

Presentation to:

ACG 101

# Trends in Lower Middle Market M&A and Private Equity

April 2016



CALABASAS CAPITAL

# DISCLOSURE

- *This presentation should not be considered in any way an offer to buy or sell a security.*
- *Buying or selling a security involves substantial risk and may be worth more or less than the original investment.*
- *This presentation is for informational purposes only.*
- *Securities offered through Fallbrook Capital Securities Corp. Member FINRA/SIPC\*.*

*\*Calabasas Capital is a dba of Fallbrook Capital.*

# INTRODUCTION TO CALABASAS CAPITAL

- We are a boutique investment banking firm serving privately held companies in the lower end of the lower middle market (\$10 million to \$100 million in revenues)
- Our professionals have significant M&A advisory and capital raising experience

## Mergers & Acquisitions

- Business sales
- Subsidiary dispositions
- Business purchases
- Mergers and JVs

## Capital Raising

- Private Equity
- Subordinated Debt
- Senior Debt
- Venture Capital

Securities offered through Fallbrook Capital Securities Corp., Member FINRA/SIPC

# CONSUMER FOCUSED BUSINESS EXPERTISE

The team at Calabasas Capital has experience in financing and M&A across many consumer sectors

## Transaction Types

- |   |  |
|---|--|
| <ul style="list-style-type: none"> <li>▪ Sell-side M&amp;A</li> <li>▪ Buy-side M&amp;A</li> <li>▪ Recapitalization</li> <li>▪ Leveraged/Mgt Buy-out</li> <li>▪ Restructuring</li> </ul> | <ul style="list-style-type: none"> <li>▪ Growth Equity Capital</li> <li>▪ Mezzanine Debt</li> <li>▪ Bank Debt</li> <li>▪ High yield Debt</li> <li>▪ IPO</li> </ul> |
|---|--|

## Consumer Products & Services Sectors

- |  |   |
|--|---|
| <ul style="list-style-type: none"> <li>▪ Food</li> <li>▪ Restaurants</li> <li>▪ Apparel</li> <li>▪ Footwear</li> <li>▪ Electronics</li> <li>▪ Building Products</li> </ul> | <ul style="list-style-type: none"> <li>▪ Retail</li> <li>▪ E-Commerce</li> <li>▪ Health &amp; Beauty</li> <li>▪ Fitness &amp; Therapy</li> <li>▪ Household Goods</li> </ul> |
|--|---|



Includes past clients of team members of Calabasas Capital

# BUSINESS-TO-BUSINESS EXPERTISE

The team at Calabasas Capital has experience in financing and M&A across many B2B manufacturing and services sectors

## Transaction Types

- |   |  |
|---|--|
| <ul style="list-style-type: none"> <li>▪ Sell-side M&amp;A</li> <li>▪ Buy-side M&amp;A</li> <li>▪ Recapitalization</li> <li>▪ Leveraged/Mgt Buy-out</li> <li>▪ Restructuring</li> </ul> | <ul style="list-style-type: none"> <li>▪ Growth Equity Capital</li> <li>▪ Mezzanine Debt</li> <li>▪ Bank Debt</li> <li>▪ High yield Debt</li> <li>▪ IPO</li> </ul> |
|---|--|

## B2B Sectors

- |   |   |
|---|---|
| <ul style="list-style-type: none"> <li>▪ Telecom</li> <li>▪ Facilities Maintenance</li> <li>▪ Commercial Printing</li> <li>▪ Health Care</li> <li>▪ Payment Processing</li> </ul> | <ul style="list-style-type: none"> <li>▪ Post-Production</li> <li>▪ Online Marketing</li> <li>▪ Market Research</li> <li>▪ Consulting</li> <li>▪ Aerospace/Defense</li> <li>▪ Equipment Rental</li> </ul> |
|---|---|



# RECENT TRANSACTIONS

**CALABASAS CAPITAL**

**ASI ENTERTAINMENT**  
has been acquired by:

**screen engine™**

ASI Entertainment and Screen Engine are both entertainment-industry focused full-service market research services companies.

Calabasas Capital served as financial advisor to ASI Entertainment.

**CALABASAS CAPITAL**

**PrintRunner**, has been acquired by:  
*Quality Printing for Less*

**UPrinting.com**  
*Spread Your Message*

a portfolio company of:

**INSIGHT VENTURE PARTNERS**

PrintRunner and UPrinting are both leading online commercial printers.

Calabasas Capital served as financial advisor to PrintRunner, Inc.

**CALABASAS CAPITAL**

**B** Background Images, Inc. has raised \$3.6 million in financing from:

**FC** Full Circle Capital

Background Images is a leading equipment rental services company to the television, motion picture, concert production and tradeshow industries.

Calabasas Capital served as financial advisor to Background Images, Inc.

**CALABASAS CAPITAL**

**Revolution**  
*Eyewear for a changing world*

has raised **Debt Financing**  
From a Private Investment Firm

Revolution Eyewear is a branded manufacturer and distributor of proprietary eyeglass frames.

