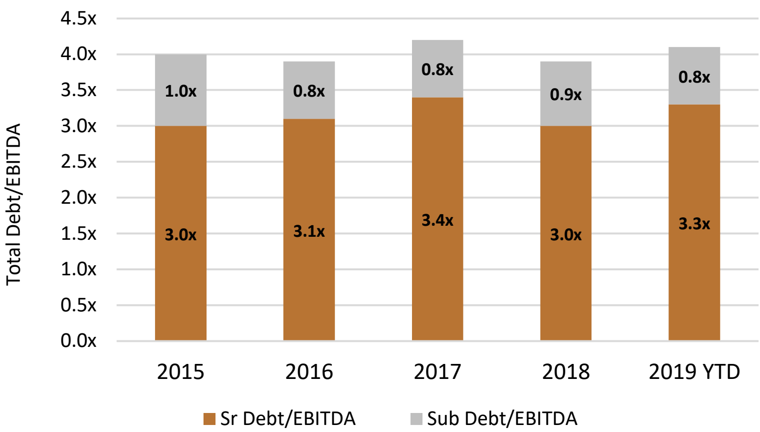
Debt Capital Market Update – Q2 2019

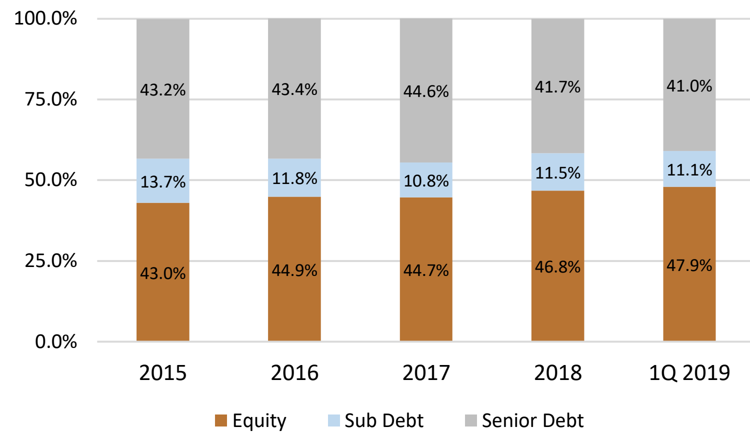
TKO Miller Debt Capital Market Analysis

- Leverage multiples remain at peak levels in M&A transactions due to an aggressive lending environment
- Leverage multiples, as measured by Total Debt / EBITDA, increased from 3.9x in 2018 to 4.1x in 2019 (as depicted in the graph, below & left)
- Transactions continue to see increasing equity contributions in response to rising purchase price multiples compared to 2018 levels (as depicted in the graph, below & right)
- Leverage conditions are expected to remain highly supportive over the next 9-12 months, but trade tariffs with China and Europe, a global economic downturn, or uncertain political conditions are capable of shifting conditions back to lower, more historical levels

Total Debt/EBITDA Multiples



Debt and Equity Contribution by Year



Source: May 2019 GF Data Leverage Report

Senior Debt Pricing – Splits by Period

TEV	2Q 2017	3Q 2017	4Q 2017	1Q 2018	2Q 2018	3Q 2018	4Q 2018	1Q 2019
10-25	4.9%	5.8%	5.5%	5.8%	5.5%	7.3%	5.2%	6.9%
25-50	5.3%	5.2%	5.5%	4.9%	5.9%	5.5%	6.1%	6.0%
50-100	6.2%	5.4%	6.0%	5.1%	7.0%	5.0%	6.5%	6.0%
100-250	6.8%	6.0%	5.4%	4.5%	6.7%	5.2%	5.3%	7.5%
Total	**5.7%**	**5.6%**	**5.6%**	**5.3%**	**6.1%**	**5.8%**	**5.9%**	**6.3%**

All-in Sub-Debt Pricing 2019 YTD

TEV	Coupon	PIK	WBR/FEES	Total
10-25	12.0%	1.9%	2.1%	14.7%
25-50	11.3%	2.2%	2.2%	14.5%
50-100	11.2%	2.5%	1.8%	14.3%
100-250	10.5%	2.5%	2.2%	13.7%
Total	**11.4%**	**2.2%**	**2.1%**	**14.4%**

