Monthly Transaction Monitor
Deal Volumes In The Age of COVID-19
September 2020

OBJECTIVE
Investment Banking & Valuation

Highlights

Stability is Returning to the M&A Market

- Control sale volumes in June and July of 2020 appear to be leveling at approximately two-thirds of corresponding 2019 levels.
- Healthy, well-performing companies are enjoying more attention from buyers given a shortage of attractive targets on the market presently.

Distressed Deal Activity May be Increasing

- Deal volumes in challenged sectors such as restaurants, retail (brick-and-mortar), and travel/leisure declined moreso than the broader market, down almost 66 percent in April versus the corresponding period from the previous year.
  - Closing in these challenged sectors increased materially in July, as predicted by bankruptcy advisory professionals in our network.

Valuation Multiples are Flat-to-Down Due to Pandemic

- Used as benchmarks for private company valuations, the performance of public company securities have been confusing the valuation picture lately.
  - With the S&P 500 up over 8 percent this year, and up over 44 percent since a Covid-related low on March 23rd, some business owners and other advisors have been wondering if middle market valuations have actually gone even higher this year.
  - A review of trends in the S&P 500 EBITDA multiple provides clues. While the EBITDA multiple is actually up almost 13 percent this year, removing the FAANG stocks from the index (Facebook, Apple, Amazon, Neflix and Google), which collectively account for over 15 percent of the S&P 500's value, the index's multiple is essentially flat.
  - Based on our activities as well as the activities of our peers, we estimate a decline in the average EBITDA multiple of approximately 1x, but actual results are highly situation dependent.

Source: S&P Capital IQ   Note: Data herein is based solely on the 6 industries Objective closely follows

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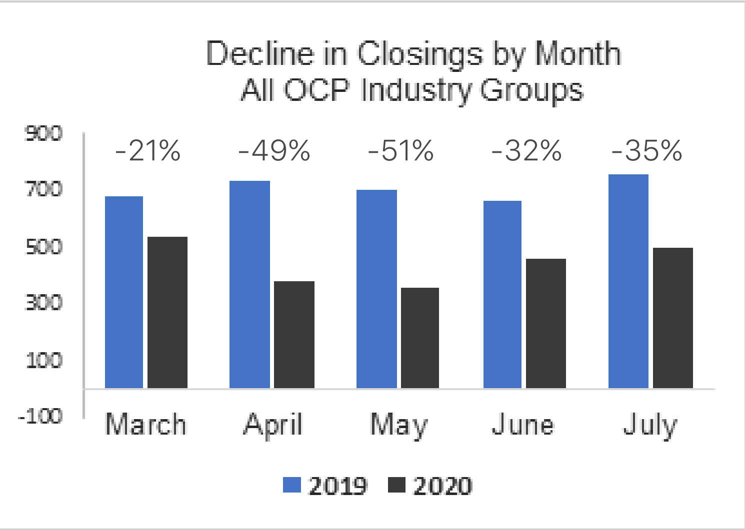
The Details

The volume of closed control sale transactions in the U.S. seems to have settled at down one-third from a year earlier, according to our research and S&P Capital IQ data (See Figure I). Covid-19 has certainly slowed deal making significantly. Optimists are quick to point out, however, that the market is far from dead, as closings continued to happen in July 2020 at approximately 65 percent of the corresponding 2019 level. That level of activity is not discouraging considering all the uncertainties, dislocations, and on-site diligence challenges that the pandemic brought.

Stability seems to be returning, with similar levels of closings in both June and July. This is a positive development given the 51 percent decline in May.

Figure 1



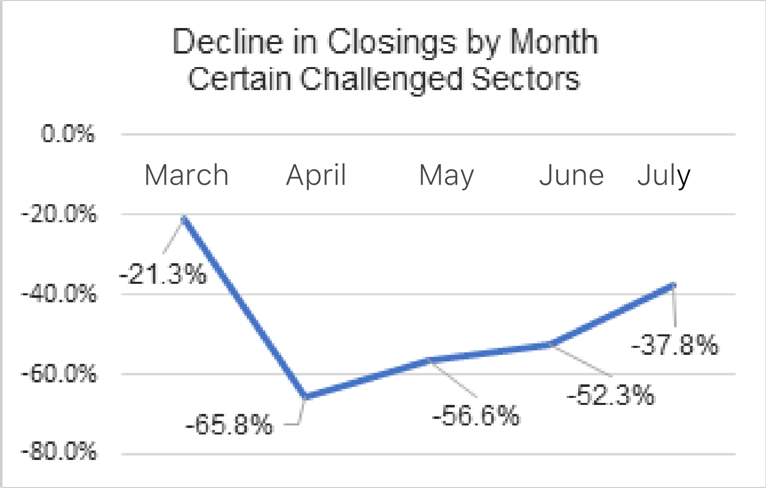
Source: S&P Capital IQ

A tale of two separate realities may be occuring. One storyline has relatively healthy companies, which thankfully remain in the majority, continuing to sell. In our view, these companies are actually enjoying more attention from buyers given a shortage of attractive targets on the market presently.

