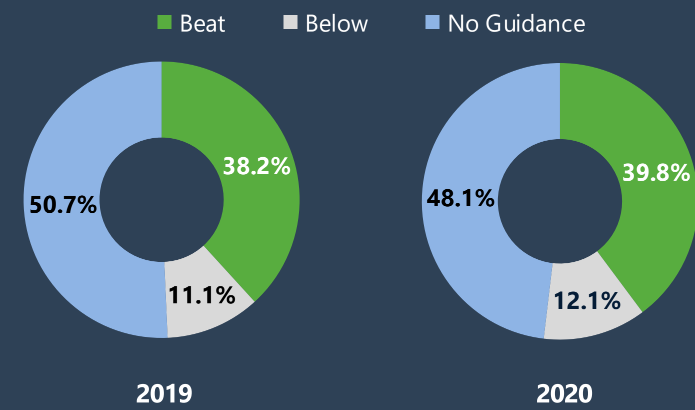
CEO CONFIDENCE

"Without substantial containment of COVID-19, widespread uncertainty will continue being the dominant cloud hanging over America's CEO community."

- Lynn Franco,
Senior Director,
The Conference Board

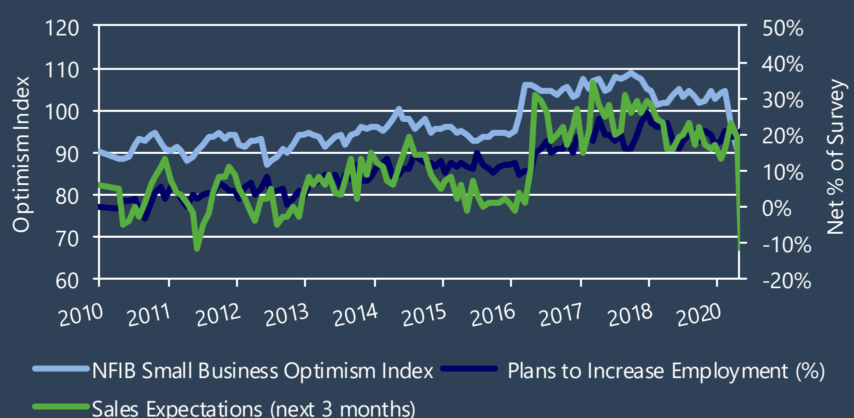


S&P 500 EARNINGS PERFORMANCE

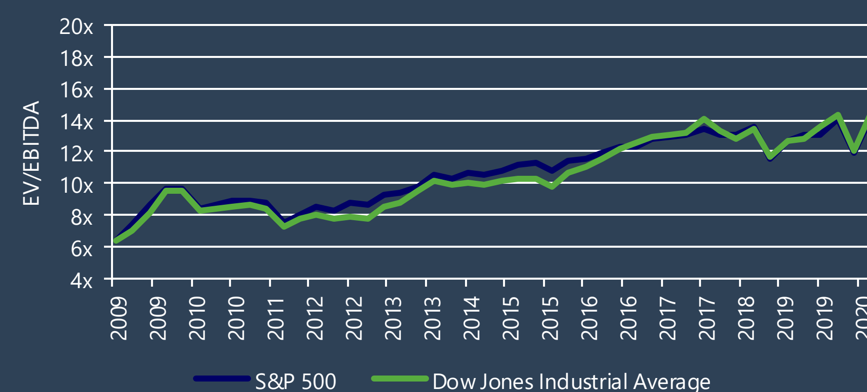


S

NFIB PRIVATE BUSINESS EXPECTATIONS



S&P 500 VS. DJIA EBITDA MULTIPLES



LEVERAGED FINANCE CONDITIONS

KEY MARKET STATS

- **Volume -** Middle market (MM) lending activity screeched to a halt in Q2 and new issuer volume has only recently returned. However, the focus has been on opportunistic, well-structured financings involving fundamentally sound businesses in recession-resistant sectors. Companies in cyclical sectors will still be able to find new capital, but on investor-friendly terms that reflect today's higher loan pricing, conservative valuations, and creative risk-return structures.

- **Pricing -** The lack of MM activity has afforded limited price visibility; anecdotally, market participants suggest pricing has widened approximately 75-150 basis points for borrowers minimally impacted by the pandemic, while yields for previously strong credits that have been directly impacted by the economic shutdowns have increased into the double digits. This commentary is consistent with the yield increases seen in the Large Corporate market (see adjacent chart).

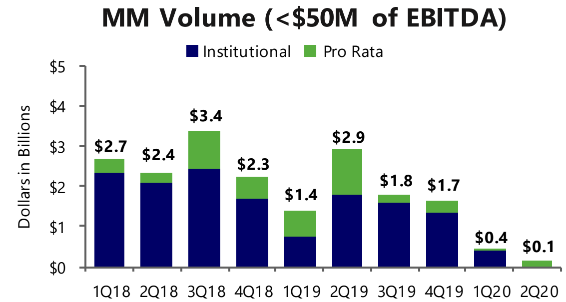
- **Leverage -** Leverage levels are highly dependent on industry sector and company performance through the COVID-19 crisis. However, market feedback indicates leverage for new loans is 0.5-1.5 turns below pre-COVID levels.

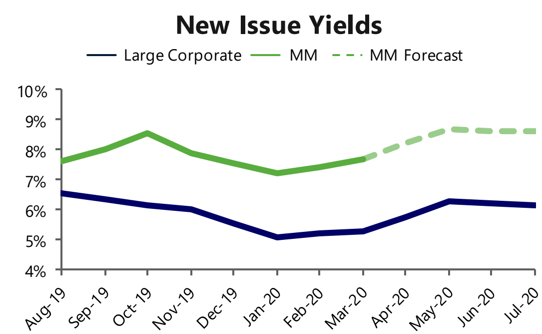
QUARTERLY MARKET OBSERVATIONS

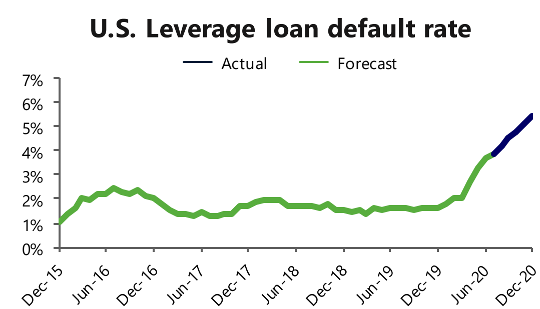
- **Erosion in Credit Quality.** With limited new deal activity, the opaque MM Leverage Lending market has provided limited relevant data points since the onset of the COVID-19 pandemic. However, given the similarities in credit quality, we can derive valuable insight between the broadly syndicated Leverage Loan market and the MM. As a result, key market indicators point to a **sharp decline in credit quality** as borrowers navigate through the economic fallout of the COVID-19 pandemic and the various measures taken to limit its spread.

- **Increasing Defaults.** The second quarter gave us a first look at the fallout from the COVID-19 crisis for U.S. leveraged loans, as the first of the pandemic-related defaults began to occur.
  - Overall, the default rate of U.S. leveraged loans increased to 3.7% at the end of June, almost double the rate at the end of March (2.0%).
  - The 3.7% default rate is the highest since September 2010, however, remains much lower than the historical levels seen during the Great Recession (8.5%+), likely as a result of the unprecedented governmental policy and stimulus response that appears to have stabilized markets for now.
  - As the pandemic persists and stimulus efforts abate, fund managers expect default rates to tick higher and reach 5.3% by the end of 2020.
  - Certain industries were hit harder than others, with Telecommunication comprising ~20% of leveraged loan defaults, followed by Oil & Gas (~13%) and Retail (~12%).

- **The Takeaway.** The deterioration of credit quality in the broader U.S. Leveraged Lending market is illustrative of current trends in the MM. As a result, the increased strain on MM borrowers and issuers is expected to lead to **reduced market liquidity and more investor-friendly terms** in the near-term as the true impact of the COVID-19 pandemic is realized.







Source: S&P Global Market Intelligence

BANKRUPTCY AND RESTRUCTURING OVERVIEW

CURRENT MARKET ENVIRONMENT

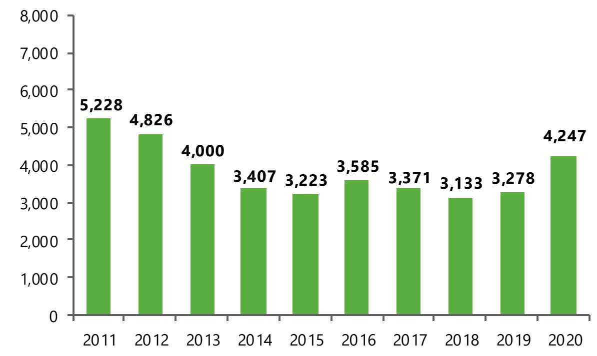
- **The commercial fallout and substantial headwinds from COVID-19 and its related lockdowns continues to wreak havoc throughout many sectors of the economy, with little clarity for what the future holds.**
    - Commercial Bankruptcy filings through July 2020 are up 30% year-over-year and represent the largest number of filings year-to-date since 2012.
    - NYU's Edward Altman's "Z-score," a leading predictor of large commercial insolvencies, forecasts a likely doubling (30 to 60) of bankruptcy filings for companies with more than $1 billion in assets by the end of the year.
    - The uptick in commercial filings is currently driven by predominantly large cap companies in the Retail and Travel sectors such as J.Crew, J.C. Penney, and Hertz.
    - **A wave of small and mid-cap bankruptcies is likely to pick up in Q3 & Q4, which could be deferred (but not necessarily avoided) by additional Congressional relief.**

NAVIGATING THE CHOPPY SEAS AHEAD

- **Applying novel strategies in novel times. For companies,** business plans will be re-evaluated and re-written. Footprints will change. Capital and technology improvements will be necessary. How companies adjust to the "new-normal" will dominate owner's and management's focus for the foreseeable future. For **lenders and creditors**, collateral bases and values are rapidly changing. New money will be needed for liquidity support and capital improvements. Forecasts based on pre-COVID-19 metrics have become stale. Lenders will be forced to find the proper balance between preserving value, supporting a borrower's continuing operations, becoming adequately protected, and avoiding overly aggressive actions that could impair value and thus their recovery. And for **landlords,** the pandemic only hastened many retail landlords' demise. Yet now, office, recreation, and entertainment-focused landlords must adjust to a shifting environment and new regulations and decide whether to work with delinquent tenants or take aggressive action like evictions. "Is there a better alternative?" will guide many landlord's approach.

