

# Transaction Trends

*Transaction Trends* provides private equity sponsors and investors with middle-market transaction information and insights compiled by the BMO Sponsor Finance group—information that helps sponsors and investors better understand the current financing climate in the middle market.

## Trickling down

Transportation & Logistics as a leading economic indicator.

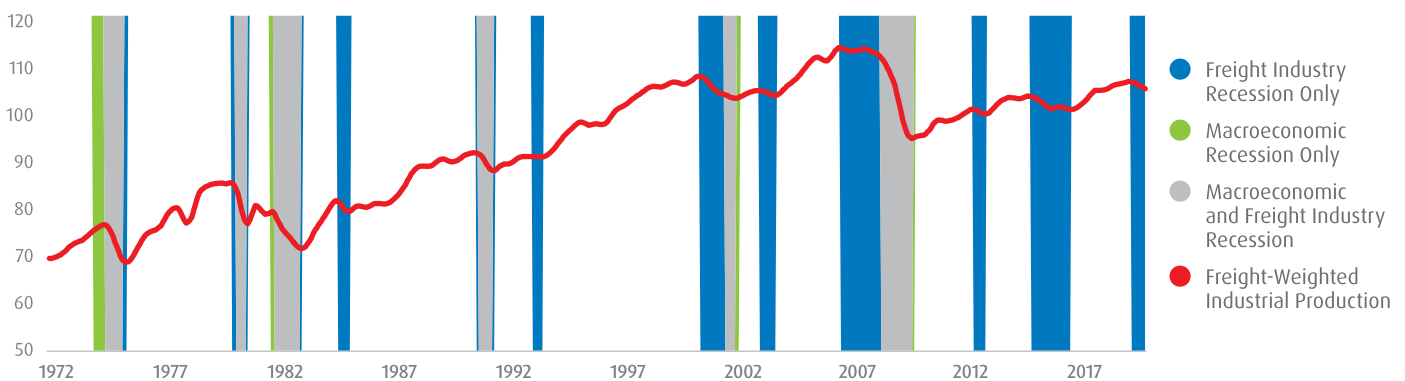
The freight industry and broader economy are closely intertwined as freight volumes and transportation trends often reflect changes in consumer demand and manufacturing output—leading up to four of the last six pre-pandemic macroeconomic recessions since 1972 (including the three most recent), the freight market entered recession, defined as two consecutive quarters of decline in freight volumes, anywhere between one month and almost two years prior to the broader economy (two consecutive quarters of negative GDP growth).

- Recession occurrences within the freight industry are also more frequent, typically experiencing a full industry-specific business cycle roughly every four years and lasting ~10 months on average.

- When not overlapping with a broader economic recession, freight recessions tend to be shorter-lived (three months on average during this period).

The industry's impact extends beyond its direct contribution to employment and GDP as it generates a multiplier effect by stimulating key industries including manufacturing, retail, and services. For every job created in the industry (which directly employs over six million people in the U.S.), several additional jobs are often created across these other sectors, reinforcing freight's role as a key economic indicator. Logistics-dependent industries account for an estimated 40% of the global economy.

## Freight-Weighted Industrial Production



Source: Convoy analysis of Federal Reserve Board, Industrial Production and Capacity Utilization 1972-present; U.S. Census Bureau, Commodity Flow Survey, 2012; U.S. Census Bureau, Advance Retail Sales, 1992-present; National Bureau of Economic Research.

## Transportation & Logistics, continued

The freight industry has faced multiple demand-related headwinds of late, including overstocked inventories, slowing retail demand & industrial production, and geopolitical & inflationary risks, leading to weakness in freight volumes since the latter part of 2022 representing the most recent example of a modest freight downturn. Unsurprisingly, the higher interest rate environment has had an impact on the industry both in terms of supply (hampering investment in fleet capacity) and demand (new auto sales, new home starts, etc.), which could result in a more prolonged period of reduced freight activity.

While imminent signs of a broader economic recession are not evident within BMO Sponsor Finance's portfolio to-date, and other factors such as employment data, consumer spending, and business investment also represent important indicators in assessing the broader economy, freight activity is a key piece of the puzzle as a leading indicator for the future health of the macro environment and demand for consumer goods, despite not having a perfect record in predicting future recessions.

