



**M&A Update**  
**U.S. Micro Middle Market**  
**1H 2023**



Member FINRA | Member SIPC

# 1 Executive Summary

## Key Takeaways



### M&A Activity

*Transaction activity in Q2 2023 falls to lowest point in past two years*



### Valuation Multiples

*Purchase price multiples dragged down by high interest rates and economic uncertainty*



### Sector Activity

*Reduced activity across the board, multiples remain strong in healthcare and business services*



### Leverage

*Credit markets tighten as senior debt rates rise*

#### In this report:

- 1 | Executive Summary
- 2 | M&A Overview
- 3 | Sector Breakdown
- 4 | Leverage
- 5 | Houlihan Capital

#### Who we are:

Houlihan Capital is a leading valuation and investment banking firm committed to delivering superior client value and thought leadership in an ever-changing landscape.

#### Micro Middle Market Overview:

Houlihan's Investment Banking group specializes in providing sell-side M&A advisory services to owners of privately-held businesses within the Micro Middle Market ("MMM"), which we define as those with total enterprise value ("TEV") below \$250M.

#### Contact Info:

200 W. Madison Street, Suite 2150  
Chicago, IL 60606

2400 Superior Avenue E., 1<sup>st</sup> Floor  
Cleveland, OH 44114

(312) 450-8600

[info@houlihancapital.com](mailto:info@houlihancapital.com)

#### Data Source:

The data used in this report was primarily sourced from GF Data, using information provided by 400+ private equity firms on their recent transaction activity.