Calabasas Capital served as exclusive financial advisor to Revolution and sourced the capital.

**CALABASAS CAPITAL**

**i.e. distribution**  
has acquired the assets of World Industries

**WORLD INDUSTRIES**

With \$3.5MM in Mezzanine Debt Financing Raised From:

**St. Cloud CAPITAL LLC**

World Industries is a leading action sports footwear brand.

A managing director of Calabasas Capital served as financial advisor to i.e., distribution while at a previous firm.

**CALABASAS CAPITAL**

**HAMLET RESTAURANT**

Hamlet Group, Inc. & Subsidiaries have been acquired by:

A Private Investment Group

Hamlet Group is an iconic national casual dining restaurant chain.

A managing director of Calabasas Capital served as financial advisor to Hamlet Group while at a previous firm.

**CALABASAS CAPITAL**

**visual data**  
MEDIA SERVICES

Has acquired a majority interest in

**re:fine**

VDMS is a leading provider of digital content distribution and post-production services in the U.S. while re:fine provides similar services in the U.K.

Calabasas Capital served as financial advisor to VDMS in the transaction.

**CALABASAS CAPITAL**

**ntn** NTN Wireless Communications

has been acquired by:

**HME**

NTN Wireless Communications is one of the largest manufacturers and distributors of restaurant, paging systems.

A managing director of Calabasas Capital served as financial advisor to NTN Wireless Communications while at a previous firm.

**CALABASAS CAPITAL**

Stix Holdings, LLC has acquired the assets of:

**PICK UP STIX**  
FRESH ASIAN FLAVORS

from **CARLSON**  
Carlson Restaurants, Inc.

Pick Up Stix is a chain of fast casual Chinese restaurants, including 70 company-owned stores and 4 franchises.

Calabasas Capital served as financial advisor to Stix Holdings, LLC an affiliate of Mandarin Express, Leeann Chin & Chin's Asia Fresh.

**CALABASAS CAPITAL**

**Z** Tranzlogic

has raised private equity from a group of investors led by:

SJ Investment Co.

Tranzlogic is a rapidly growing provider of retail customer analytics leveraging payment processor networks.

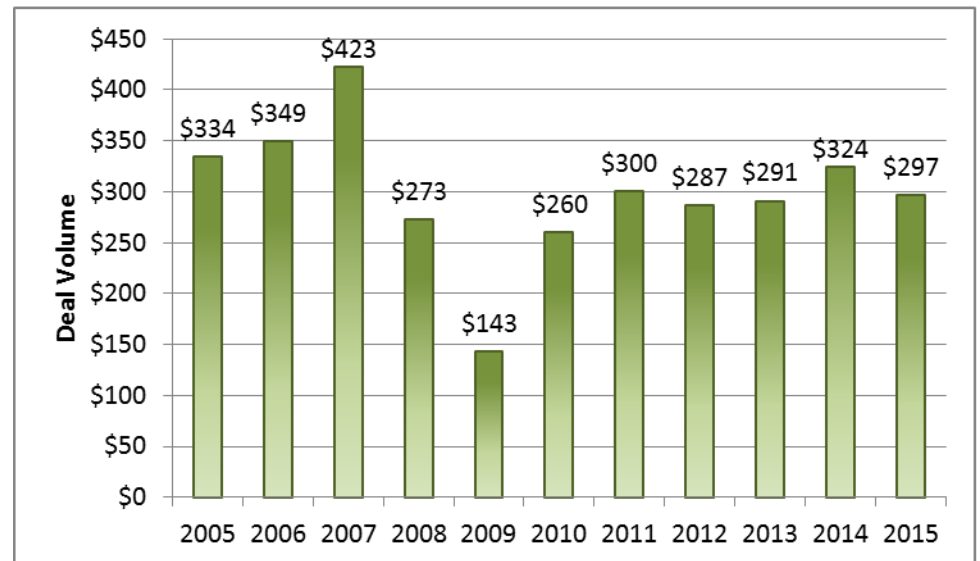
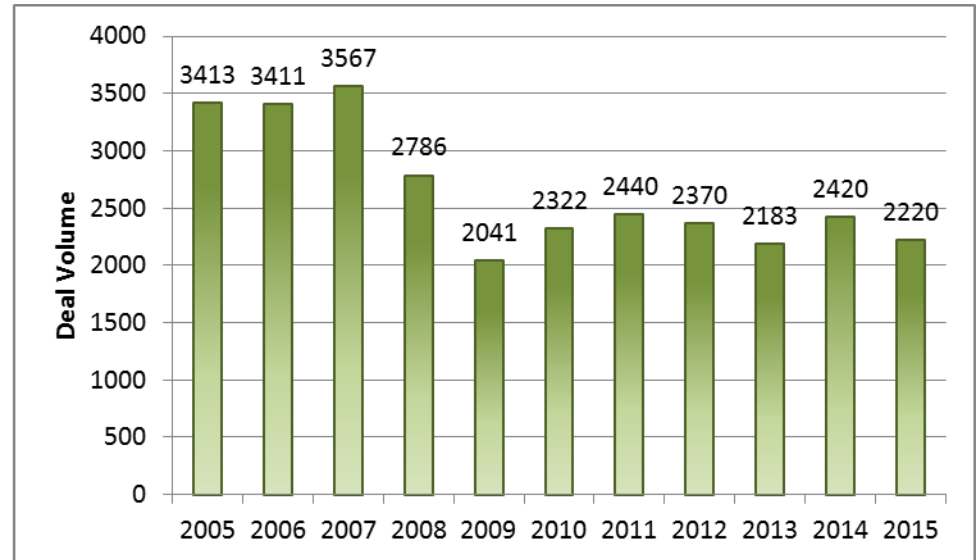
Calabasas Capital served as financial advisor to Tranzlogic, LLC.