The other storyline is that of troubled companies in challenged sectors such as restaurants, brick-and-mortar retail, and travel/leisure. These companies have generally been in distress and, in many cases, propped up by government relief, have not been transacting in recent months.

Figure II charts YOY monthly deal volume declines in these challenged sectors and shows a steeper drop than the broader M&A market, bottoming in April at minus 65.8 percent. Surprisingly, closings in these specific sectors have bounced back, only down by approximately 38 percent in July. In our view, the improving trendline is not an indication that most of these businesses are out of the woods. More likely, distressed deals are now beginning to close.

Figure 2



Source: S&P Capital IQ

Dealmakers are being asked to provide an indication of just how much Covid-19 has caused valuation multiples to decline. We have heard a range of responses from our peers that typifies what we are seeing in our own portfolio of sell-side clients. Some of our clients have been negatively impacted, while it is arguable that others may be receiving higher valuations due to Covid. It is hard to say for sure, but we estimate that there's been a decline in EBITDA multiples on average of approximately 1x.

This view flies in the face of what we are seeing with publicly-traded securities. As shown in Table I, the S&P 500 is actually up over 8 percent this year. Only ***S&P's Industials index*** remains under water this year, despite a rise of nearly 43 percent since March 23rd.

It is risky to assume much from broadly-focused public stock indices like the S&P 500 when valuing privately-held companies. However, a careful segmenting of index data can be instructive. As illustrated in Figure III, the EBITDA multiple of the S&P 500 suggests a

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The Details (cont.)

material expansion of almost 13 percent since the beginning of the calendar year. However, the index has been heavily impacted by the FAANG stocks (Facebook, Apple, Amazon, Netflix and Google) which have moved up inordinately since January 1. These 5 stocks, whose collective market capitalization has risen by over 50 percent this year alone, account for over 15 percent of the S&P 500's value.

Table 1

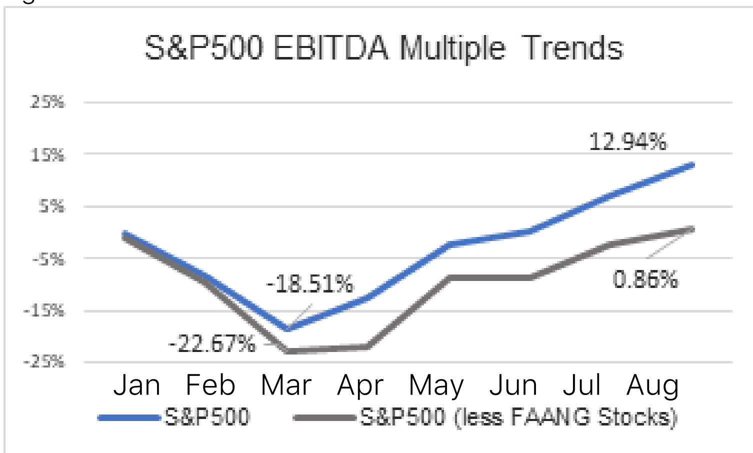
Stock Index Performance by Sector 2020

	01/2 - 03/23	03/24 - 09/1	01/2 - 09/1
S&P 500 Index (^SPX)	-31.32%	44.10%	8.25%
Consumer Discretionary	-28.55%	63.46%	26.89%
Consumer Staple	-21.93%	28.00%	4.77%
Healthcare	-26.84%	33.13%	4.80%
Industrials	-41.14%	42.59%	-5.36%
Information Technology	-24.39%	61.84%	34.98%

Source: S&P Capital IQ

It is clear that the FAANG stocks have moved the market and confused certain valuation metrics. As shown in Figure III, removing these stocks from the index

Figure III



Source: S&P Capital IQ

indicates that multiples on average for public securities are up a negligible amount in 2020. Further, discounts for size, lack of marketability, and systemic factors may substantiate conventional thinking that multiples have indeed declined on average this year.

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