

# GK QUARTERLY



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## *The Current State of Middle Market Mergers, Acquisitions and Capital Markets*

Representatives of RSM US LLP, CIBC Cleary Gull, CIBC US (structured finance), Green Light Growth Partners and Godfrey & Kahn joined RSM's regional CFO Club meeting Nov. 16 to discuss the current state of middle market mergers and acquisitions and capital markets. The following are highlights:

1. Through August 2021, deal volume for transactions with values < \$500 million is up 21% and deal size 90% from 2020 levels, according to data from Robert W. Baird & Co., with "lots of capital chasing a limited number of deals."
2. Private equity fundraising and allocations to this sector by pension funds, endowments, family offices and other institutional investors are at record levels.
3. For financial buyers and transactions < \$250 million, the average transaction multiples have held relatively steady. "7x is the new 6x" if comparing the current market to the middle market prior to the Great Recession. Viewing datasets that combine strategic acquirers with private equity pushes the average to around 9.5x, which is also relatively flat compared to 2020 levels.
4. "Hot" sectors include robotic automation, health care, consumer products and the supply chain that supports them (e.g., distribution and packaging), infrastructure, and outsourced business services that are isolated from supply chain disruptions and can offer recurring revenue streams.
5. Top-of-the-market multiples demand clean (or substantially clean) accounting and other due diligence. Buyers are less likely to allow adjustments for "COVID-19 effects" in target earnings and pro forma earnings arguments.
6. For deals between \$10 million and \$250 million in EV, the average leverage reports are in at 3.8x total leverage, 3.3x on a senior basis. Credit pricing in 2021 has returned to levels closer to 2019, following some pricing escalation during 2020.
7. For further context, high-yield corporate debt is trading below 5% interest.
8. This environment has put pressure on, and displaced in certain cases, a mezzanine debt market.
9. Deal volume, in particular in this last half of 2021, has put pressure on the M&A system. Deals are taking longer to sign and close in this environment as lenders, insurance providers, accountants, lawyers and other consultants (tech, environmental/regulatory, antitrust, etc.) are operating at full or excess capacity.

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10. Deal volume has caused representations and warranties insurance carriers to move upstream in deal size and pricing. Average premiums have moved up during 2021 to somewhere in the 4.0%–4.5% range, with total costs in the 5.0%–5.5% range, and there is less insurer interest at the lower ends of the middle market. This pricing has moved 1.0%–1.5% from 2020 figures and a steady pro-insured trend line over the last five or so years. Insureds have also faced an increase in proposed exclusions to coverage in certain circumstances, which can be negotiable depending on the issue, available diligence and other factors.
11. Increased antitrust scrutiny, and capacity issues at the Department of Justice and Federal Trade Commission, have slowed closing of certain transactions or at a minimum added uncertainty.
12. The panel views 2022 as another probable strong environment for middle market M&A activity. The abundance of capital seeking opportunities is the overriding variable pushing this outcome. Challenges related to inflation, supply chain, freight, labor and COVID-19, to name a few (and note that the Omicron variant was not widely discussed or publicized at the time of the panel), are unlikely to materially change the trajectory of the market in 2022, if these potential headwinds stay within currently predicted outcome ranges and new material headwinds do not present themselves.

## About Godfrey & Kahn's Corporate/M&A Practice

Godfrey & Kahn has the experience and perspective of more than 50 transactional attorneys, positioning us well to handle a large number of deals each year across multiple industries. Our Wisconsin footprint allows us to deliver national expertise at smaller market rates. Every day our attorneys act as an extension of our clients' businesses by offering strategic insights and identifying, managing and mitigating risk. Whether we're collaborating with your in-house counsel or serving as your outside general counsel, our attorneys will provide practical legal solutions.

From startup businesses in growth mode to mature multinational corporations, Godfrey & Kahn attorneys regularly assist clients in the following areas:

- Mergers, divestitures and acquisitions
- Private equity
- Startups & venture capital
- Debt and equity financing
- Securities
- Corporate governance
- Commercial contracts
- General counsel & strategic advisory