# TEAM

- **David Bonrouhi, Managing Director**
  - 20 Years Experience in Investment Banking (14) & Private Equity (6)
  - Licensed, non practicing CPA
  - Series 7, 63 and 79 Securities Licenses
  - CA Real Estate Broker (inactive)
  - MBA from UCLA's Anderson School of Management
  - Masters Degree in Taxation; Bachelors Degree in Accounting
  - Two years experience in Big 6 Public Accounting (PwC)
- **Brandt Blanken, Managing Director**
  - 20 Years Experience in Investment Banking (15) & Private Equity (5)
  - Series 7, 24, and 63 Securities Licenses
  - Principal of Fallbrook Capital
- **Laura Azzalina, Vice President**
  - Corporate Controller, VP M&A, and VP Finance roles in various industries, from travel, fashion, and lifestyle to renewable energy
  - Advisor, Goldman Sachs 10,000 Small Businesses Program
  - 2 Years Big 6 Accounting Experience (Deloitte)
  - Undergraduate Degree in Business from Boston University
  - MBA from Babson College

# MIDDLE MARKET M&A ACTIVITY

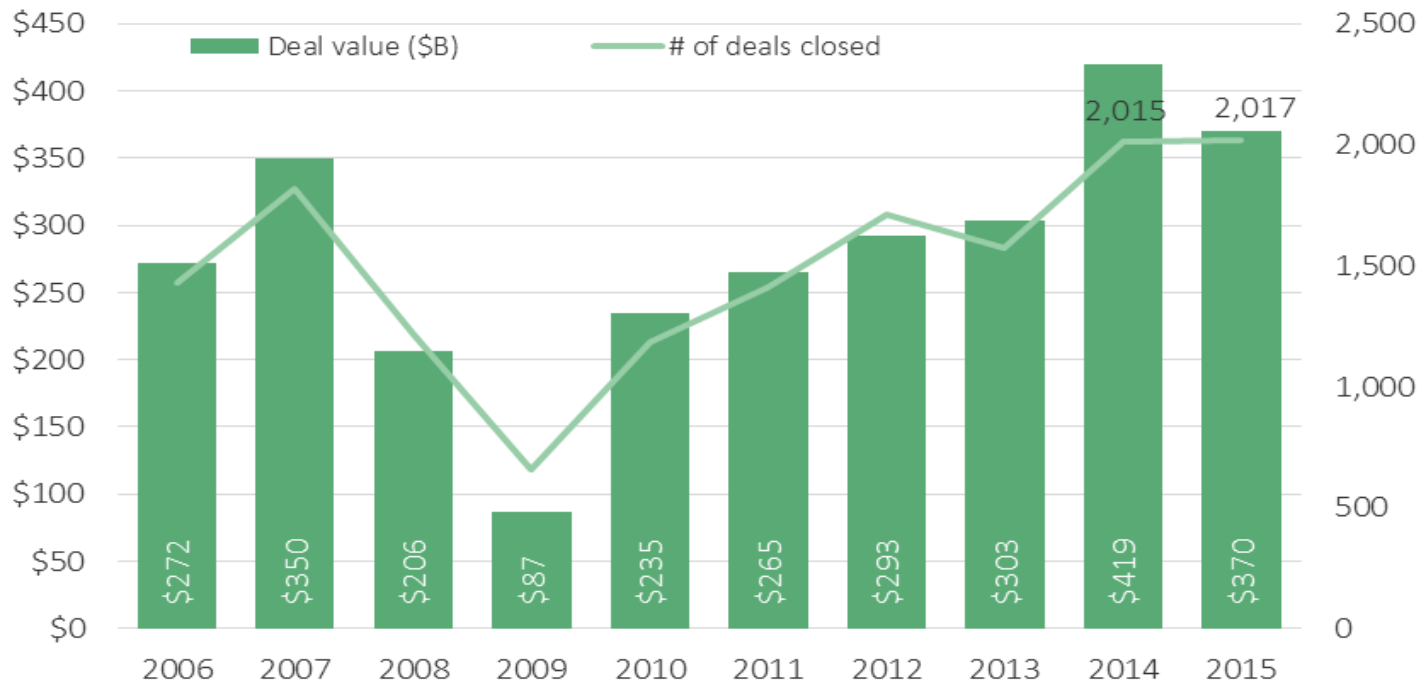
- Middle-market M&A activity dropped 8% in terms of both volume and value in 2015 from 2014.
- 2015 deal activity was front-loaded with a strong 1<sup>st</sup> quarter and weak 4<sup>th</sup> quarter. The 4<sup>th</sup> quarter showed a dramatic dip, with 167 fewer deals closed than in 2014, representing a 26% drop.
- Valuations remained strong however with a continued limited supply of high quality deal flow. Inflated valuations, the likes of which had not been seen since pre-recession 2007, permeated the landscape. The high prices kept many dealmakers away.
- Another factor that entered into play at the end of the year was the rising price of debt as dealmakers turned to alternative higher cost lenders while banks began to respond to regulatory pressures.
- The first two months of 2016 delivered just 236 closed middle-market transactions, the worst deal volume for the period since 1991, based on analyzing data from Thomson Reuters.



