

M&A REVIEW

CORE CAPITAL'S QUARTERLY NEWSLETTER
LATE SUMMER 2014



Welcome to Core Capital Group's quarterly newsletter, *M&A Review*, which highlights activity and trends in mergers and acquisitions (M&A), including a recap of middle-market M&A transactions as well as specific data, including multiples, for industry sectors.

Core Capital is an investment banking firm that has served the strategic transactional needs of business owners for more than 23 years. We specialize in helping middle-market companies across many industries and have a particular expertise in technology. We leverage our operational experience and sector-specific knowledge to provide a range of services, including mergers, acquisitions and capital raises, as well as strategic planning and valuations.

Our process is built on the three pillars of **experience**, **research**, and **financial engineering**. We work with businesses across the nation and throughout the world and welcome the opportunity to speak with you about your company's goals.

OUR PERSPECTIVE – VALUATION DRIVERS

While **valuation drivers** vary depending on the industry and the company, the factors noted below normally play a major part in determining a company's market valuation. Most valuations in Private Equity (PE) markets are done using EBITDA (Earnings Before Income Tax, Depreciation, Amortization) multiples, although revenue multiples are sometimes used. Variables that will influence your company's valuation include:

■ **Revenue Growth and Quality** — Not only is demonstrating historical growth important, but investors will also focus on prospects for future growth. They will want to see growth projections that are neither overly conservative nor overly aggressive, but rather the most defensible. Projections that show growth to \$30 million in sales in a \$75 million industry can be more difficult to defend than becoming a \$50 million company in a \$1 billion industry. Other factors of interest are a low customer concentration and recurring revenue, which can lead to predictable and sustainable cash flow, and are definite advantages that demonstrate revenue quality.

■ **Margins and Cash Flow** — Gross margins are a good proxy for scalability as they measure the incremental cost of additional sales. Negative earnings early on in a company's life cycle can be tolerated, but a clear path to future profitability is necessary. While net income or EBITDA can be distorted by accounting gimmicks, cash flow tends to be a truer measure of a company's ability to pursue opportunities that improve company value.

■ **Scalability** — Having the proper systems and procedures in place allows companies on a strong growth path to expand without major disruption. A truly scalable company has the infrastructure necessary to maintain (and



grow) margins even when revenue significantly increases. PE firms make a distinction between scaling with people and scaling with technology, with a preference toward the latter.

■ **Porter’s Five Forces** — Most PE firms look at companies through the lens of Michael Porter’s Five Forces, which include 1) Threat of new entrants; 2) Threat of substitute products or services; 3) Bargaining power of buyers; 4) Bargaining power of suppliers; and 5) Rivalry among existing firms. In the long run, a company well-positioned to take on these forces will have a sustainable competitive advantage, leading to above-average performance. As these factors are related to price, cost and required investment, they help determine profitability (a key valuation driver) now and in the future.

■ **Financial quality** — Financial statements need to stand up to significant scrutiny during the due diligence process, therefore it’s important to have financials that are well constructed. Consider having financial statements reviewed or audited as you approach a transaction, as “outside eyes” increase investor confidence.

This is in no way an exhaustive list of valuation measures, but rather some of the more common elements that investors look at. For further discussion on this topic, please give us a call. In addition to our M&A advisory services, Core Capital Group offers valuation services.

SECOND QUARTER 2014 RESULTS

The results for 2Q 2014 shown in the following three tables include data from 191 active Private Equity contributors as reported by GF Data.

■ **Overall valuations** continued to remain steady and relatively unchanged from 1Q. The average TEV (Total Enterprise Value)/EBITDA multiple came in at 6.4x when 41 completed transactions were analyzed. The previous quarter multiple was 6.3x.

Total Enterprise Value (TEV)/EBITDA

Total Ent. Value	2003-09	2010	2011	2012	2013	2Q '14	TOTAL	No. Transactions
\$10-\$25 million	5.5	5.3	5.3	5.6	5.9	5.3	5.5	766
\$25-\$50 million	6.1	6.1	6.0	6.1	7.0	6.3	6.2	574
\$50-\$100 million	6.6	6.5	7.2	6.8	6.7	6.9	6.7	405
\$100-\$250 million	7.2	6.5	7.5	7.4	7.1	8.3	7.3	170
TOTAL	6.0	5.9	6.2	6.2	6.5	6.4	6.1	
No. Transactions	1,056	197	203	239	145	75		1,915

Source: GF Data Resources LLC

■ **In the first half of this year**, valuations for larger businesses remained relatively strong, averaging 6.4x. Companies with above-average EBITDA margins and higher revenue growth were valued 15 percent higher over other businesses (6.8x).