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## Multiple perspectives

A conversation with Cameron Hewes, Head of BMO's Middle Market M&A.

BMO Sponsor Finance's Head of Originations (Jennifer Kloud) sits down with Cameron Hewes to discuss the current middle market M&A environment, BMO's advice to clients, and expectations through the rest of the year:

### **Market Activity: How has pitch activity trended over the last quarter?**

Pitch activity has slowed down materially over the past few months. Sellers have been waiting to see how the company will be impacted by the variety of macroeconomic factors projected, buyers willingness to pay premium valuations, and to see if financing markets will improve as rates peak.

### **Sponsor vs. Strategic: How active are strategics now and what percent of BMO processes are solely focused on strategic?**

Strategics have been very active, we are getting a wide range of inbounds wanting to see more deals. Additionally, ~25-35% of BMO's Middle Market M&A processes are strategic only processes.

### **Timing to Market: Do you expect more deals to come to market over the next six months?**

BMO currently has ~25 active processes and have been closing nearly a deal a week over the past two months. That being said, we've certainly held some opportunities back but our advice to an "A" business is to launch as quality is generally down and Sponsors have more time to review compared to 2021.

### **Outlook for the Year: Does the market anticipate a recession this year and when will volume pick up?**

The headlines continue to kick out the timing of a potential recession; however, most of our clients are not seeing any recessionary impacts or anticipating them in the near term. Regarding increased volume, our conventional wisdom is post Labor Day but this "rush" also continues to be gradually pushed out.

### **Multiple Perspectives: Are multiples coming down as expected or holding due to the scarcity of opportunities?**

Generally, deals are down 1-2x from where we'd expect them to trade in 2021. However, the "A" businesses aren't seeing a big discount (if any).

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[BMO Sponsor Finance and BMO Middle Market M&A are available to discuss any questions; please reach out to your BMO Sponsor Finance or M&A coverage contact.](#)

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## BMO spotlight

BMO provides financial advisory solutions, industry expertise, and LBO financing leadership.

L2 Brands Holdings, LLC (“L2 Brands” or the “Company”) was acquired from Dominus Capital (“Dominus”) by funds under management by Sentinel Capital Partners, L.L.C. (“Sentinel”) in November 2022. BMO Sponsor Finance was the existing Lead Arranger and Administrative Agent for L2 Brands under Dominus ownership and led the LBO financing for Sentinel on its acquisition of the Company. Additionally, BMO Capital Markets Corp. acted as financial advisor to Sentinel with respect to its acquisition of L2 Brands, as well as its subsequent add-on acquisition of Ouray Sportswear in January 2023. BMO provided differentiated advice and insights on this buy-side assignment and acquisition financing by leveraging its unique knowledge of L2 Brands and the blank and licensed apparel subsectors.


L2 Brands is a leading designer, manufacturer, and marketer of custom apparel and headwear for the collegiate, destination and leisure, and corporate markets. L2 Brands is known for its best-in-class design, decoration, and customization capabilities, premium product assortment, and ability to offer a one-stop-shop solution for customers. Since its inception, L2 Brands has grown into a diversified business with a successful history of long-term profitable growth.

BMO assisted Sentinel in maintaining a competitive bidding dynamic within a shortened transaction timeline given the uncertainty in the markets at the time of both the L2 Brands LBO and the Ouray Sportswear add-on. BMO’s deep relationships and connectivity across the apparel and softlines industry, as well as our existing financing relationship, led to high impact advice and seamless execution on the transactions.


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These transactions highlight the strength of BMO’s U.S. M&A and Sponsor Finance capabilities, and our ability to provide clients with a full suite of solutions across our platform.


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Acquisition of




Financial Advisor  
November 2022




Portfolio Company of



Acquisition of




Financial Advisor  
January 2023



Committed Financing

Lead Arranger  
November 2022



Committed Financing

Lead Arranger  
January 2023

## We are the experts

Despite market turbulence, **wealth management** has remained a highly attractive sector for equity and debt investors alike. A highly fragmented industry, especially for registered investment advisors (“RIAs”), provide an attractive opportunity to scale via acquisition coupled with strong underlying organic growth and demand drivers.