Sources: PitchBook Data, Mergers & Acquisitions, Thomson Reuters.

Source: PitchBook Data. Deals valued \$25mm to \$1bn.

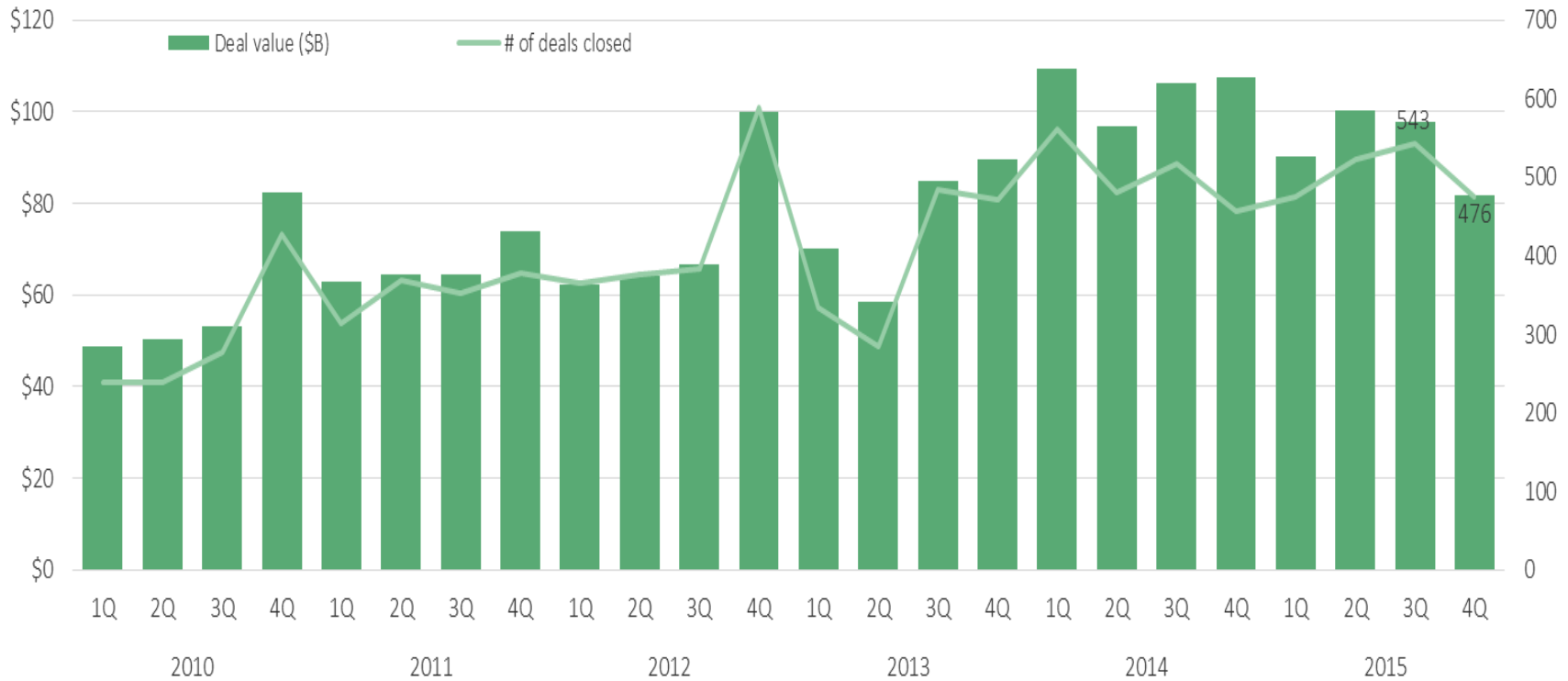
# MIDDLE MARKET PE ACTIVITY - ANNUAL



- \$370 billion was invested by PE firms in the Mid-Market in 2015 across 2,017 completed deals, representing a year-over-year decline of 12% in terms of total value
- The total number of completed deals was basically flat

Source: PitchBook Data deal sizes \$25 million to \$1 billion.