Total Enterprise Value (TEV)/EBITDA

All Industries by EBITDA Size

EBITDA	2003-09	2010	2011	2012	2013	2Q '14	TOTAL	No. Transactions
3-5	5.7	5.8	5.6	5.6	6.2	5.4	5.7	517
5-8	6.1	5.8	6.3	6.2	6.5	6.2	6.1	467
8-10	6.1	5.8	6.8	7.0	5.4	6.1	6.2	158
>10	6.2	6.2	6.7	6.3	6.5	7.6	6.4	412
TOTAL	6.0	5.9	6.2	6.1	6.3	6.4	6.1	
No. Transactions	850	161	172	201	111	59		1,554

Source: GF Data Resources LLC

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■ **Eighty percent of the deal volume** recorded by GF Data comprises four of the categories, including manufacturing, business services, health care services and distribution. Manufacturing companies' multiple of 6.3x reflects an increase of .4 above the long-term average. Business services remain relatively the same, averaging 6.1x.

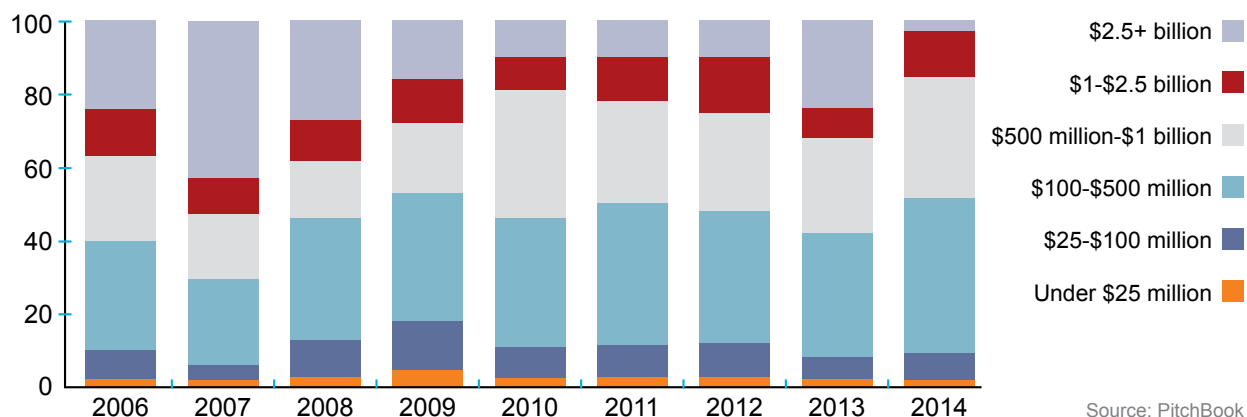
Total Enterprise Value (TEV)/EBITDA By Industry Sector

Industry	2003-09	2010	2011	2012	2013	2Q '14	TOTAL	No. Transactions
Manufacturing	5.9	5.9	6.0	5.9	5.9	6.3	5.9	834
Business Services	6.1	6.0	6.5	5.7	6.7	6.0	6.1	339
Health Care Services	6.6	6.7	7.2	7.1	7.4	7.6	6.8	181
Retail	6.5	5.5	5.8	5.9	7.5	5.6	6.4	61
Distribution	5.9	5.5	6.0	6.3	6.8	7.1	6.1	201
Publishing & Media	7.4	4.2	6.1	11.4	6.1	N/A	7.3	34
Technology	5.8	5.5	8.1	7.4	9.5	6.6	6.7	47
Other	5.8	5.7	5.1	6.3	6.2	5.8	5.8	219
No. Transactions	1,056	197	203	239	145	75		1,916

Source: GF Data Resources LLC

■ **According to PitchBook**, transactions under \$500 million accounted for over half of all the capital invested in 2Q 2014. The middle market is also the most active when deal count is considered.

Percentage of Deal Volume by Deal Size Range



Source: PitchBook

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