- **How will the Bankruptcy Courts and processes react?** As boilerplate bankruptcy guidelines and rules become unworkable, or even obsolete in today's climate, many companies must decide whether seeking the protection of the Bankruptcy Code is the best course of action to preserve value and hope. For instance, will Courts provide more leeway to non-traditional approaches during these non-traditional times? Add to that the ever-changing uncertainty of finding new financing (traditionally a challenge for Debtors anyway) or meeting covenants post-filing, a key gating factor for companies entering bankruptcies is being raised now far more: Is there more value in an immediate liquidation or a going-concern? To that effect, constituencies must consider that:
    - Sales timelines have shrunk. While bankruptcy can allow for quick sales, some debtors are finding that days and weeks matter more than ever.
    - Weekly budgets and forward-looking financial statements are primary pieces of information and decision makers in bankruptcy. The sudden and changing reliability of those has thrown even more uncertainty into the process.
    - Will Congress allow companies in Chapter 11 to receive PPP Loans in the next round of stimulus and relief?
    - How does the newborn Sub-Chapter 5 Bankruptcy and its increased debt threshold to capture more small cap companies effect the landscape? Will companies find this a more debtor friendly and less costly process?

Commercial Bankruptcy Filings
(Through July)



Source: Epiq Systems, Inc.

FINANCIAL ADVISORY SERVICES

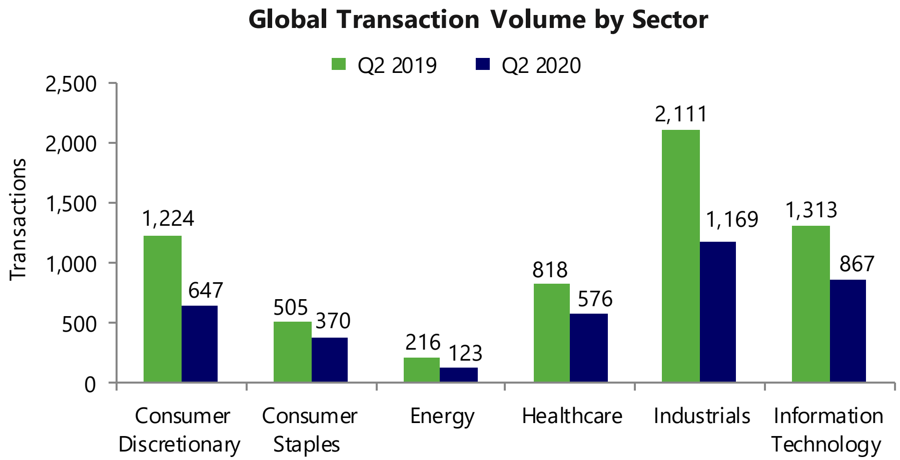
Our Financial Advisory Services Group serves both private and public companies, PE sponsors, management teams, and commercial lenders by delivering immediate leadership and financial & operational acumen. The group is comprised of C-level operators and financial engineers with capabilities across corporate turnarounds, restructurings, operational reengineering, valuations, due diligence and specialty M&A, among other disciplines.

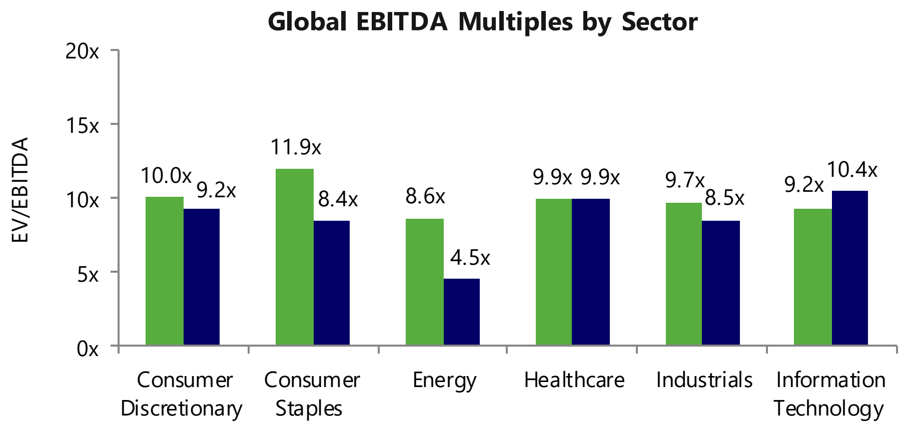
INDUSTRY SPOTLIGHT: INDUSTRIALS

David Bench
Managing Director
949-734-7888
dbench@capstoneheadwaters.com

Overview: In middle-market M&A, Industrials is one of the more heavily impacted sectors when measuring the change in transaction count and transaction multiples through economic cycles. So far in 2020, these two measures have borne this out and portends the likelihood of choppy waters for Industrials M&A in the near to mid-term. The COVID pandemic is accelerating changes within Industrials through trends of e-commerce, productivity-related automation and other technology, renewed focus on product sourcing and supply chain efficiency, manufacturing reshoring, and facility and worker health and safety. These are among the factors contributing to M&A winners and losers within Industrials subsectors. Consequently, Capstone focuses on subsectors demonstrating resiliency such as industrial technology (robotics, guided vehicles, sensors, automation), defense (modernized weapons programs), packaging (sustainable, cold-chain supply, e-commerce), fabricated metal products (supporting medical and specialty industrials), essential services (auto repair, facility services/HVAC/cleaning/repair), and services/products that support WFH and employee safety (home furnishings, home repair, PPE).

Cyclical M&A: Industrials M&A metrics (measured in terms of changes in deal count and transaction multiple) tend to lead in a downturn and lag during economic recovery. The following charts illustrate, global Industrials transaction count was off 45% in Q2 YOY compared to 37% for overall Q2 activity. Additionally, global Industrials M&A multiples were off 12.4% in Q2 YOY compared to an overall M&A multiple change of 7.0%. Leading factors that drive this sector volatility of Industrials M&A include capital intensity, option for delayed capital expenditures, fluctuation in raw material costs, and off-shore competitive threats.





Source: Capital IQ
Includes deals with multiples 3x-20x; Enterprise Value < $500 million

INDUSTRY SPOTLIGHT: INDUSTRIALS (CONTINUED)

Capstone expects the subsequent trends to drive M&A activity:

- **E-Commerce:** Increases in e-commerce have contributed to M&A in packaging, distribution, infrastructure development, and technology to track inventory and deliveries while creating opportunities for small businesses to broaden their customer bases. We project robust M&A activity in these sectors with a growing emphasis on sustainable packaging as the volume of packaging explodes. Packaging related to cold chain supply, grocery delivery, and restaurant takeout and delivery will also be growth areas as upscale eateries seek innovative packaging to retain the quality and food presentation of takeout.

- **Technology:** We have witnessed and expect continued focus on additive manufacturing and increasing productivity using factory and warehouse robotics, automation, sensors and related technology. Investment in these technologies facilitates increased manufacturing productivity while reducing the need for human capital. These lead to a reduction in payroll and benefits expenses and a reduced risk of interruption due to labor shortages, strikes, or pandemic-related disruptions.

- **Market Fragmentation:** We are anticipating strong interest in fragmented markets that offer higher than average visibility, such as military weapons programs for fighter jets. The supply chains surrounding major programs, including the Joint Strike Fighter (F-35), are complex and include many small niche players. As product manufacturing and services herein can often be sole sourced, private equity consolidators are actively buying and integrating businesses that support the programs that have the longest expected product life cycles and can often do so in an accretive manner.

- **Reshoring and Supply Chain:** During the pandemic, there has been a renewed focus on raw material and product sourcing and supply chain efficiency. Concerns about concentrated supply sources were initially launched by the China-U.S. trade war and associated tariffs. The outbreak added to these concerns of supplier concentration as companies experienced supply disruptions from Chinese suppliers. The combined effect of the trade war and China concentration has led companies to accelerate the reshoring of manufacturing and redirecting supply chains toward domestic sources and/or non-Chinese foreign sources. Our expectation is that supply chains will continue to be more localized and provide increased opportunities for M&A in distribution and fabricated metal products.

- **COVID-Pandemic:** The 2020 pandemic is contributing to factors that will have near- and mid-term impact on certain industrial sectors. Businesses that support business travel appear to be facing negative systemic changes (aircraft production, hotel construction, etc.) while those experiencing an updraft include facility services (repair/HVAC & filtration/cleaning services & solutions), employee safety (PPE, especially medical grade PPE), and support WFH (home repair and renovation products, home furnishings including desks, lighting, etc.).