### Attractive Investment Opportunity

- **Long term secular growth.** As more households accumulate wealth, there is a strong, consistent demand for wealth management services.
- **Industry talent.** There is a continued transition of advisors from the warehouses to the independent channel.
- **Diversity.** Scaled platforms possess diversity by advisor, client, and asset composition.
- **High free cash flow conversion.** As a services business, the primary investments are technology implementation.

### Growth Drivers

- **Organic.** Advisors source clients from their professional / personal network or through the custodial referral channel (i.e. Fidelity, Charles Schwab). Growth is measured based on AUM excluding market movement. While client retention from both channels remains similar, the custodial channel requires a percentage of the fees to be shared with the referral partner.
- **Inorganic.** An active market for sole proprietors or small groups of advisors has been driven by a number of different objectives, including (i) nearing retirement age and no clear line of succession, (ii) increasingly complex technology requirements, (iii) demand for broader product suite, including alternatives, and (iv) lack of desire to run the back office administration.

### Valuation

- **Considerations.** Given the registration and / or regulatory complexities of operating both a registered investment advisor and a broker dealer, many operations are run as one or the other. Hybrid models, a combination of fee based revenue and brokerage products have gotten more traction in the marketplace for scaled platforms and provides the ability to offer annuities and other traditional brokerage products.
- **Scaled Platforms.** Platform multiples vary widely from the low-teens to 20x+ based on the organic growth rate, the orientation of the business (i.e. high net worth or mass affluent) and the revenue composition (i.e. broker dealer executing trades or a registered investment advisor with a fee based approach). In order to differentiate, increasingly advisors are offering ancillary services such as tax preparation, financial planning and other concierge-type services.
- **Tuck-in Acquisitions.** For advisors seeking freedom from the burdens of running their own business, selling to a strategic buyer is an attractive option. Client relationships are the underlying foundation of the business and the successful transition of those relationships is critical making the sale process very personal for sellers. Smaller transactions (i.e. sub \$2MM of compensation adjusted EBITDA) garner

multiples in the high single digits and often are structured as a combination of upfront consideration, earn out and deferred purchase price based on retention and/or market movement.

### Industry Considerations

- **Robo Advisors.** In the mass affluent side of the market, our clients have not seen a slow down in new growth or attrition as a result of robo advisors, however this is a consideration as a younger demographic of investors become more active in the market.
- **Fee Compression.** Fee compression has been a hot topic in the sector, however BMO has not seen any material movements in average advisory fees.
- **Lending.** Historically, lenders were cautious on the sector for two reasons, market movement and security package associated with broker dealers. The impact of potential market movement was an impediment to full leverage for wealth management, however given the high retention and cash flow conversion lenders have accepted this risk. Pure play broker dealers remain more challenging principally because of the transaction based business model and the potential for volatility.

### Key Metrics

- In evaluating wealth management platforms, BMO Sponsor Finance has focused on advisor and client retention metrics, organic growth, flows data, and asset composition.
- There is often imperfect or incomplete information available for the tuck in acquisitions. Therefore, a strong track record of successful integration and retention is critical.
- Leverage is evaluated both on a trailing twelve month basis as well as a run-rate based on most recent AUM, fee rate and expense structure.

### Observations

- **Entrance Point.** Private equity buyers have typically started with a smaller platforms and executed a buy and build or acquired a more scaled platform.
- **EBITDA Margins.** EBITDA margins in the sector are generally 35%-40% and are highly dependent on the comp reset, ownership structure, and service offering.
- **Ownership structure.** A key to success has been a diversified ownership structure whereby the advisors retain a strong incentive to drive growth.
- **Exit Alternatives.** Many of the scaled platforms have either remained or returned to the private market. Given the scale of some of the larger platforms, it is likely that one will test the IPO market if market conditions are optimal.