# 2

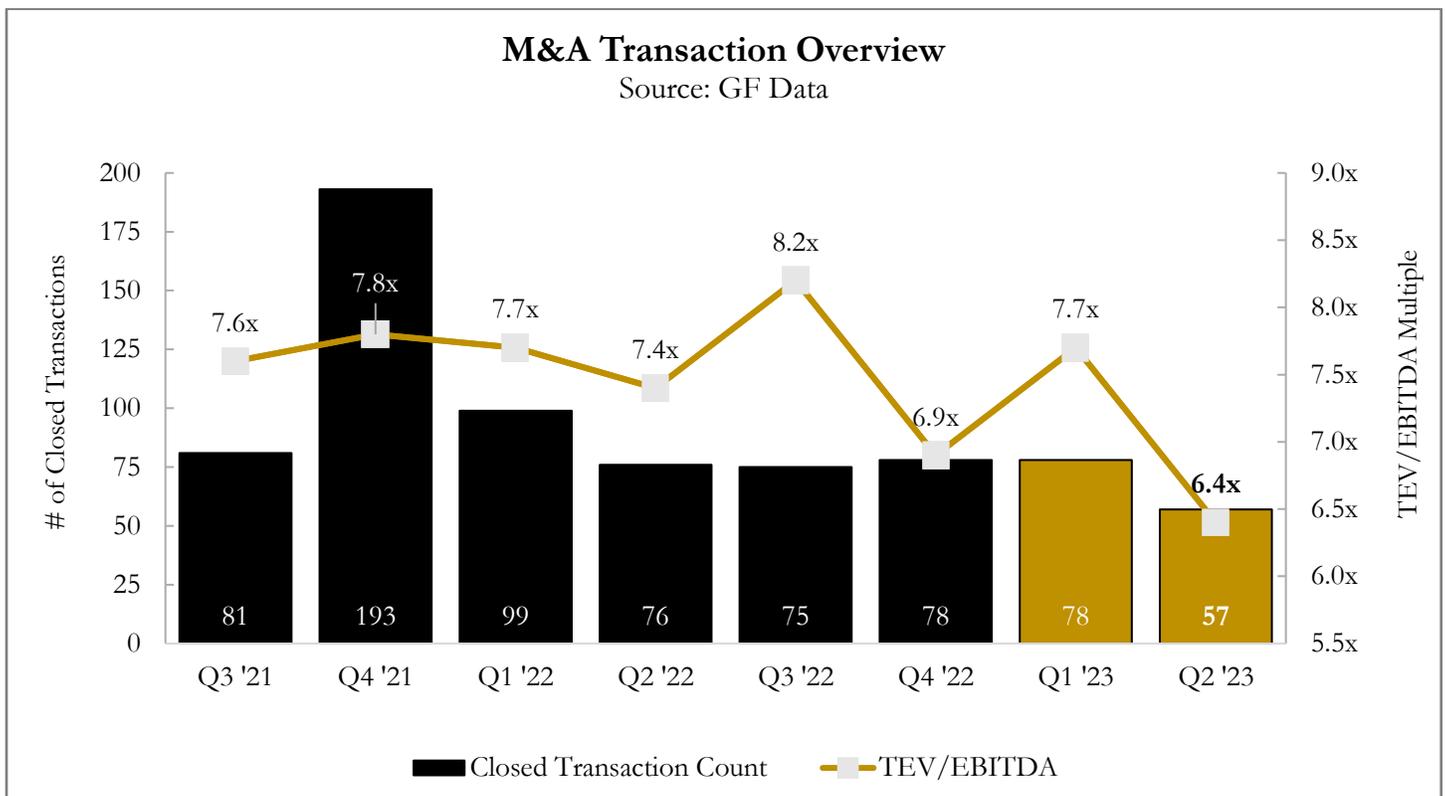
## M&A Overview

*Sharp Decline in Deal Activity and Valuation Multiples*

After a year of steady deal closings in 2022, M&A activity in the Micro Middle Market (“MMM”) exhibited a notable decrease in the first half of 2023 compared to the preceding two (2) years due to a combination of factors, including economic uncertainties and shifting investor sentiments. Persistent economic challenges, marked by supply chain disruptions and inflation concerns, led many potential buyers and sellers to exercise caution, resulting in more modest M&A activity.

Valuation multiples on completed deals decreased notably in Q2 2023, averaging just 6.4x trailing twelve-month (TTM) adjusted EBITDA, compared to 7.7x in Q1 and an average of 7.6x across the prior three (3) years. This recent shift was influenced by the surge in interest rates – as the central bank shifts towards tightening monetary policies to combat inflation, borrowing costs for buyers have increased significantly. Consequently, this higher interest rate environment not only tempered enthusiasm for M&A transactions but also contributed to a pronounced decline in valuation multiples, signaling a notable shift in the investment landscape during Q2 2023.

Despite recent challenges, the lower middle market remains a dynamic space, and the decrease in activity in Q2 2023 can be viewed as a temporary adjustment rather than a long-term trend, with the potential for resurgence as conditions stabilize.