INDUSTRIALS GROUP FOCUS

Industrials M&A thrives during sustained periods of economic growth and optimistic outlook. The Q2 2020 downdraft in Industrials M&A and the historical prolonged recovery for such activity supports Capstone's viewpoint that the most robust activity will be sector-specific. Sub-sectors Capstone is currently active within or has recently completed transactions within include:

- Specialty packaging: cold chain supply, e-commerce, sustainable
- Facilities services & MRO: test & measurement, HVAC & filtration, energy efficiency, cleaning products, support services
- Fabricated metal products: precision manufacturing, welding & tooling, medical, aerospace, specialty industrial
- Industrial technology: automation, robotics, sensors & optical components
- Value-added distribution: packaging supplies, MRO supplies, safety supplies
- Employee health and safety: PPE, cleaning materials, EHS software
- WFH support: home furnishings
- Auto aftermarket: parts production, repair services

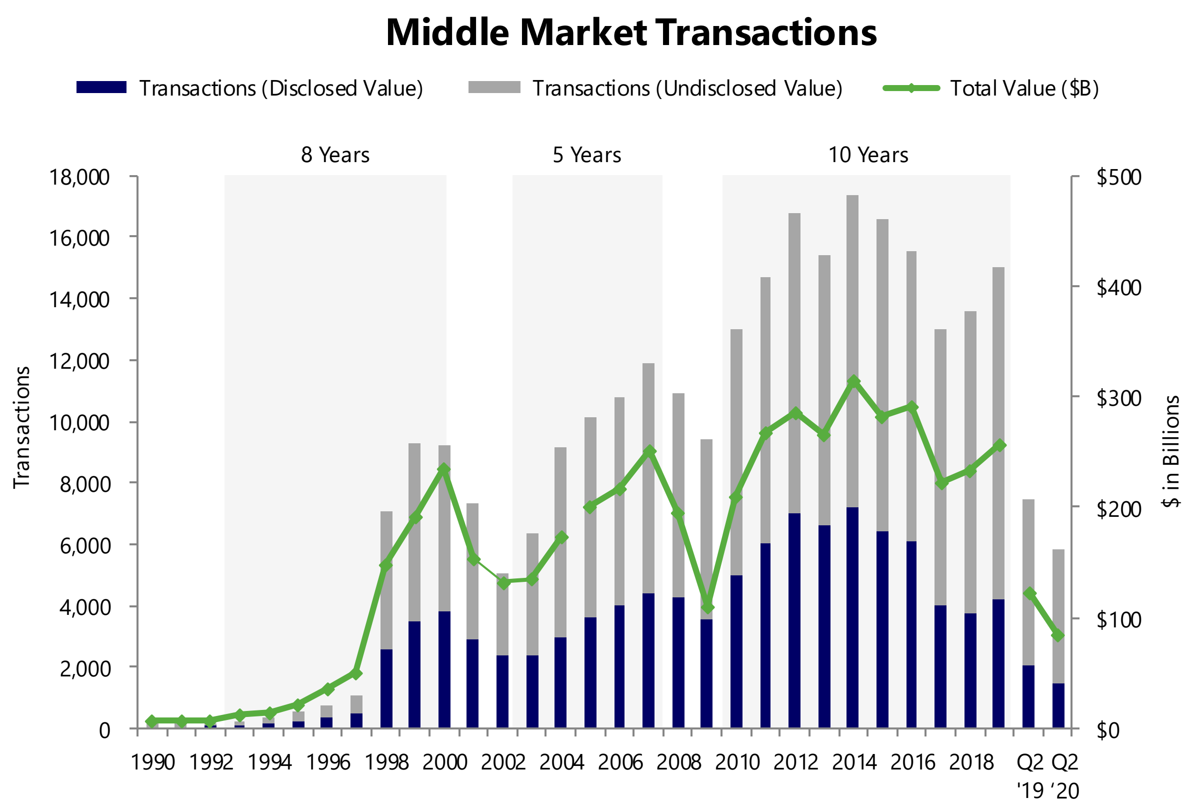
MIDDLE MARKET M&A ACTIVITY

Capstone Headwaters

M&A AMID ECONOMIC CYCLES

M&A VOLUME DROPS 22% IN SECOND QUARTER

- M&A transaction volume in Q2 fell nearly 41% from the prior quarter and has declined approximately 22% year-over-year through first half of 2020.
- Q2 deal activity bore the full effects of COVID-19 with total deal value falling 31.6% year-over-year from $123.9 billion to $84.7 billion.
- As the timeline for the virus extends, M&A activity is likely to remain suppressed as buyers lack significant visibility into pricing and full year performance.

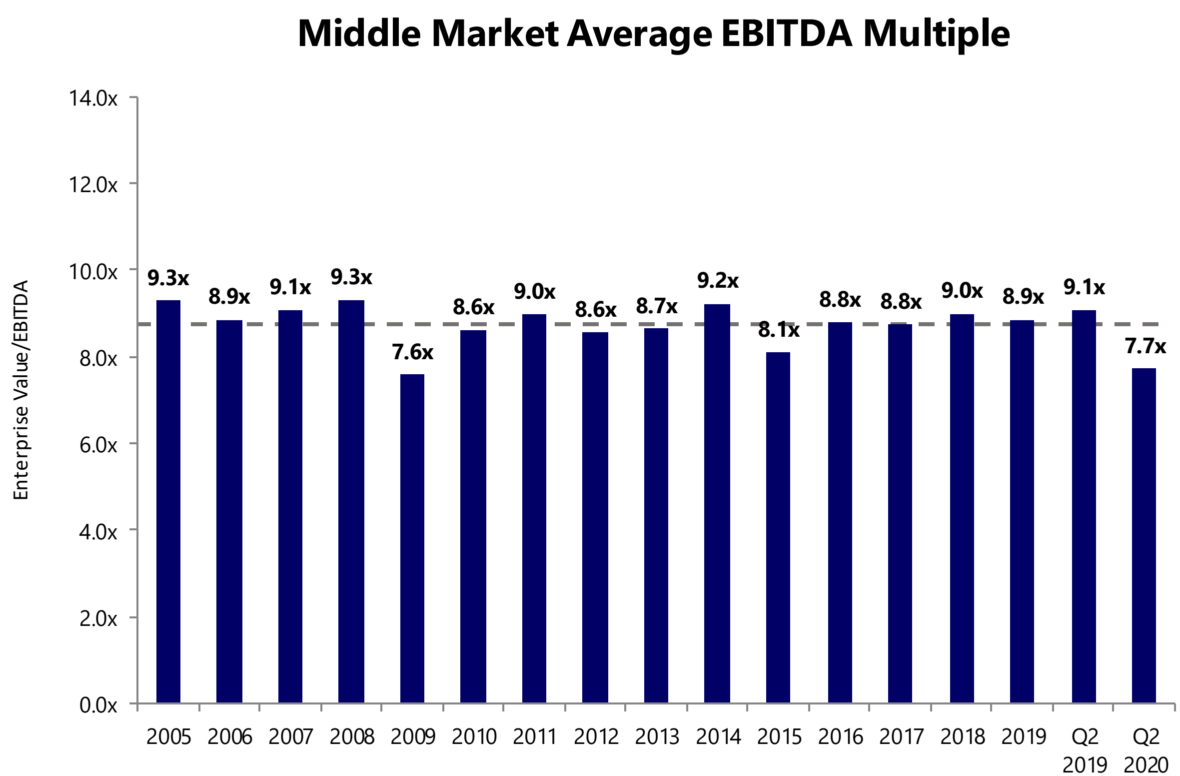


Note: Shaded areas indicate expansion
Source: Capital IQ
Enterprise Value < $500mm

PRICING TRENDS

AVERAGE EBITDA MULTIPLE FALL TO HISTORIC LOWS

- The average EBITDA multiple declined year-over-year from 9.1x to 7.7x, representing the lowest valuations since 2009. Multiples in Q2 failed to exceed historic averages of 8.8x for the first time since 2017.
- COVID-19 severely hampered earnings in Q2 while simultaneously allowing opportune buyers to acquire targets at depressed levels.
- The event-driven pullback of multiples through 2020 differs from past cyclical or secular downturns, as underlying economic fundamentals were generally strong prior to the outbreak of the virus.