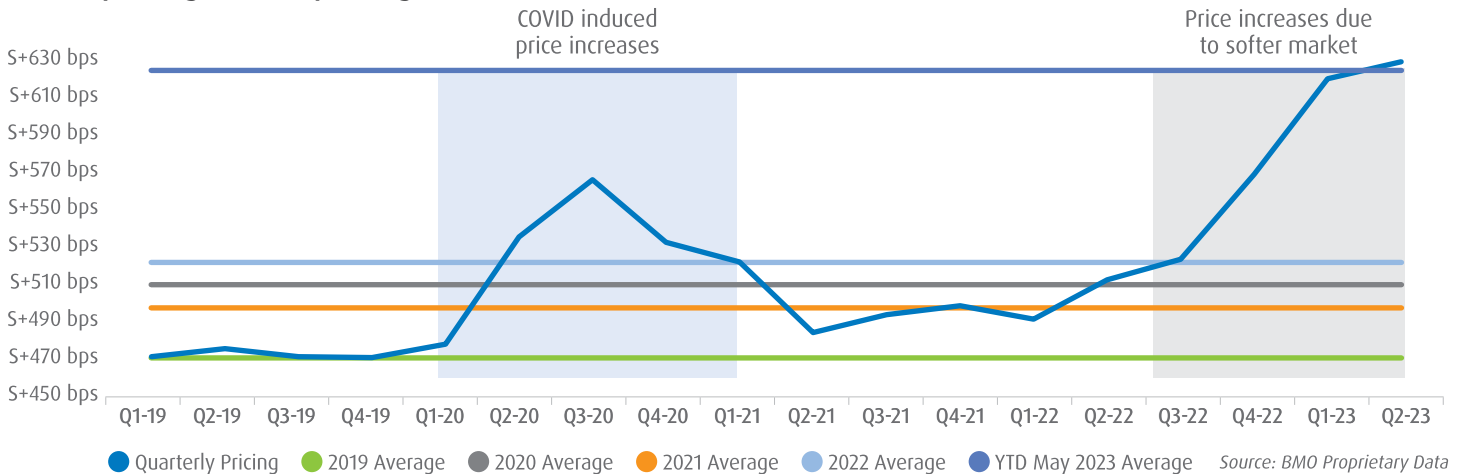
# A peek behind the curtain

A snapshot of BMO's proprietary portfolio and transaction data.

## Pricing trends—all transactions

- As illustrated in the chart below, spreads on new transactions have continued to widen from Q2'22 through Q1'23 as a result of market disruptions that began in the Spring / Summer of 2022, followed by macroeconomic headwinds and Federal Reserve tightening.
- Existing platforms that have executed upon a material amendment in the last ~6-9 months (i.e. incremental capital raise for an add-on) likely has seen pricing on existing debt repriced to market (either within the MFN or full reset).
- While recent normal course levered LBOs have priced recently in the S + 600-650 bps range in the last ~6-9 months, BMO has seen signals of spreads flattening, and potentially tightening towards the lower end of this range in recent weeks.

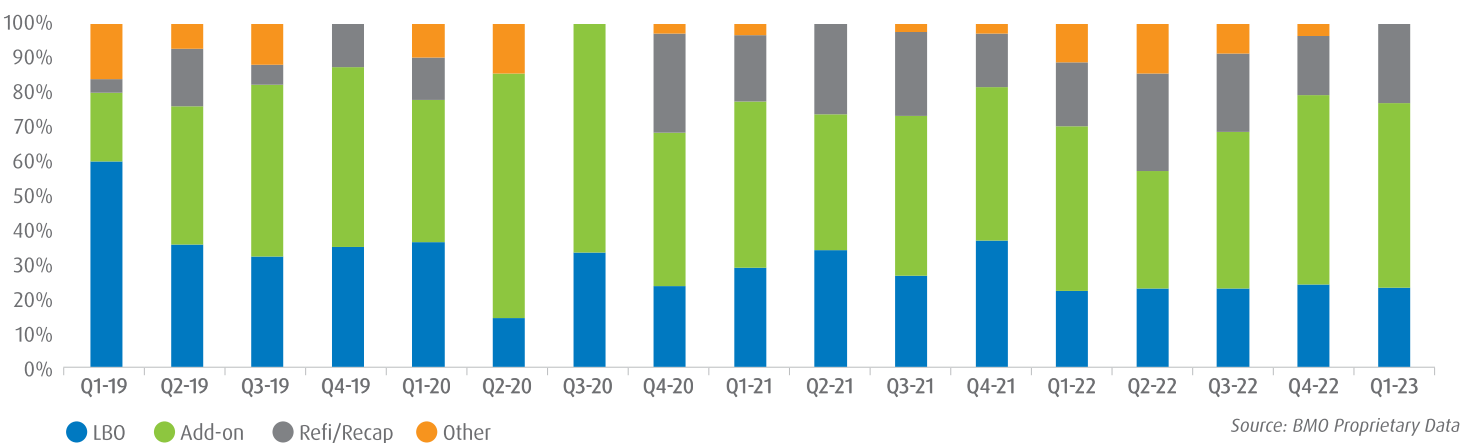
## Quarterly Pricing and Yearly Averages