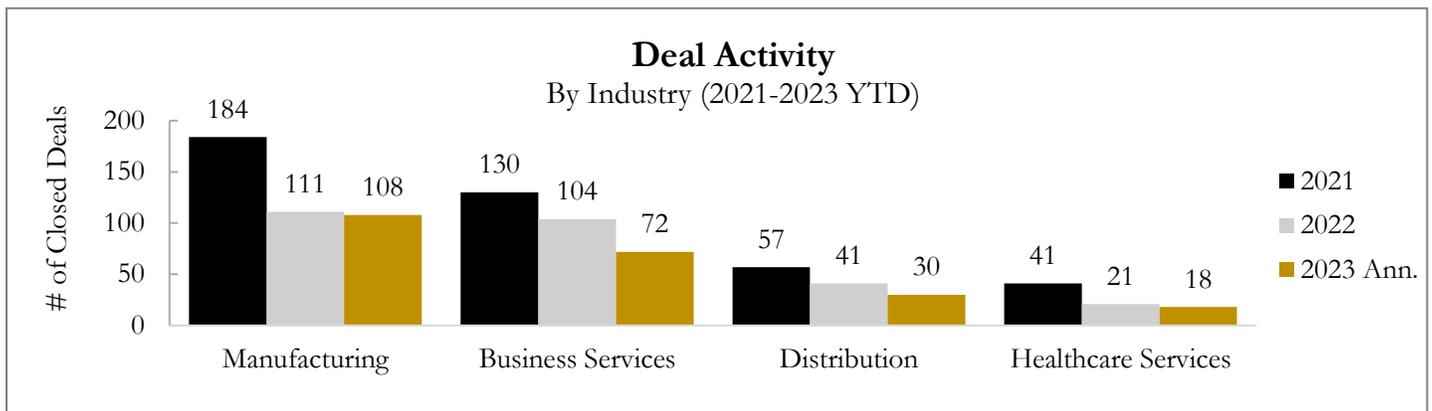
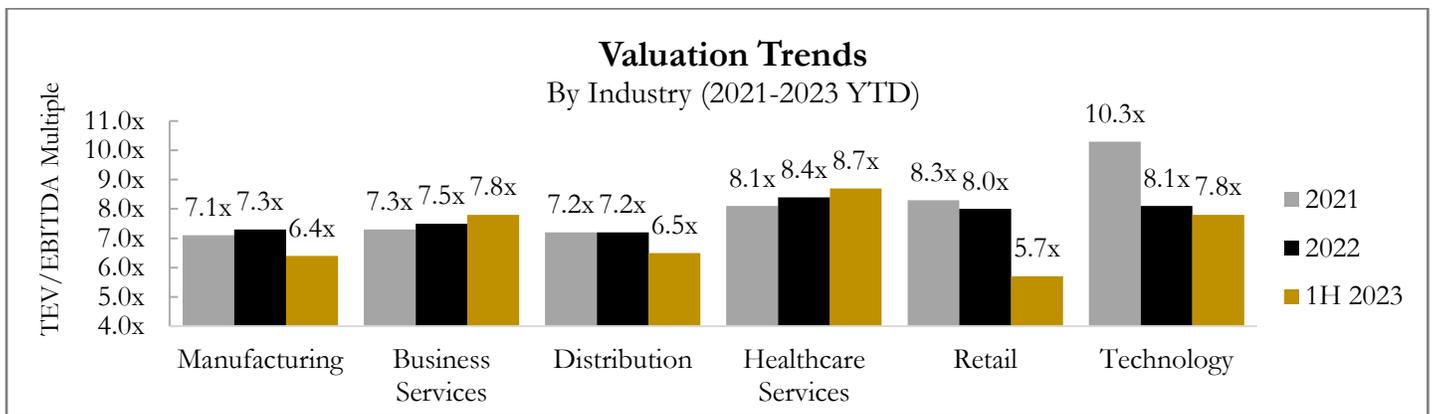
# 3

## Sector Breakdown

*Decreased Volume Across Sectors, Multiples Remain Strong in Healthcare and Business Services*

While the broader M&A market cooled off in the first half of 2023, valuation trends have differed across industries. The table below compares TEV/EBITDA multiples in 2022 vs. 1H 2023 in six (6) major industries.

The largest valuation declines occurred in asset-heavy businesses such as manufacturing, distribution, and retail. During the same period, there was a slight increase in multiples paid for business services (B2B) and healthcare companies.



The chart above analyzes deal volume broken down by industry from 2021-2023, with 2023 annualized based on data through Q2. As shown, the decrease in M&A activity has been consistent across the board, with each sector showing year-over-year (YoY) declines since 2021.

Another notable M&A trend has occurred amongst financial buyers in recent quarters. A number of private equity firms have pulled back in 2023, focusing on optimizing their portfolio companies rather than pursuing new platform acquisitions. This has contributed to a notable decline in sponsor-to-sponsor deal activity thus far in 2023.