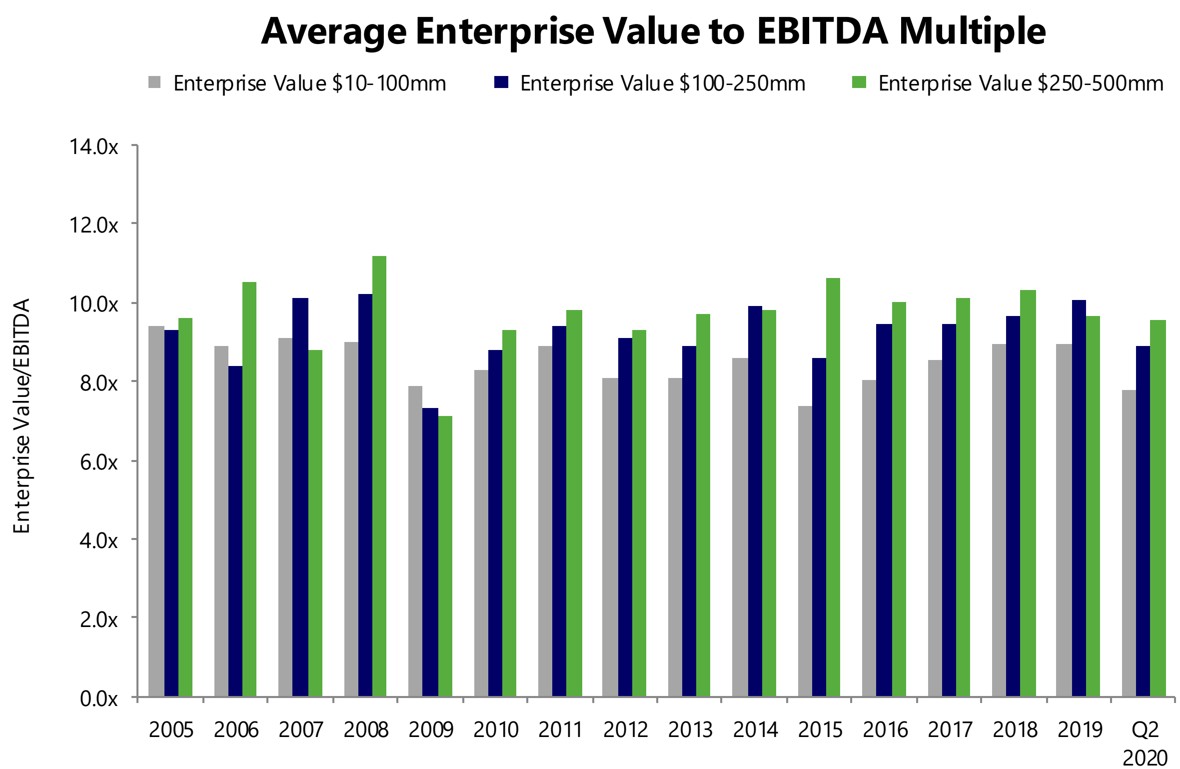


Source: Capital IQ
Includes multiples 3x-16x
Enterprise Value < $500mm

BREAKING IT DOWN BY SIZE

VALUATIONS DECLINE ACROSS ENTERPRISE VALUE RANGES

- The average EBITDA multiple in the $250-$500mm range outperformed other middle market ranges, as multiples among smaller transactions were severely impacted.
- Transactions in the $10-$100mm segment, which accounted for nearly 50% of disclosed deals, dropped to 7.8x – their lowest level since 2015. The $100-$250mm segment also dropped to a five-year low, at 8.9x in Q2 compared to 8.6x in 2015.
- Lenders have demonstrated more willingness to provide leverage towards acquisitions of targets with scale and market share as opposed to targets lacking significant industry penetration.



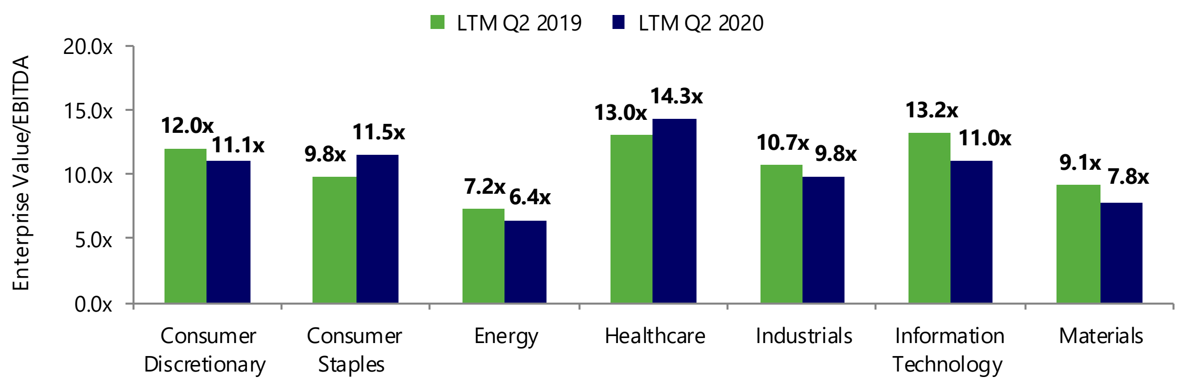
Source: Capital IQ
Includes multiples 3x-16x

BREAKING IT DOWN BY SECTOR

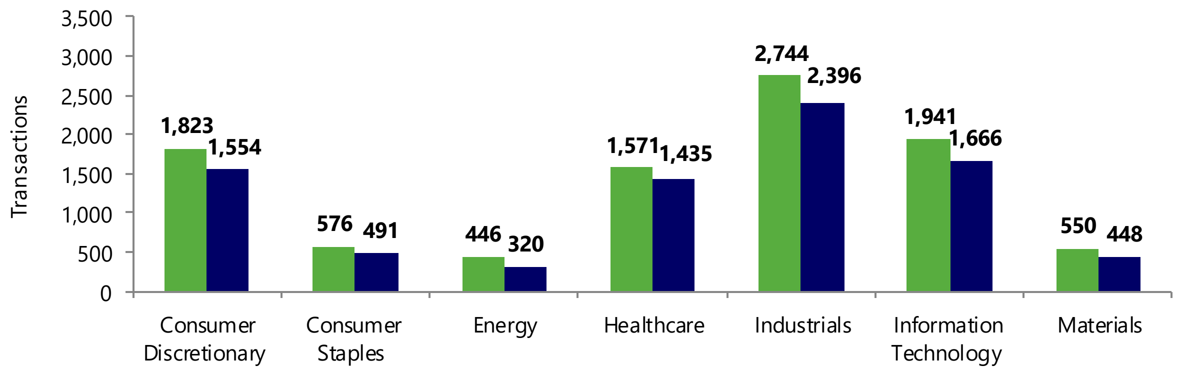
HEALTHCARE SECTOR THRIVES IN SECOND QUARTER

- While multiple averages fell across nearly all sectors, the Healthcare sector has exhibited notable resilience with multiples increasing year-over-year to 14.3x in LTM Q2.
- M&A activity slowed across all sectors compared to LTM Q2 2019 as businesses reduced capital spending and drew down on credit facilities to ensure ample liquidity in the near-term while faced with heightened full year uncertainty.
- COVID-19 performance may become an additional deal consideration for buyers in the future, assessing the resilience and defensibility of cash flows among target companies.

LTM Average EBITDA Multiple by Sector



LTM Transactions by Sector



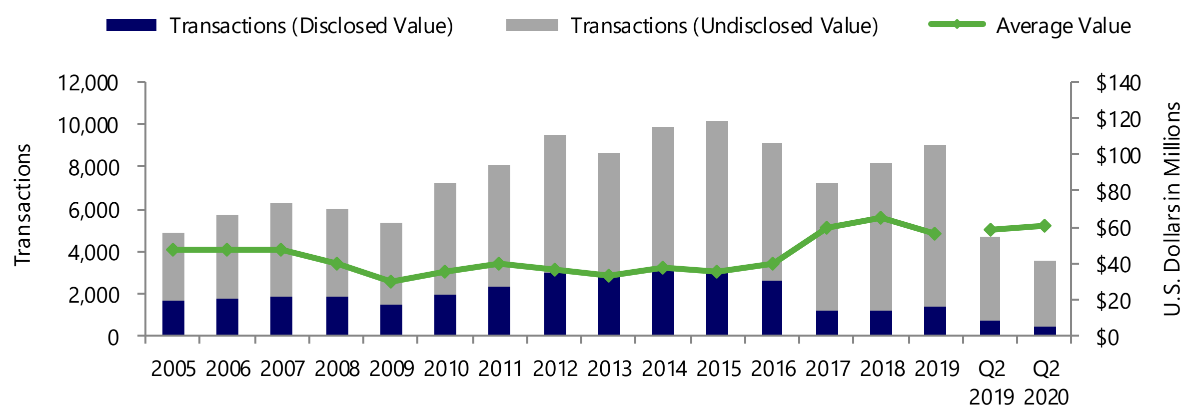
Source: Capital IQ
Includes multiples 3x-30x; Enterprise Value < $500mm

STRATEGIC ACQUIRERS

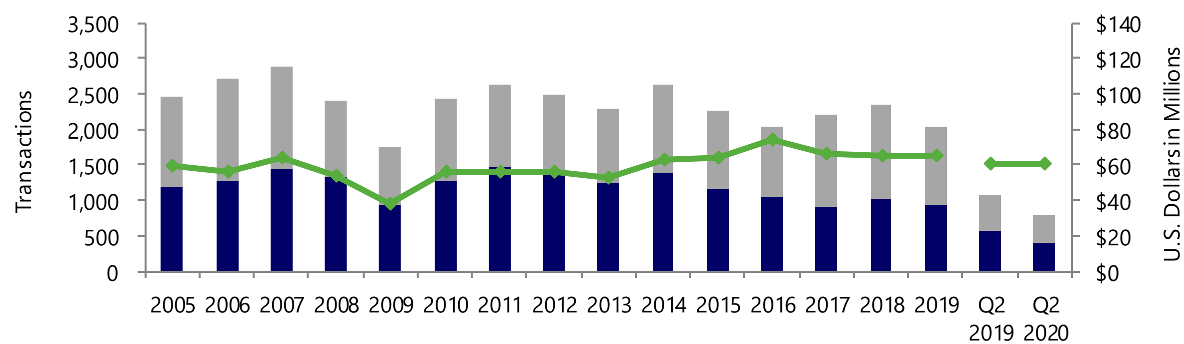
DEAL VOLUME FALLS, AVERAGE VALUE REMAINS STEADY

- Average transaction value for acquisitions by private companies increased slightly year-over-year through Q2, rising to $60.3 million compared to $58.8 million in Q2 2019. Deal volume fell substantially, declining 25.4% from the prior year period.
- The number of acquisitions by public companies also saw severe declines, falling by 27.1% year-over-year while average deal value was nearly equivalent to the prior year period.
- The shift from a seller's market to a buyer's market has accelerated through Q2 and Capstone expects downward pressure on deal volume and value through year-end.