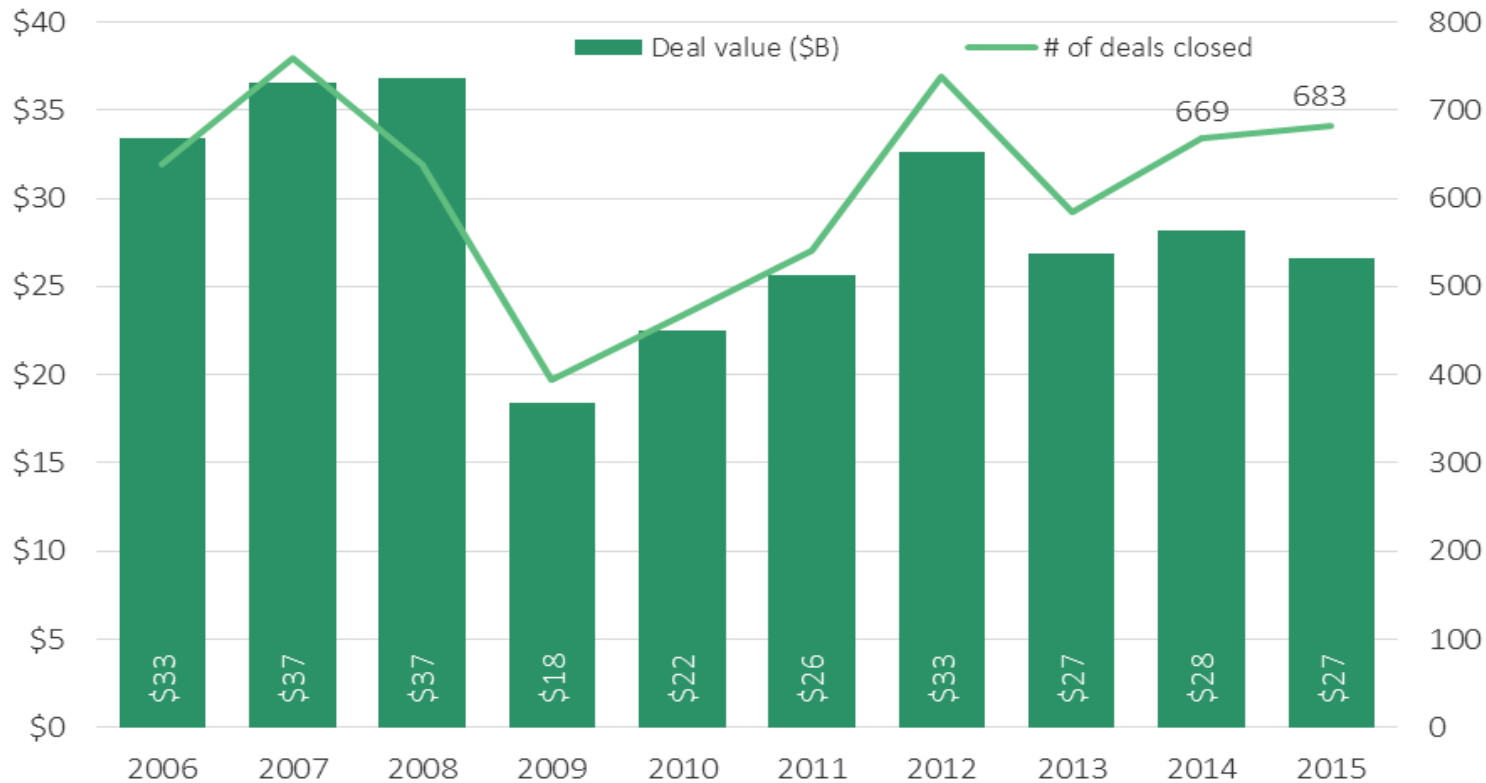
# MIDDLE MARKET PE ACTIVITY - QUARTERLY



- On a quarterly basis, we saw healthy growth from 1Q to 2Q, followed by a slight drop off in total value midway through the year.
- Activity plunged in 4Q, however, in a shift likely attributable to some of the same trepidations we saw affect total M&A and PE activity during the same timeframe.

Source: PitchBook Data, deals valued \$25mm to \$1bn.

