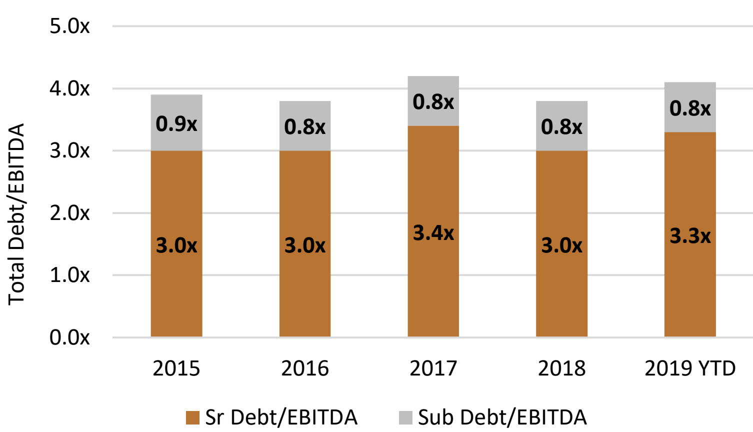
Debt Capital Market Update – Q4 2019

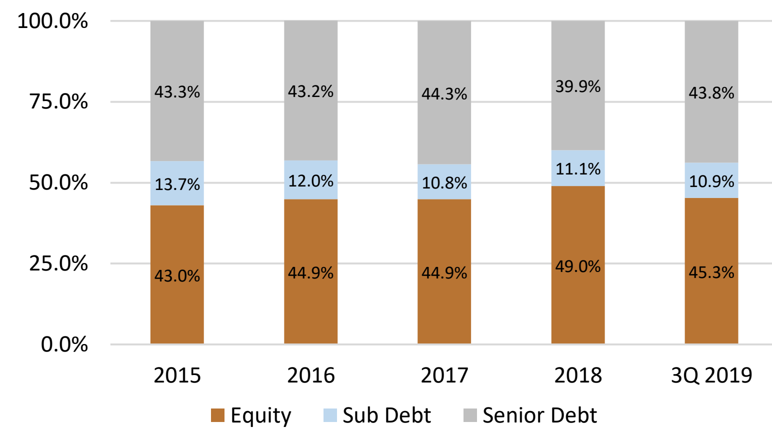
TKO Miller Debt Capital Market Analysis

- Leverage multiples remain at peak levels in M&A transactions due to an aggressive lending environment
- Leverage multiples, as measured by Sr. Debt / EBITDA, increased from 3.8x in 2018 to 4.1x in 2019 (as depicted in the graph, below & left)
- Transactions are utilizing more Senior Debt in response to rising purchase price multiples compared to 2018 levels (as depicted in the graph, below & right), signaling that lenders are in competition with one another and are willing to stretch to get deals done
- Leverage conditions are expected to remain highly supportive over the next 8-10 months, but a halt in business spending, a global economic downturn, or uncertain geopolitical conditions are capable of shifting conditions back to lower, more historical levels

Total Debt/EBITDA Multiples



Debt and Equity Contribution by Year



Source: November 2019 GF Data Leverage Report

Senior Debt Pricing – Splits by Period

TEV	4Q 2017	1Q 2018	2Q 2018	3Q 2018	4Q 2018	1Q 2019	2Q 2019	3Q 2019
10-25	5.5%	5.8%	5.5%	7.3%	5.2%	6.4%	5.5%	6.4%
25-50	5.5%	4.9%	6.0%	5.5%	6.1%	6.0%	5.6%	5.0%
50-100	6.0%	5.1%	7.0%	5.0%	6.5%	6.2%	5.4%	5.3%
100-250	5.4%	4.5%	6.7%	5.2%	5.3%	7.6%	6.2%	5.0%
Total	**5.6%**	**5.3%**	**6.1%**	**5.8%**	**5.9%**	**6.3%**	**5.6%**	**5.4%**

All-in Sub-Debt Pricing 2019 YTD

TEV	Coupon	PIK	WBR/FEES	Total
10-25	11.7%	2.4%	1.8%	15.1%
25-50	1..0%	1.9%	1.5%	13.6%
50-100	10.8%	2.8%	1.5%	13.4%
100-250	10.6%	1.8%	1.9%	13.9%
Total	**11.1%**	**2.2%**	**1.7%**	**14.0%**

Source: November 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, above & left) (i.e. greater ability to fund acquisitions or dividend recapitalizations)
- 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 recently lowered interest rates three times in 2019
- Banks and other short-term lenders are eager to place capital; however, they are also quick to tighten their underwriting standards to consumers and businesses during recessionary times
- Non-bank lenders such as insurance companies (rates of approximately 4.25%) 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 above & right) with their senior debt structure when exploring financing for acquisitions to further increase their equity returns

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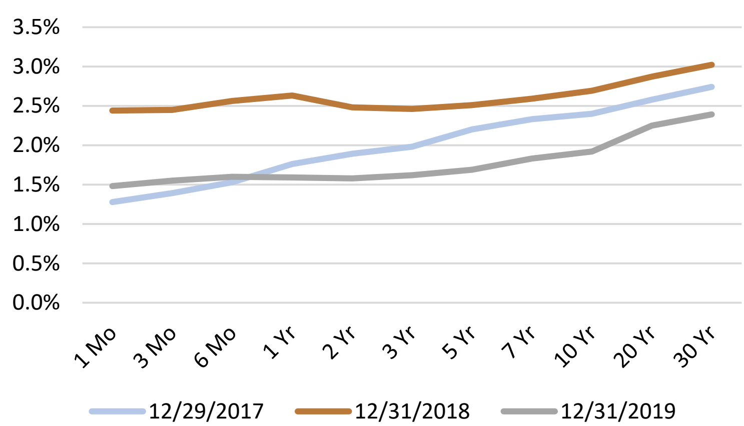
Interest Rate Update

- The most recent yield curve returned to normal (or upward sloping) and has less than a 50-basis point spread between the 1-month US Treasury and a 30-year US Treasury, suggesting that the economy may be reverting to growth mode (as depicted in the graph, below & left)
- A normal or upward sloping yield curve indicates yields on longer-term bonds may continue to rise, resulting in periods of economic expansion. This economic cycle may have more life left that could be carried by businesses borrowing money and investing in fixed assets
- Recent FOMC guidance suggests that interest rates should remain unchanged as long as inflationary pressures continue to be stable
- The risk of the Fed lowering interest rates further (after lowering them three times in late 2019) is that if the economy moves into an unexpected recession, the Fed may be disarming themselves of some possible ammunition it would need to lower rates
- The annual inflation rate rose for the third straight month to 2.3% in December 2019 from 2.1% in November 2019, primarily due to an increase in gas, food, shelter, and other energy prices, and is slightly above the Fed's target level of 2.0%
- As business leaders and key decision-makers get more clarity on the election front and certainty with the signing of the first phase trade agreement with China, they may be more inclined to invest in technology and production assets, as these activities will drive higher outputs
- I would recommend borrowing money and fixing long-term interest rates in case the Fed decides to keep interest rates flat or raise them to cool the economy (as depicted in the graph, below & right). Commercial banks, pension funds, and insurance companies are all looking to lend money at rates that are low and fixed for a period of 5 to 25 years to businesses who are making money and investing in the future

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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