Acquisitions by Private Companies



Acquisitions by Public Companies

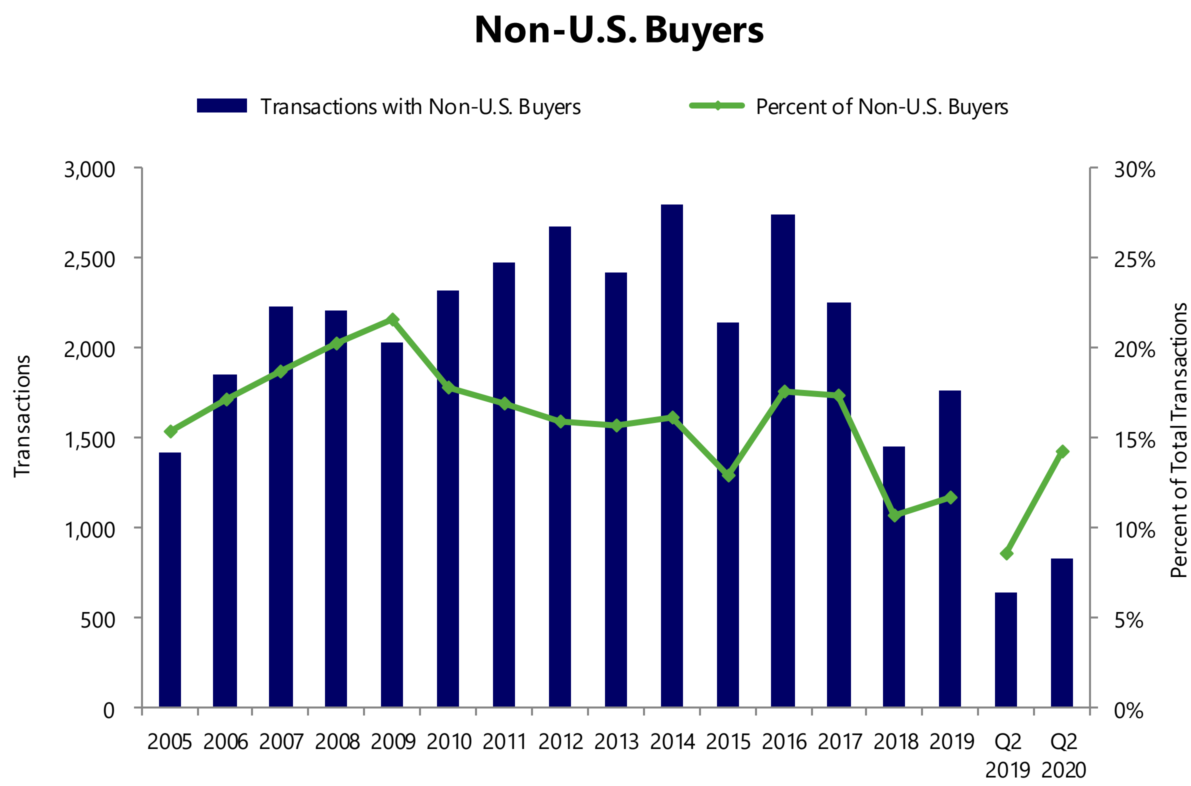


Source: Capital IQ
Enterprise Value < $500mm

FOREIGN ACQUIRERS

NON-U.S. BUYERS REMAIN BELOW HISTORIC AVERAGES

- Non-U.S. buyers increased year-over-year to comprise 14.3% of transactions, however, remain behind historic averages. Travel restrictions and lockdown measures have placed significant downward pressure on cross-border negotiations.
- Health concerns and uncertainty regarding a second wave of infections is forecast to weigh on future transaction volume among foreign acquirers.
- Sustained cross-border transaction activity is likely to depend on adoption of remote technologies to compensate for a lack of in person discussions and due diligence.

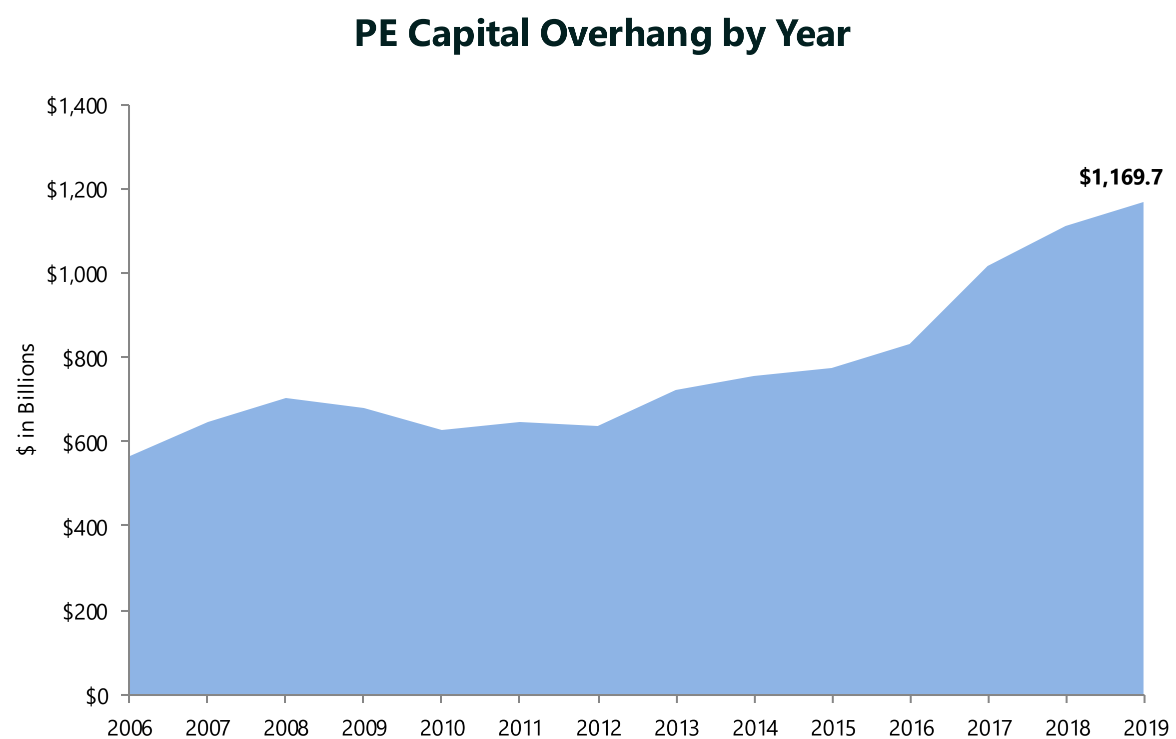


Source: Capital IQ
Enterprise Value < $500mm

PRIVATE EQUITY DRY POWDER

DRY POWDER LEVELS REMAIN FAVORABLE FOR PE DEALS

- Capital overhang, or cash that private equity (PE) firms need to deploy into investment opportunities, has spiked since the Great Recession and reached historic levels in 2019, approaching $1.2 trillion.
- Instead of focusing on new acquisitions, PE firms turned toward internal portfolio risk mitigation and pulled down the entirety of their capacity in revolving credit facilities. Also many institutionally-owned businesses qualified for and took PPP funds.
- While capital deployment was insubstantial in Q2, the vast amount of dry powder creates a favorable backdrop for the resumption of PE deal activity in future quarters.



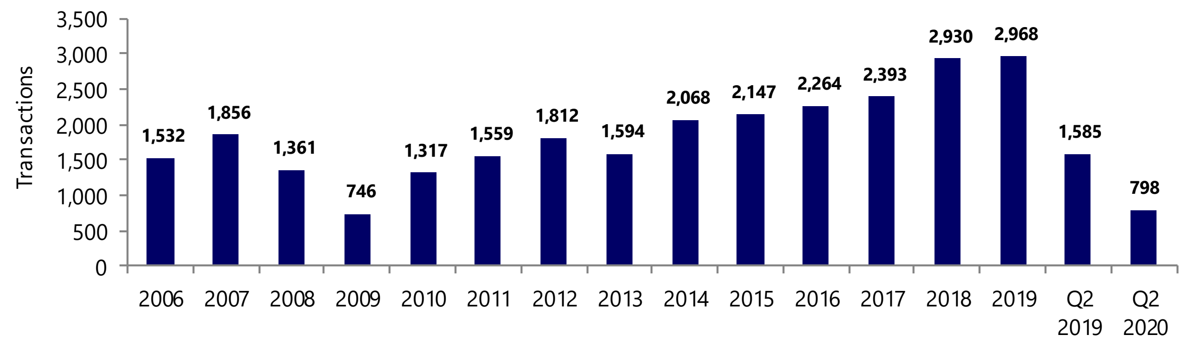
Source: PitchBook

PRIVATE EQUITY ACTIVITY

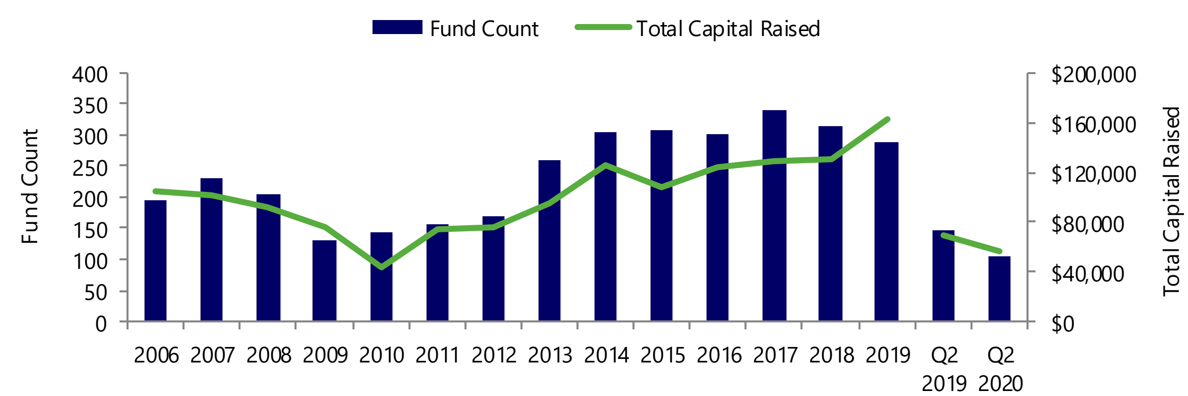
PE CLOSED TRANSACTION VOLUME SLOWS

- PE middle market deal activity fell nearly 50% year-over-year through Q2 with 798 transactions compared to 1,585 through Q2 2019 as PE firms focused on the health of platform investments and targeted fewer, smaller deals.
- PE fundraising trailed the record-setting pace seen in 2019 but remained at healthy levels through Q2 2020 with $56.4 billion in total capital raised across 104 funds.
- Capstone expects these near-term trends to continue as PEGs assess COVID-adjusted EBITDA and investment criteria, while shifting investment strategies toward distressed deals, credit opportunities, and minority investing.

