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The State of M&A: A Look at 2023 and the Year Ahead

Deal Environment

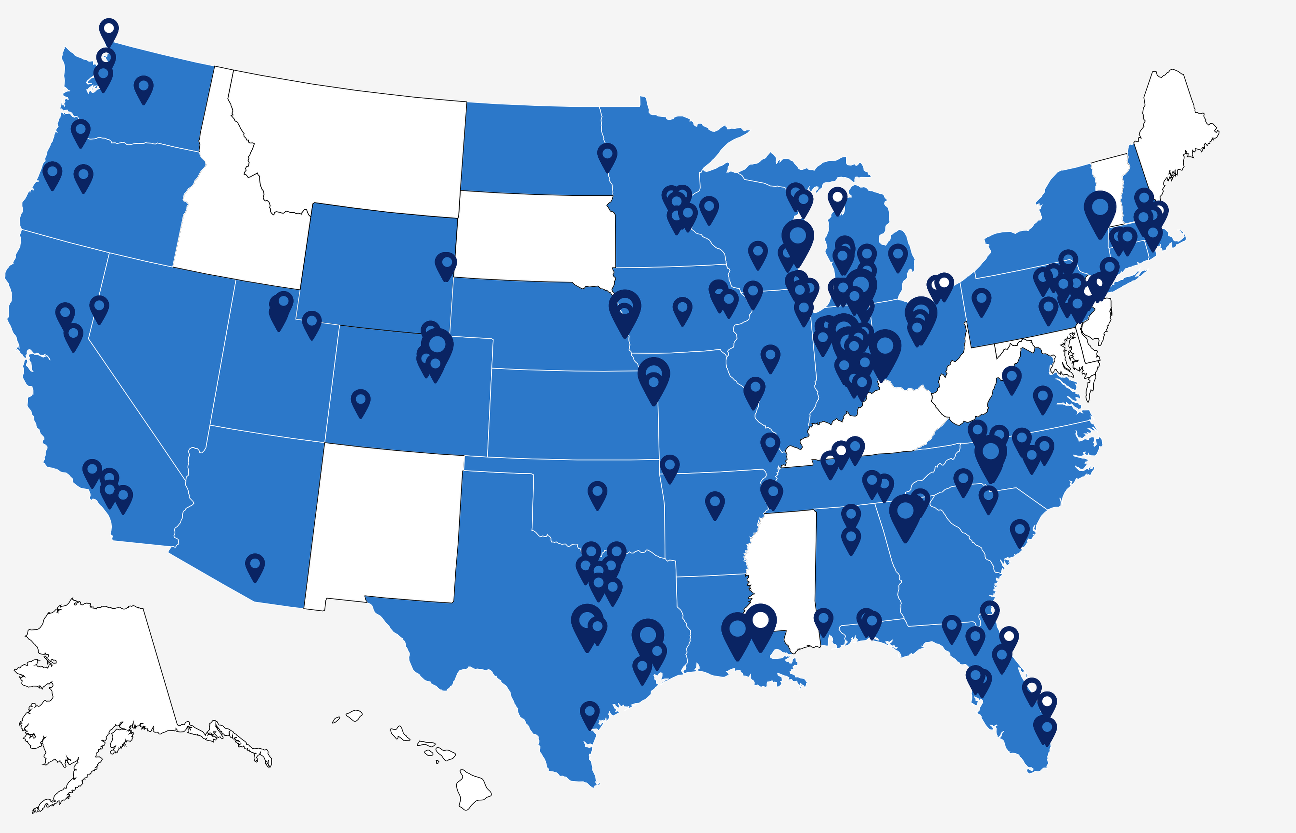
In 2023, the mergers and acquisitions (M&A) landscape faced challenging macroeconomic conditions. Fears of a recession, rising interest rates, and growing geopolitical tensions added uncertainty to an already slow deal market. Differing valuation expectations dampened deals as sellers continued to look for valuations close to peak levels and buyers held out for more conservative multiples.

Despite this, the lower middle-market continued to show resilience in getting deals done. Some dealmakers embraced creative structures that leveraged seller-backed financing options to bridge the gap. Other private equity investors remained active by relying primarily on equity or existing debt facilities to execute add-on acquisitions.

According to GF Data, average multiples in the lower middle-market held steady in 2023 and even increased in the second half of the year. This dynamic incentivized some sellers to transact and proved buyers were motivated to deploy capital for quality assets.

Even with the tough market conditions, KSM's Transaction Advisory Services Group grew 40% in 2023, with nearly 150 deals touched in a wide variety of industries.