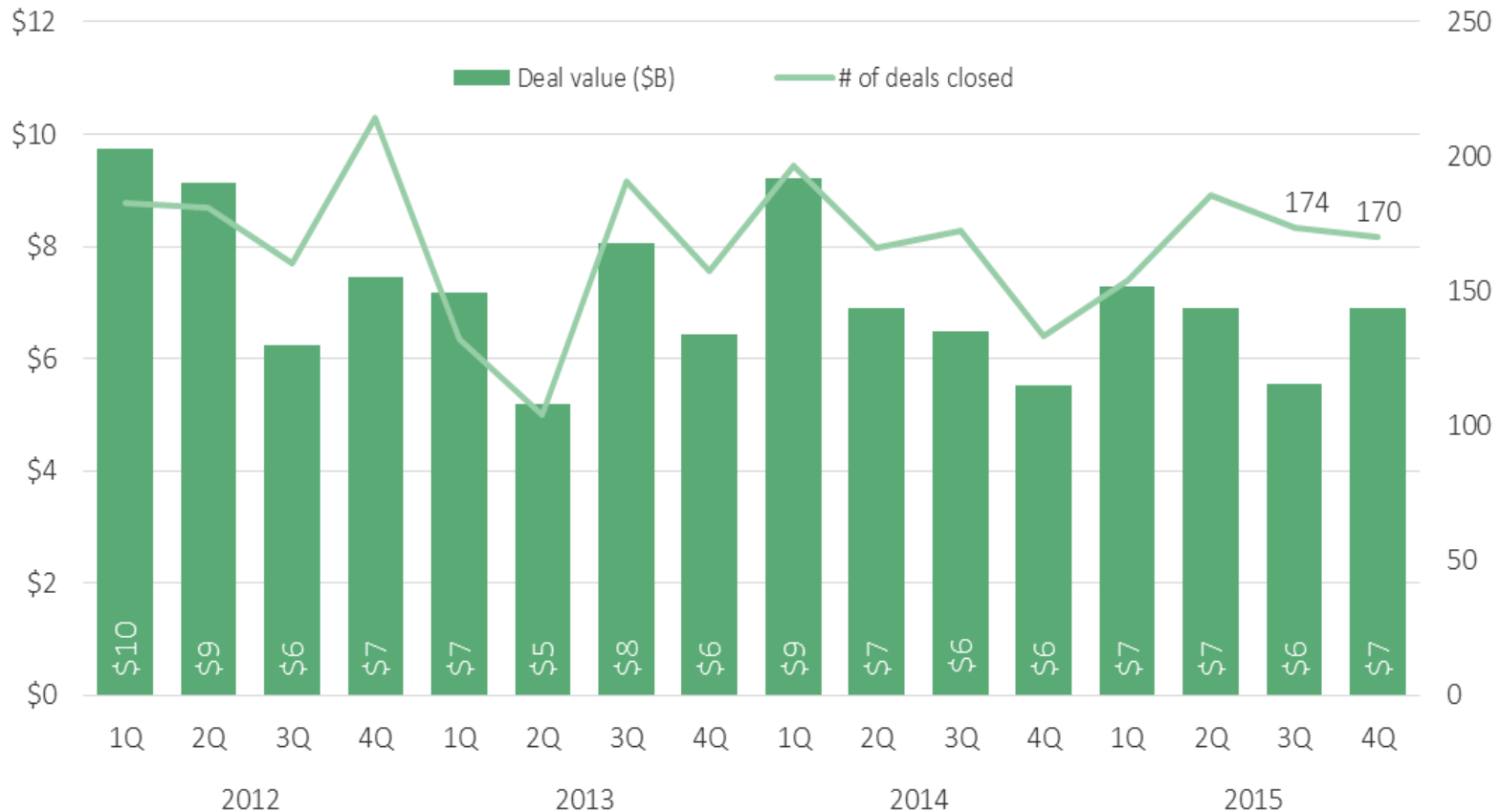
# LOWER MIDDLE MARKET PRIVATE EQUITY ACTIVITY



- With PE buyers being squeezed out by strategics in auction processes, we've seen LMM transaction volume remain stable.
- While PE deal volume was flat and deal value was down 12% in the overall middle-market, the lower middle market PE segment was noticeably stronger
  - PE in the LMM was down by only 5% in value last year and while deal volume increased 2% compared to 2014.

Source: PitchBook Data deal values \$25 million to \$100 million.

# LOWER MIDDLE MARKET PRIVATE EQUITY ACTIVITY

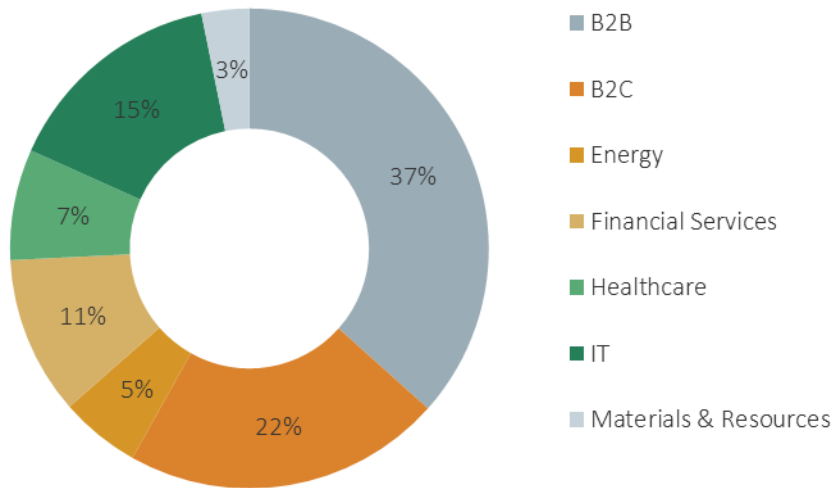


- In the LMM, the value of PE investments actually increased in the 4<sup>th</sup> quarter, compared to a significant sequential quarterly drop in the overall mid-market.
  - Deal volume dropped only 2% compared to a 12% sequential drop in the overall mid-market

Source: PitchBook Data deal values \$25 million to \$100 million.