Middle Market Transactions Closed by Private Equity Firms



Middle Market Fundraising by Private Equity Firms

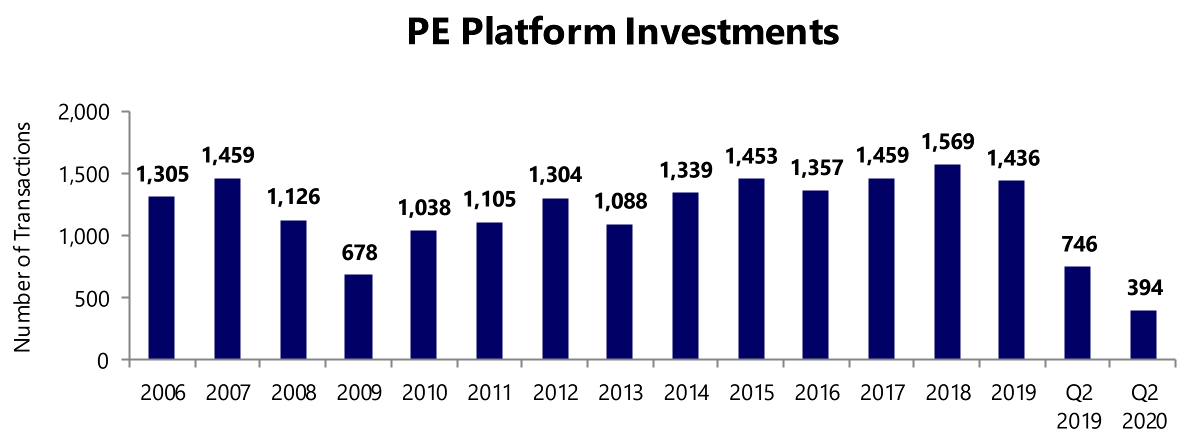


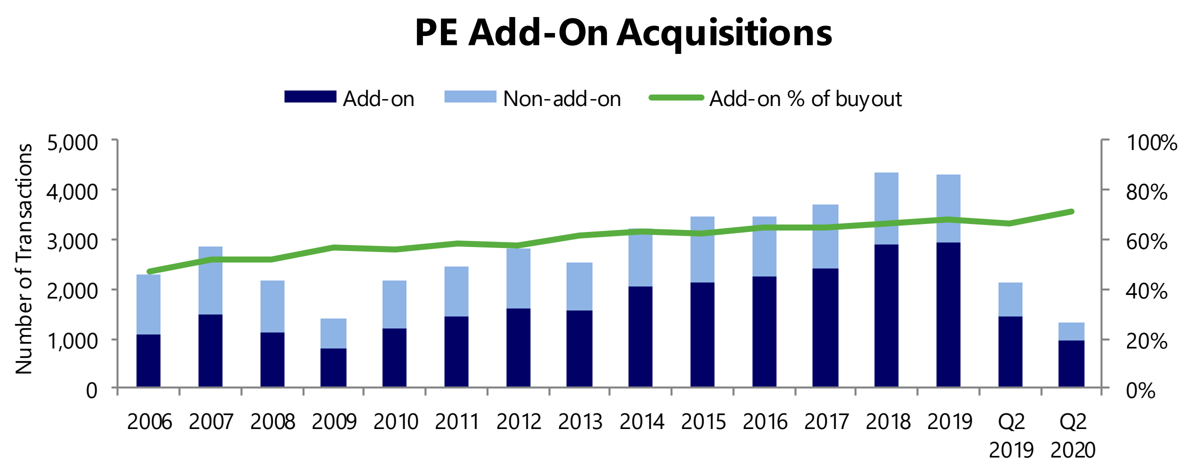
Source: PitchBook
Note: EV; $25-$500mm, Fund size < $5B

PRIVATE EQUITY TRANSACTION TYPES

PE ADD-ONS COMPRISE MAJORITY OF TRANSACTIONS

- U.S. PE platform investments have fallen dramatically through the first half of 2020, decreasing 47.2% year-over-year. When compared to the Q2 2019 alone, volume has fallen 68.8% year-over-year.
- Challenges in the lending environment through Q2 placed downward pressure on platform deal volume and larger, heavily debt-financed transactions.
- U.S. PE add-on acquisitions comprised over 71% of total buyouts through Q2 as PE firms pursued smaller transactions to ensure liquidity amid a challenging lending environment.



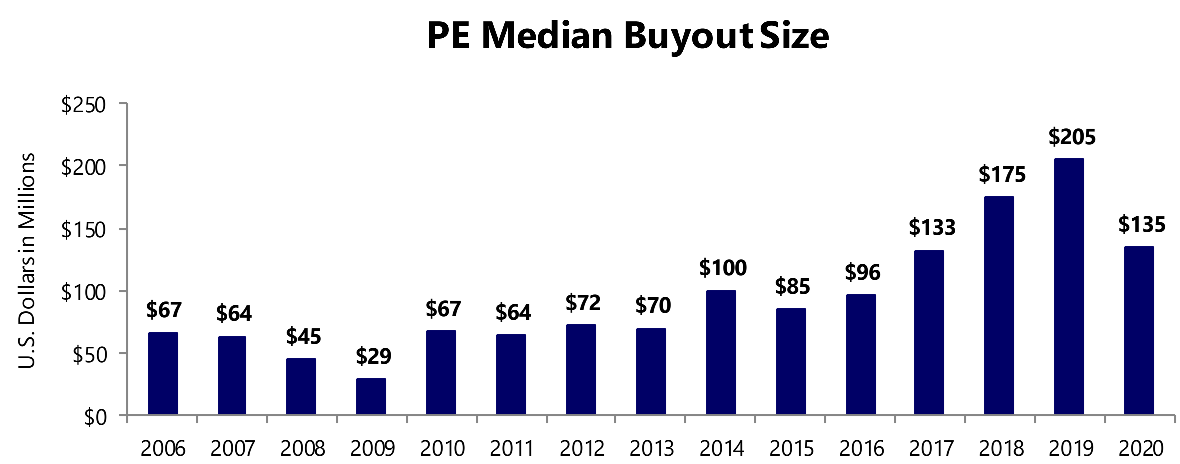


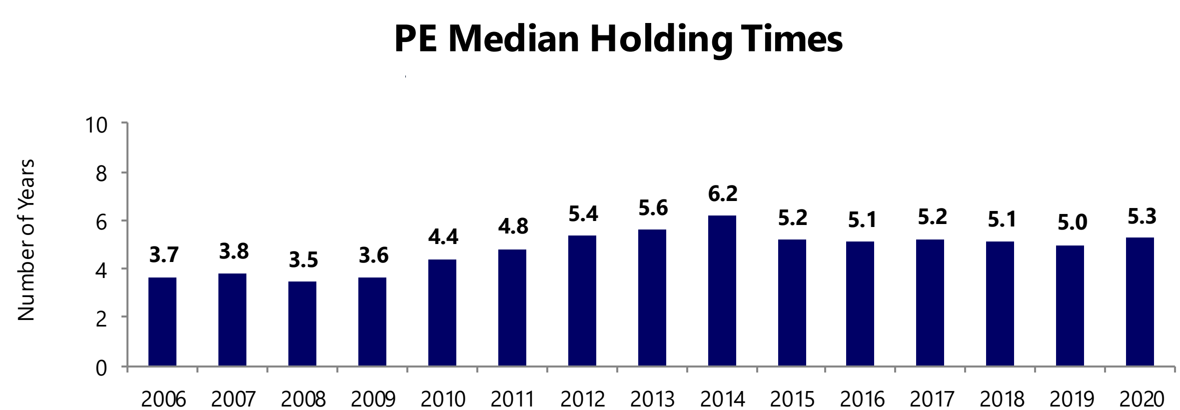
Source: PitchBook
Note: Includes all U.S. PE transactions

PRIVATE EQUITY BUYOUT SIZE AND HOLDING TIMES

PE BUYOUT SIZE DECLINES THROUGH Q2

- PE firms have employed more creative deal-making tactics through 2020, targeting smaller companies without institutional backing which has been reflected in median buyout size declining substantially from $205 million in 2019 to $135 million through Q2.
- Holding times continued to remain at elevated levels as sponsors have postponed exits while awaiting further market transparency and pricing.
- The realizable impacts of lengthening holding times are not likely to manifest in the immediate future. Notably, holding times in the five years following the financial crisis increased substantially before normalizing in 2015.





Source: PitchBook

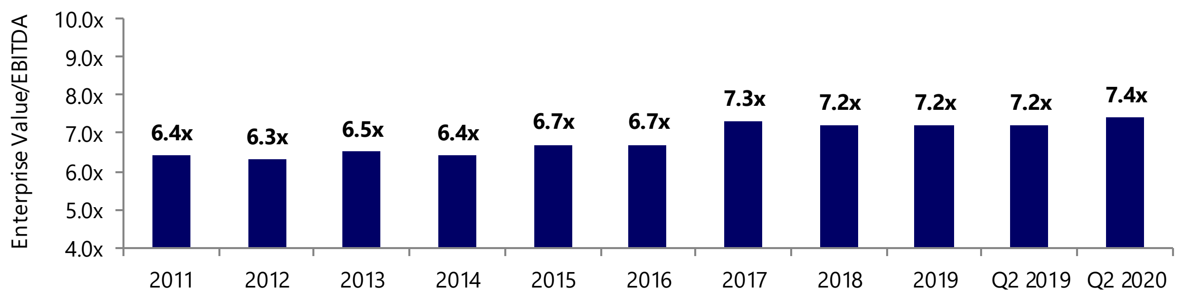
Note: Pitchbook changed methodology to only include buyout deals as of Q3 2017. All data reflects new methodology.