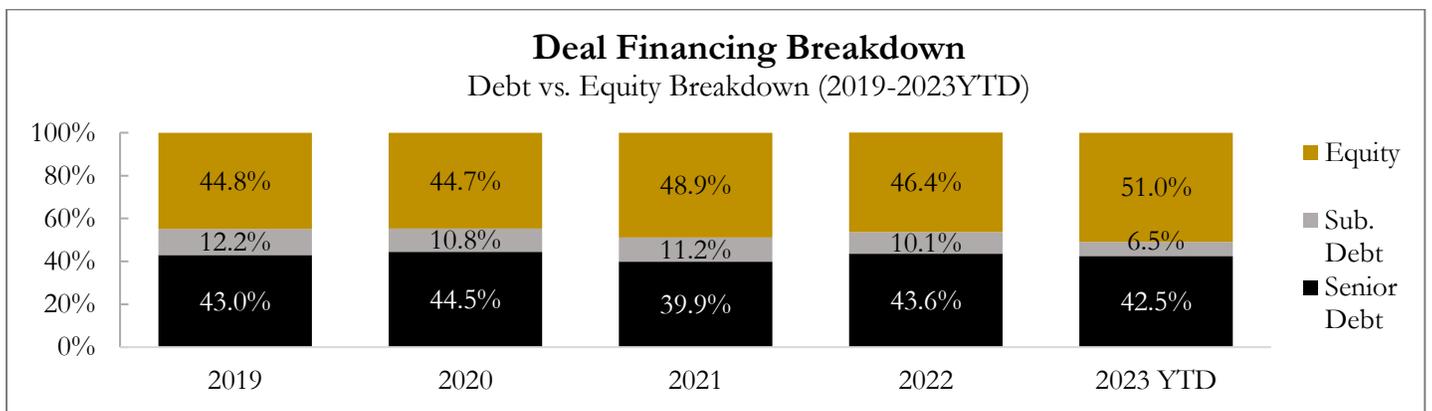
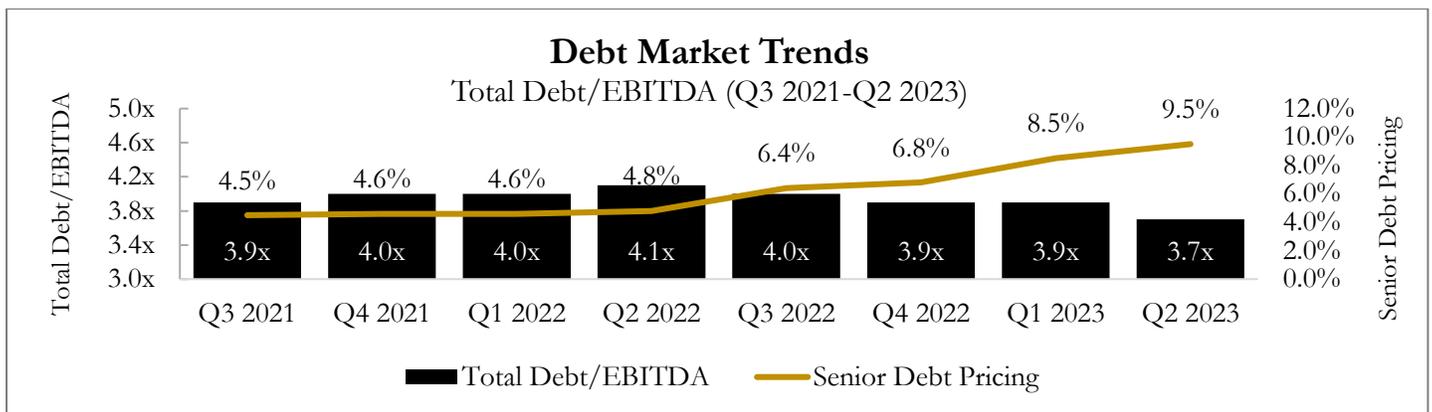
# 4

## Leverage

*Debt Markets Tighten as Rates Continue to Rise*

M&A lending markets have tightened in recent periods due to rising interest rates. Banks and lending institutions have become more selective in their lending practices while requiring a more rigorous evaluation process. This has made it essential for companies to demonstrate strong financial health and a clear strategic rationale for their proposed transactions.