# 2015 PE LMM INVESTMENTS BY SECTOR

BY NUMBER OF DEALS



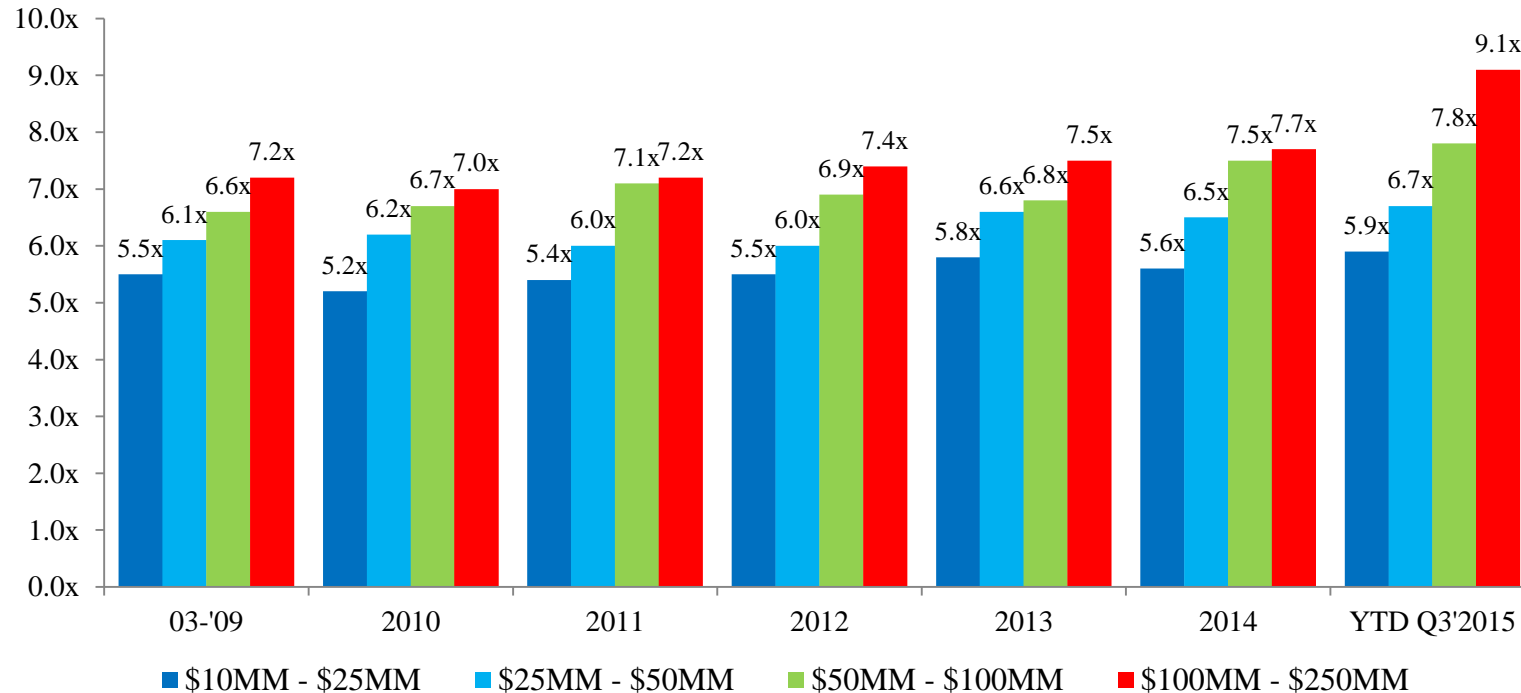
|                       | 2015 |
|-----------------------|------|
| B2B                   | 250  |
| B2C                   | 147  |
| Energy                | 37   |
| Financial Services    | 73   |
| Healthcare            | 51   |
| IT                    | 103  |
| Materials & Resources | 22   |

- Business (B2B) Products & Services remains the largest area of interest for Private Equity, followed by Consumer Products & Services. This has held true for many years
- The concentration of investment in B2B at the lower ends of the middle market illustrates the ongoing building out of B2B platforms.

Source: PitchBook.