KSM by the Numbers



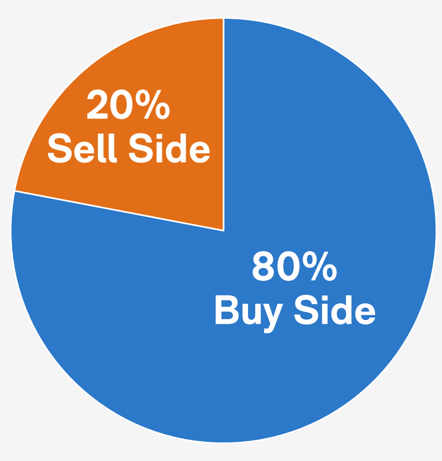
~150 Deals Touched

10+ Unique Industries Served

$2M-15M Average EBITDA Range

Up to $175M Deal Range

19 KSM Transaction Advisory Services Team Members



90 Private Equity Buy-Side Deals

24 Strategic Buy-Side Deals

Deal Environment

Industrial

Leveraging our deep expertise in the industrial sector, our transaction advisory team worked on over 60 industrial deals throughout 2023. Much of this volume was driven by add-on activity in the heavy equipment and commercial trade spaces. Many deals in the industrial space involve increased diligence around revenue recognition due to the frequency of longer duration projects and accounting for customer contracts. Companies that utilize the percentage of completion (POC) method of accounting estimate revenue and expenses for projects, which can lead to unexpected changes in earnings and net working capital during the historical period. KSM's transaction advisory team is well versed in evaluating the impact of POC accounting and ensuring it is properly reflected in deal dynamics for both buyers and sellers.

Manufacturing & Distribution

KSM saw an increase in manufacturing and distribution deals in 2023, with volume up 54% from the prior year. Although volume was strong, deals were notably slower to move through the diligence process due to increased investor scrutiny caused by macroeconomic uncertainty. Purchase price multiples in the manufacturing space saw positive momentum in the second half of 2023. According to GF Data, private equity-backed manufacturing deals with enterprise values between $10 million and $250 million had an average valuation multiple of 6.7 times the trailing-twelve month adjusted earnings before interest, taxes, depreciation, and amortization (EBITDA) in the second half of the year. The average valuation multiple through the first two quarters of 2023 was only 6.4 times the trailing-twelve month adjusted EBITDA.

Consumer

Deal volume in the consumer sector continued to be soft in 2023 as consumer discretionary spending was muted by persistent inflation, high interest rates, and fear of a possible recession. Despite the headwinds, some buyers reentered the consumer space when record high inflation numbers began to decline in the first quarter. The KSM team worked on three times more consumer deals in 2023 than the prior year, primarily in the fresh produce, niche food, and recreation spaces. Industry experts expect the consumer space to rebound, albeit slowly, in 2024 as inflation continues to cool and consumer confidence increases.

Business Services

Business services deal activity remained steady in 2023. Investors were attracted to the sector due to its recurring revenue and a belief that many parts of the industry are recession-resistant. According to GF data, overall valuations on business services deals are still above the historical multiple average of 6.9 times. In 2023, KSM worked on several deals in the business services sector, predominately in the wealth management, professional staffing, and insurance spaces.

Transportation & Logistics

Freight continued to face a challenging environment in 2023, with pricing and volumes down substantially from 2021 highs. Freight brokers saw an across-the-board decline in revenue and profitability that nearly halted the M&A market in 2023. The trucking sector was also affected by slowing freight and freight rates; however, well-capitalized buyers in niche spaces still found ways to transact. Because of KSM's deep transportation and logistics industry expertise, we helped several clients navigate the uncertainty of the freight market and close successful transactions in 2023. We, along with other industry professionals, anticipate that there will be pent-up demand in the M&A market once the freight market tightens back to historical levels.

2024 Outlook

What will 2024 hold for dealmakers? Overall, there appears to be optimism that 2024 will bring an increase in deal volume. Despite macroeconomic headwinds, private equity firms are not in the business of keeping capital on the sidelines, and aging sellers have grown impatient waiting for valuations to return to 2021 levels. As the valuation gap between buyers and sellers continues to narrow, baby boomers will likely put their businesses on the market, providing opportunity for increased deal volume in 2024 and beyond.

KSM's transaction advisory services team saw robust deal flow in the fourth quarter of 2023, which continued into the first quarter of 2024. We are expecting another year of robust lower middle-market M&A activity.

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