PRIVATE EQUITY VALUATIONS

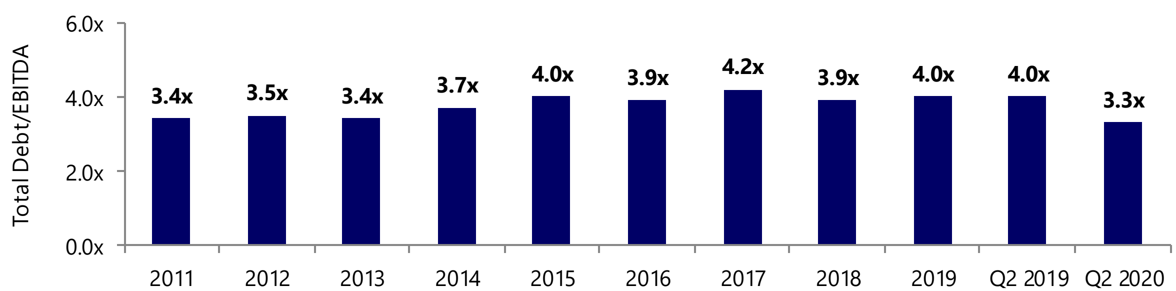
PE EBITDA MULTIPLES UNCHANGED FROM Q1 2020

- The average EBITDA multiple paid by financial buyers in Q2 was elevated year-over-year at 7.4x compared to 7.2x in Q2 2019 and equivalent to Q1 2020 valuations.
- While PE EBITDA multiples have displayed resilience in Q2, these valuations have been achieved on dramatically lower deal volume and significant declines in debt usage.
- Average debt multiples pulled back substantially in Q2, falling to 3.3x EBITDA representing a notable shift from the 3.9x to 4.2x valuations that have prevailed in recent years. In addition, senior debt dropped from 3.4x to 2.8x in Q2.

Average EBITDA Multiple Paid by Financial Buyers



Average Debt Multiple of Middle Market LBO Transactions



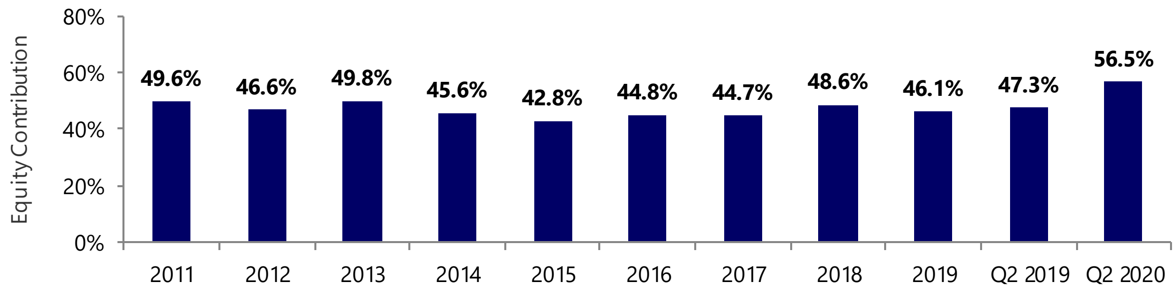
Source: Source: GF Data®
Includes multiples 3x-15x; Enterprise Value $10mm-$250mm

PRIVATE EQUITY VALUATIONS

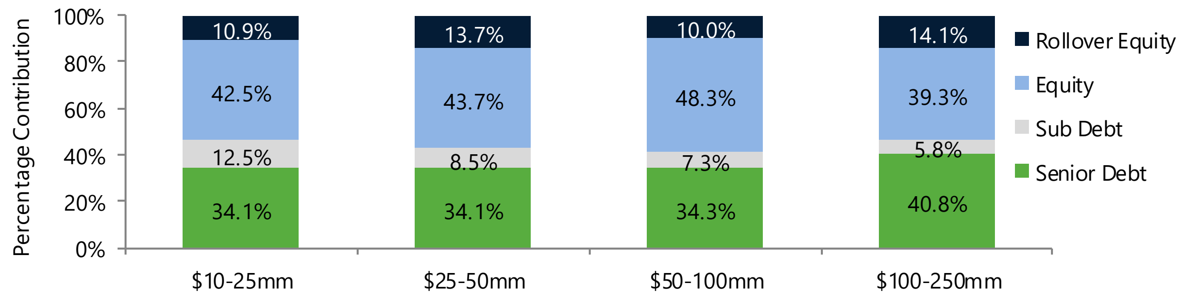
EQUITY CONTRIBUTIONS REACH HISTORIC LEVELS

- Buyers have demonstrated greater willingness to accept elevated equity share to complete transactions in Q2, with equity contributions reaching 56.5% in middle market leveraged buyouts (LBO), a remarkable year-over-year increase.
- Despite a strained lending environment, mezzanine and junior capital providers have managed to increase average debt from 3.7x in Q1 to 4.6x in Q2 2020.
- Transactions in the $50-$100mm market utilized the largest percentage of total equity at 58.3%, while larger transactions in the $100-$250mm range were able to employ higher senior debt levels.

Average Middle Market LBO Equity Contribution



Equity and Debt Contribution by Enterprise Value



Source: Source: GF Data®
Includes multiples 3x-15x; Enterprise Value $10mm-$250mm

CAPSTONE BAROMETERS

Capstone Headwaters

LEADERSHIP THROUGH COVID-19 ERA

As a firm, we have mobilized our resources to deliver an integrated solution to business owners navigating through these times. We can help frame your decisions, access capital to protect your position, and provide specialty transaction expertise to capture opportunities as they arise. We are engineered to help companies through every stage of the business lifecycle.

Mergers & Acquisitions

We assist opportunist acquisitions, execute sales, and navigate distressed transactions.

Strategic Acquisitions

- Target Identification
- Valuation & Structure
- Buy-Side Due Diligence
- Quality of Earnings
- Buy-Side M&A Execution

Sales & Divestitures

- Corporate Valuation
- Market Assessment
- Transaction Readiness
- Sell-Side M&A Execution
- Asset Divestiture

Distressed Transactions

- Business Unit Divestiture
- Distressed M&A
- §363 Sale

Financial Advisory

We specialize in performance improvement and value creation in difficult situations.

Board Advisory

- Strategic Blueprinting
- Evaluate Capital Adequacy
- Performance Tracking
- Management Accountability
- Communication

Operational Effectiveness

- Cost Structure Management
- Operational Assessment
- Management Assessment
- Sales Augmentation
- Organizational Optimization

Crises Management

- Turnaround / Interim Mgmt.
- Corporate Restructuring
- Bankruptcy Protection

Capital Access

We help manage through new or existing lenders or investors and secure an optimal solution.

Debt Financing

- Bridge / Interim Financing
- ABL and Cash Flow Revolvers
- 1st and 2nd Lien Term Loans
- Subordinated Debt
- Sale-Leasebacks

Equity Financing

- Growth Equity
- Secondary Equity Recaps
- Structured Equity
- Acquisition Financing
- Investor Management

Alternatives

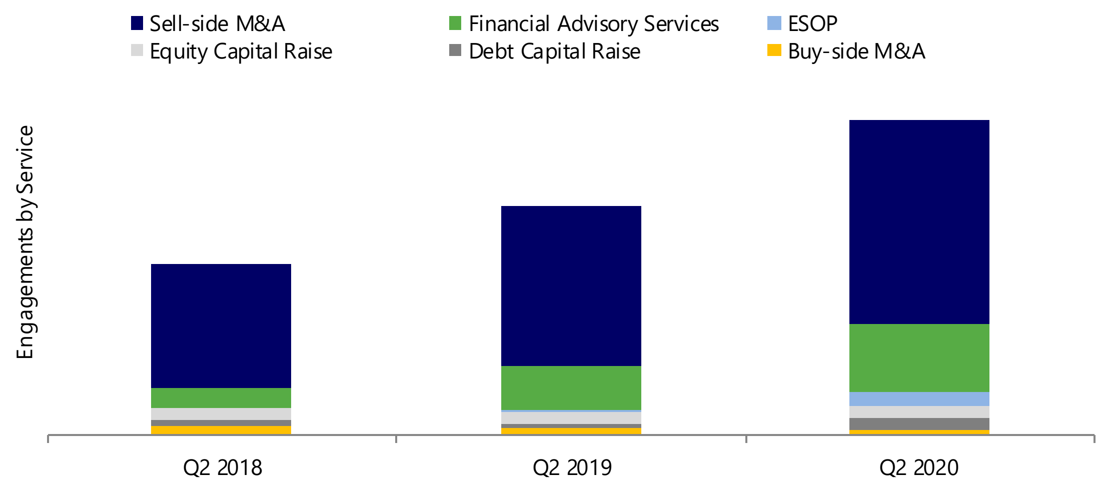
- Creditor Mediation
- DIP and Exit Financing
- Government Support Programs

FIRM DATA

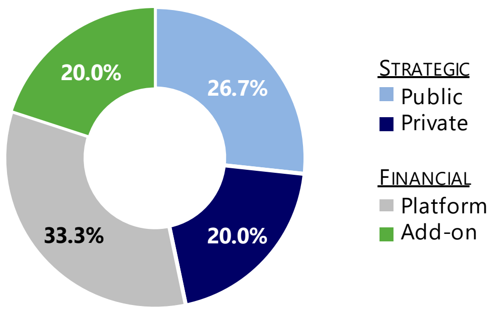
NUMBER OF ENGAGEMENTS REMAIN HIGH IN PANDEMIC

- Capstone has remained highly active with new and existing engagements despite the pandemic and has closed more than 15 transactions year-to-date.
- Over the trailing twelve-month (TTM) period, 53% of our clients completed a merger or acquisition with a financial buyer, while the remaining 47% were targeted by a strategic private or public company.
- Capstone continues to evolve to meet the needs of middle market companies and has recently welcomed Managing Director Kenneth Wasik to the firm to head our Consumer & Retail Group.