# LOWER MIDDLE MARKET PE DEAL VALUATIONS

## EV/EBITDA Multiples by Deal Size

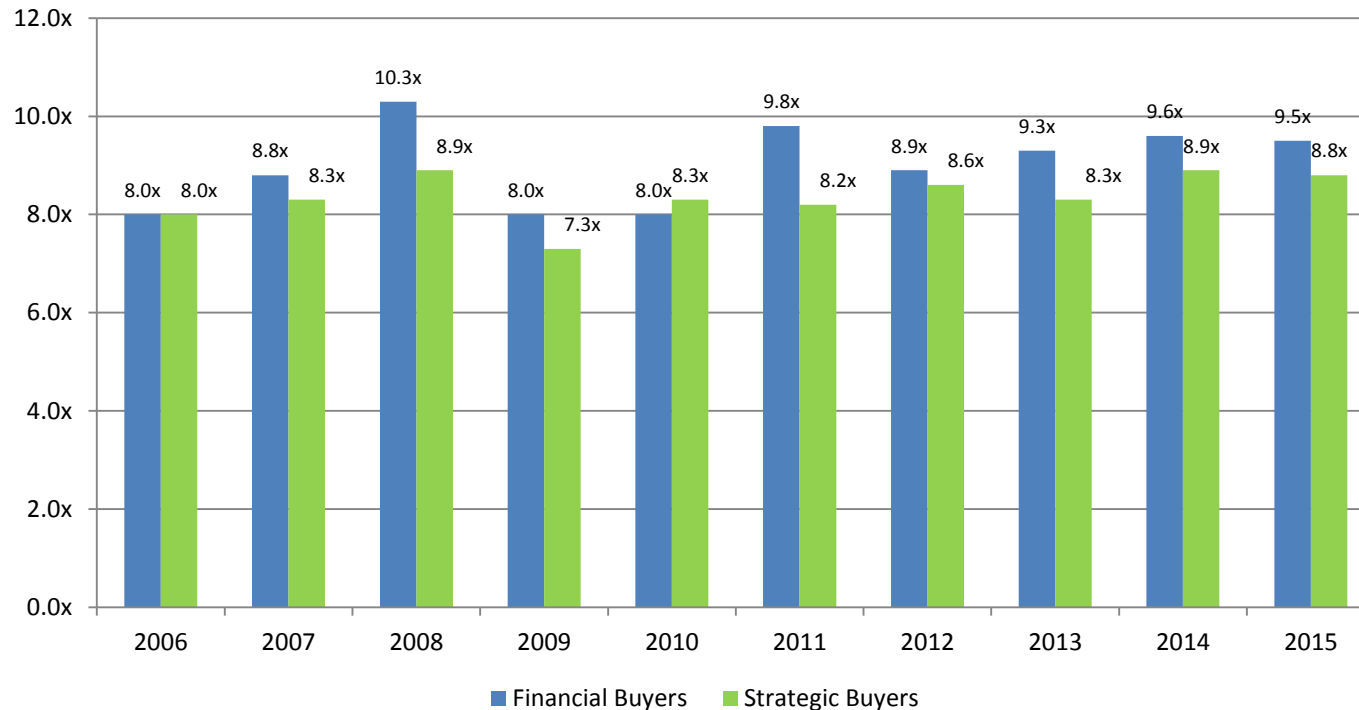


- Private equity deal valuations indicate a continuing trend of bigger is better.
  - For the most part, deals of at least \$25MM in size have seen an increase in multiples with the largest increases seen in deals of over \$100MM
  - Valuations for small deals however (less than \$25MM) finally ticked up in 2015 as activity at the lower end tends to lag activity and trends at the upper end
  - Despite size, multiples for growing companies in strong sectors are higher than average

Source: GF Data.

# PRIVATE EQUITY VS. STRATEGIC VALUATIONS

## EV/EBITDA Multiple by Buyer Type (Upper Middle Market)



- From looking at the broader M&A middle market data above, we can see that valuation multiples have generally increased from both strategic and financial buyers over the past several years.
- Continuing a multi-year trend, PE buyers have been paying more than strategic buyers.
- These higher prices being paid by PE funds reflect the urgency in deploying un-invested capital, the availability of debt financing as well as the scarcity of “good” deals.

Source: PitchBook Data (deals valued \$50MM to \$1Bn).

# BUSINESS OWNER SURVEY BY CITIZENS BANK

In late 2015, Citizens Commercial Banking conducted a survey of 598 U.S.-based middle market business decision-makers who are open to or currently engaged in some form of corporate development activity, including mergers, acquisitions and raising capital. For the purposes of this survey, middle market businesses are defined as private or public companies with annual revenue between \$5 million and \$2 billion.

- Top concerns among buyers are “inherited liability” and “overpaying for an acquisition.” Smaller middle market firms (below \$25 million revenue) are also worried about losing key employees during an acquisition, while larger firms are worried about market fluctuations that could impact deal values.
- 83% of upper middle market (greater than \$25 million revenue) potential sellers report that they have been either extremely (25%) or moderately (58%) impacted by volatility in the global economy.
- 41% of upper middle market potential sellers fear a significant financial crisis in the next three years.
- Top reasons for selling are to provide liquidity for owners and to take advantage of current market value. 41% of lower middle market owners also cite “fatigue.”
- The greatest worry among middle market sellers is being underpaid for their firms.
- 56% of upper middle market sellers say they believe asset valuations will stay the same (42%) or even decrease (14%) over the next year.