Source: May 2019 GF Data Leverage Report

- The low cost of debt for middle market companies continues to fuel aggressive growth initiatives for both strategic and financial buyers as depicted in the chart on the above left (i.e. greater ability to fund acquisitions)
- The debt market is a key underlying driver of M&A valuations; valuations will decrease when leverage multiples fall and the cost of debt increases, which doesn't appear to be the case anytime soon as the Federal Reserve just lowered interest rates
- Banks and other short-term lenders are eager to place capital, however, they are also quick to tighten their underwriting standards to businesses and consumers during recessionary times
- Non-bank lenders such as insurance companies (rates of approximately 4.5%) or pension funds (rates averaging 5.0%) may be able to lock in less-expensive, longer-term capital (15 to 20 years) in order to purchase fixed assets or fund shareholder buyouts
- Many middle market companies may combine subordinated debt (the cost of such debt can be seen in the chart on the above right) with their senior debt structure when exploring financing for acquisitions to further increase their equity returns

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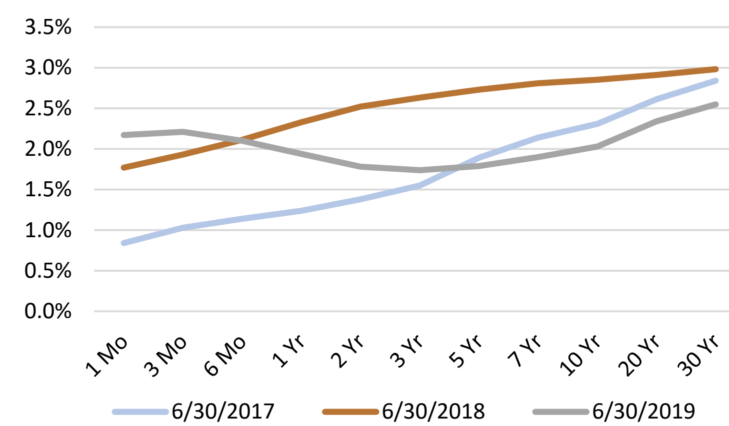
Interest Rate Update

- The most recent Yield Curve has less than a 50-basis point spread between the 1-month US Treasury and a 30-year US Treasury suggesting that this flattening could mean an economic downturn is on the horizon (as depicted in the graph below on the left)
- In order to avoid an economic downturn, the Federal Reserve recently lowered interest rates by 25 basis points for the first time since December 2008, after raising rates nine times since late 2015
- Recent FOMC guidance suggests that although recent government reports indicate that the economy remains on solid footing, rates had to be lowered as a precautionary measure, to spur consumer and business spending before the economy actually falls into a recession
- The government decided to take action due to the uncertainty around trade tariffs, low inflationary pressures and potential global weakening. The risk of the Fed lowering interest rates, is that if the economy moves into a recession, the Fed may be disarming themselves of some possible ammunition it would need to continue to lower rates and it may also create dangerous bubbles in other risky asset classes
- The annual inflation rate slowed for the eighth straight month to 1.6% in June 2019 from 1.8% in May 2019, primarily due to a decline in gas, food, oil, and electricity prices, and remains below the Fed's target level of 2.0%
- Now may be a good time to remain flexible and not fix long-term interest rates in case the Fed decides to further reduce interest rates (as depicted in the graph below on the right). Commercial banks and asset based lenders may be a good option at the moment as they both provide the most flexibility, and, until the debt markets stabilize a bit, I would recommend utilizing a line of credit vs. fixed rate debt

Daily Treasury Yield Curve Rates



10-Year Treasury Rate

Source: U.S. Department of the Treasury

About TKO Miller

TKO Miller, LLC is an independent, advisory-focused, middle market investment bank. With over 130 years of collective transaction experience, TKO Miller provides merger and acquisition and financial advisory services for privately-held and private-equity owned businesses, with a special focus on family-and-founder-held businesses.

TKO Miller aims to bring value to clients by combining outstanding people with a results-oriented, flexible approach to transactions. Our services include company sales, recapitalizations, asset divestitures, and management buyouts. TKO Miller has a generalist focus and has served clients in a wide range of industries, including manufacturing, business services, consumer products, and industrial products and services. For more information, visit our website www.tkomiller.com

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