Capstone Engagements By Service



Capstone TTM Buyer Breakdown



Source: Capstone propriety data based on live engagements and closed sell-side engagements

YEAR-TO-DATE DEAL CLOSINGS

Capstone is an active leader in middle market M&A advisory and has closed a number of deals this year, serving clients and their needs despite the unprecedented disruptions to the economy. Select the deal tombstones below to read the full press release.

sani-tech west
has been acquired by
3i

ALIGN CAPITAL PARTNERS
has secured debt financing for its acquisition of
ETC

Themis Bar Review
has been acquired by
UWorld

ORIGINATION O2D
has been acquired by
Wind Point Partners

Sun Devil Auto
has been acquired by
GB Auto Service, Inc.
a portfolio company of
GREENBRIAR EQUITY GROUP, L.P.

sib FIXED COST REDUCTION
has been acquired by
O2 Investment Partners

WESTERN FORGE & FLANGE CO.
has been acquired by
WYNNCHURCH | CAPITAL

KNIGHT ENTERPRISES
has been acquired by
Mill Point Capital

VECTORZERO
has been acquired by
MathWorks

REVOLUTIONARY SECURITY
has been acquired by
accenture

LENCORE
COMFORT. PRIVACY. INTELLIGIBILITY.
has been acquired by
emmis communications

mmi sonora
has been acquired by
ARCH
a portfolio company of
The Jordan Company

EB INDUSTRIES
has been acquired by
MCM

BACKBONE
IT Audit . Security . Data Privacy
has been acquired by
CYNERGISTEK

CALIPER
has been acquired by
psi

LEADERSHIP TEAM

JOHN FERRARA, FOUNDER AND CEO

jferrara@capstoneheadwaters.com | 617-619-3325

John has dedicated 30+ years to serving as a trusted advisor to privately held businesses. Representative of over 200 engagements, he has acted as investment banker, management consultant, interim executive, investor, founder and board member. John has been recognized as one of the Top 50 M&A advisors in the U.S. and honored as an M&A Advisor Hall of Fame inductee. Under his leadership, Capstone has expanded to 19 offices in the U.S., U.K., and Brazil with an international platform that spans over 450 professionals in 40 countries worldwide. John graduated from Wesleyan University with an MBA from UCLA and The London School of Economics.

PHIL SEEFRIED, PRESIDENT

pseefried@capstoneheadwaters.com | 303-572-6004

Phil has 30+ years of experience across most major financial markets. He was the co-founder and CEO of Headwaters MB until the acquisition by Capstone in 2017. He started his career with Bankers Trust, later working for Credit Suisse/First Boston. He was named Co-Head of Leveraged Finance at CSFB, responsible for managing close to 200 deals totaling $40 billion. Seefried was then named CFO of the 350-person Global Credit Group. He left Credit Suisse in 2000 and spent a year as CFO of Open Access Broadband Services before launching Headwaters in 2001. Phil holds an MBA from Stanford University and a BA from Williams College.

PAUL JANSON, COO

pjanson@capstoneheadwaters.com | 303-887-0174

With 25 years of executive experience, Paul manages all administrative, legal and compliance matters for the firm and serves on Chairman of the Investment Banking Committee. On the M&A Advisory side, he is active in telecommunications services, manufacturing and infrastructure. Previously, Paul served as President & CEO of Camiant, a Packet Cable Multimedia broadband company. Paul was also CEO of Worldbridge Broadband Services Inc, a broadband and telecommunications company that was later acquired by C-Cor. Paul then became President of C-Cor's Global Services Division. He earned a BA-Business from Saint Anselm College.

BRIAN DAVIES, HEAD OF FINANCIAL ADVISORY SERVICES GROUP

bdavies@capstoneheadwaters.com | 617-619-3328

Brain has 20+ years of experience working in the fields of corporate recovery, business reorganization and interim management services. He has provided financial advisory services to lenders, debtors, creditors' committees, trustees and equity holders in bankruptcy matters and out-of-court restructurings. Brian has provided assistance to under-performing businesses, acquirers of distressed companies. He has worked with companies to develop cost containment and asset rationalization plans, improve liquidity, re-engineer financial and other back-office functions. He received a MS from Bentley University and MSF from The McCallum School, Bentley University.

LEADERSHIP TEAM (CONTINUED)

JACOB VOORHEES, HEAD OF GLOBAL M&A

jvoorhees@capstoneheadwaters.com | 617-216-1543

Jacob brings over 15 years of experience to the Capstone Headwaters investment banking team. As one of the founding members of Capstone Partners, he helped build Capstone's brand over the past decade until the merger with Headwaters MB in late 2017. Today, Jacob serves as the Head of Global M&A and is responsible for spearheading our international capabilities and coverage. Formerly, Jacob was with Andersen Corporate Finance LLC, where he focused his efforts on the software and direct marketing industries. Jacob received an MBA from the Sloan School of Management at Massachusetts Institute of Technology (MIT) and a BS from Cornell University.

KENT BROWN, HEAD OF DEBT ADVISORY GROUP

kbrown@capstoneheadwaters.com | 303-951-7127

Kent brings over 30 years of corporate debt placement and advisory experience. He has extensive experience in arranging various forms of middle-market corporate debt, including leveraged loans, asset-based loans, subordinated debt, second-lien and uni-tranche facilities, syndicated credit facilities, venture debt, equipment leases, private securitizations, sale-leasebacks, and mortgages, among other structures. Previously, Kent was a Managing Director at William Blair & Company, where he worked for over 25 years. Kent began his career with Arthur Andersen. He earned an MBA from the University of Chicago and a BS from the University of Colorado at Boulder.

DANIEL MCBROOM, HEAD OF INVESTMENT BANKING SERVICES

dmcbroom@capstoneheadwaters.com | 303-951-7128

Daniel has 15 years of private and investment banking experience, and is responsible for sourcing and analyzing hundreds of companies a year introduced by the firm's institutional clients and partners. Select companies are engaged and his team will stay involved until the transaction is closed. These deals total over six billion of enterprise value annually. Prior to Capstone Daniel worked at Bear Stearns and Goldman Sachs. Before his financial career, Daniel spent seven years as a pilot in the United States Air Force. As an Air Force Officer, he was deployed to forward locations in support of Operation Enduring Freedom. He earned an MBA from the University of Notre Dame and a BS from the United States Air Force Academy.

BRENDAN BURKE, HEAD OF PRIVATE EQUITY SPONSOR COVERAGE

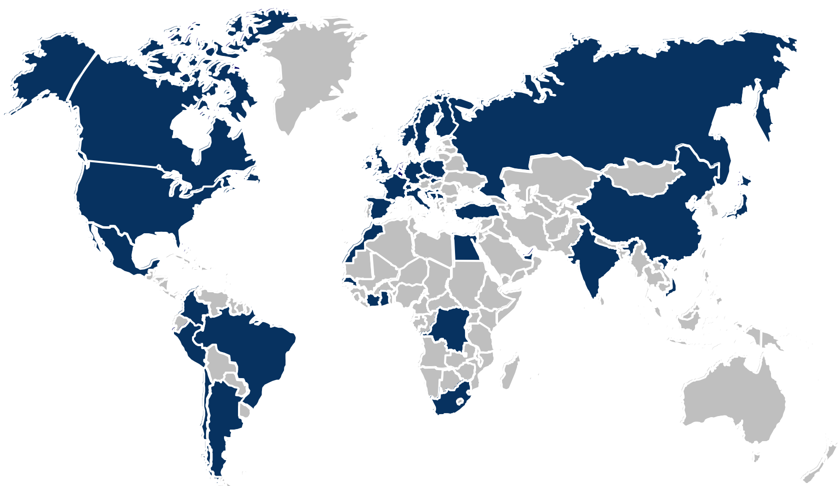
bburke@capstoneheadwaters.com | 303-531-4603

Brendan has 16 years in investment banking experience. He oversees the firm's outreach to private equity sponsors and recruitment of senior investment bankers. Since joining Headwaters MB (now Capstone) in 2004, he has held roles in transaction execution, business development, recruiting and marketing. In 2012, he was awarded 40 UNDER 40 by the M&A Advisor. He received a BA in Politics, Philosophy, Economics from Pomona College.

Capstone Headwaters

Capstone Headwaters is an elite investment banking firm dedicated to serving the corporate finance needs of middle market business owners, investors and creditors. Capstone Headwaters provides merger & acquisition, private placement, corporate restructuring and financial advisory services across 16 industry verticals to meet the life cycle needs of emerging enterprises. Headquartered in Boston, MA and Denver, CO, Capstone Headwaters has 19 offices in the U.S., U.K., and Brazil with a global reach that includes over 450 professionals in 40 countries.

BUILT FOR THE MIDDLE MARKET



Report Contributors

Sarah Doherty, Vice President of Research
sdoherty@capstoneheadwaters.com | 617.619.3310

Connor McLeod, Research Associate
cmcleod@capstoneheadwaters.com | 617.619.3319

Ben Kelly, Research Analyst
bkelly@capstoneheadwater.com | 617.619.3390

Visit **Capstoneheadwaters.com** to find out more about transaction and advisory services and to access market commentary and industry insights.

Follow Us