The chart below shows total debt/EBITDA on a rolling four-quarter basis from Q3 2021 to Q2 2023. Inflation in the US peaked in June 2022 at 9.1%, causing the Fed to hike rates more aggressively in the months following, ultimately sending senior debt rates climbing from 4.8% in Q2 2022 to 9.5% in Q2 2023. During this same period, the average total debt on deals declined by nearly a half turn from 4.1x to 3.7x EBITDA.



As illustrated in the chart above, acquirers have used an increasing amount of equity financing to fund their acquisitions as debt markets have tightened. This is another key driver in declining valuation multiples, as higher equity contributions mean buyers aim to reduce purchase price to achieve their target rate of return.

---

# 5 | Houlihan Capital

*Investment Banking team*

Houlihan Capital’s Investment Banking group offers an integrated advisory approach that draws upon our strategic and technical expertise, industry knowledge, transactional and financing experience, and expansive network of institutional and private investors to guide shareholders and management teams. We understand the time sensitivity of many of our assignments and work diligently to meet these demands while minimizing operational disruption, allowing clients to focus on their business.

Our team works with businesses across all major industries with an enterprise value greater than \$5.0 million and EBITDA between \$1.0 million than \$20.0 million. Many businesses of this size have a unique story to tell, and we are committed to structuring a tailored approach to assist clients in achieving their strategic, financial, and risk-management objectives.

Our investment banking professionals function as an extension of our client’s management team, providing specialized transaction advisory support derived from years of hands-on experience. Our clients can stay focused on running their business while Houlihan runs a successful sale process.

**To find out more about how Houlihan can assist in the deal process, please contact one of the following members from our team:**



**Monica Blocker**  
Director – Business Dev.  
(312) 450-8699 (Chicago)  
mblocker@houlihancapital.com



**Andy Smith**  
President  
(216) 340-8011 (Cleveland)  
asmith@houlihancapital.com



**Frank Martinez**  
Vice President  
(872) 277-0185 (Chicago)  
fmartinez@houlihancapital.com



**Chuck Fenske**  
Vice President  
(216) 273-3593 (Cleveland)  
cfenske@houlihancapital.com



**Jacques Zureikat**  
Senior Associate  
(872) 277-0186 (Chicago)  
jzureikat@houlihancapital.com

*Houlihan Capital is a broker-dealer registered with the US Securities and Exchange Commission (SEC) and member of the Financial Industry Regulatory Authority (FINRA) and the Securities Investor Protection Corporation (SIPC).*

© 2023 Houlihan Capital, LLC. All rights reserved.



## Disclosure

This newsletter is a periodic compilation of certain completed and announced merger and acquisition activity. Information contained in this newsletter should not be construed as a recommendation to sell or a recommendation to buy any security. Any reference to or omission of any reference to any company in this newsletter shall not be construed as a recommendation to sell, buy or take any other action with respect to any security of any such company. We are not soliciting any action with respect to any security or company based on this newsletter. This newsletter is published solely for the general information of clients and friends of Houlihan Capital, LLC. It does not take into account the particular investment objectives, financial situation, or needs of individual recipients. Certain transactions, including those involving early stage companies, give rise to substantial risk and are not suitable for all investors. This newsletter is based on information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied upon as such. Prediction of future events is inherently subject to both known risks, uncertainties and other factors that may cause actual results to vary materially. We are under no obligation to update the information contained in this newsletter. We and our affiliates and related entities, partners, principals, directors, and employees, including persons involved in the preparation or issuance of this newsletter, may from time to time have “long” and “short” positions in, and buy or sell, the securities, or derivatives (including options) thereof, of companies mentioned herein. No part of this newsletter may be copied or duplicated in any form by any means, or redistributed without the prior written consent of Houlihan Capital LLC.