## Quarterly transaction activity by deal type—all transactions

- New LBO activity has remained suppressed, particularly in comparison to FY21 levels.
- Suppressed new deal activity has largely been attributed to tightening of appetite within the financing markets (primarily driven by increasing rates which has impacted leverage) and dislocations in bid / ask valuations between buyers and sellers with mixed signals on the economic outlook.
- As such, there has been a flight to quality (and to extent more scale) where “A-list” assets continue to command strong buyer interest and lender support, whereas “B and C-list” assets have been best executed via strategic buyer angles.
- While new platform activity has remained slow relative to recent years, sponsors continue to remain active in pursuing add-ons within their existing platforms.
- M&A bankers continue to indicate healthy mandated pipelines and pitch activity, with the key decision point being the right time to launch the transaction to the broader market.

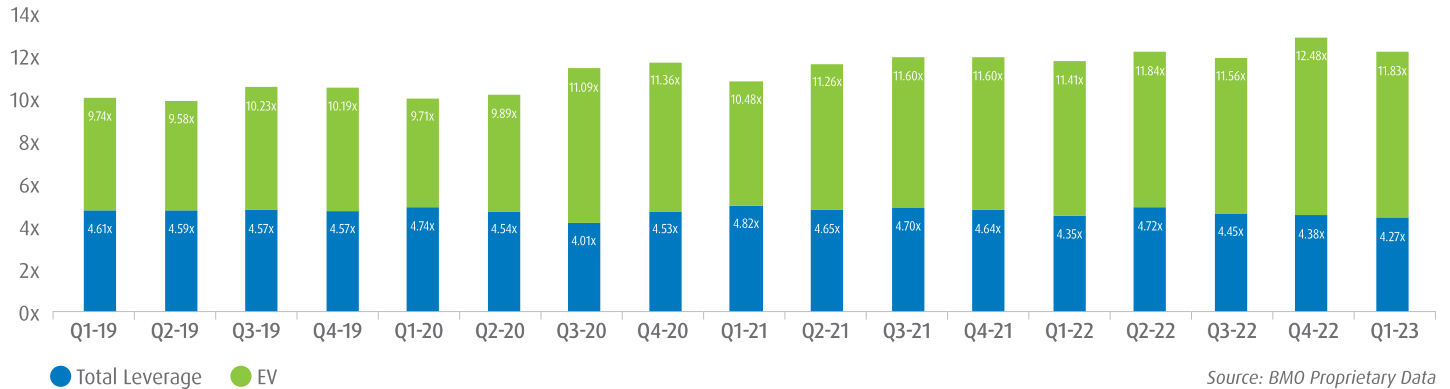
## Deal Volume by Transaction Type—All Transactions



### Average total leverage trends (all transactions)

- As a result of rising interest rates (which impacts cash flows / debt capacity), leverage for transactions have moderated modestly over the past ~12 months, but EV multiples have remained roughly in line with past quarters.
- This is partially driven by a flight to quality by both sponsors and lenders on deals executed, where highly attractive and non-cyclical assets continue to command strong interest (and valuation multiples) as in past quarters.

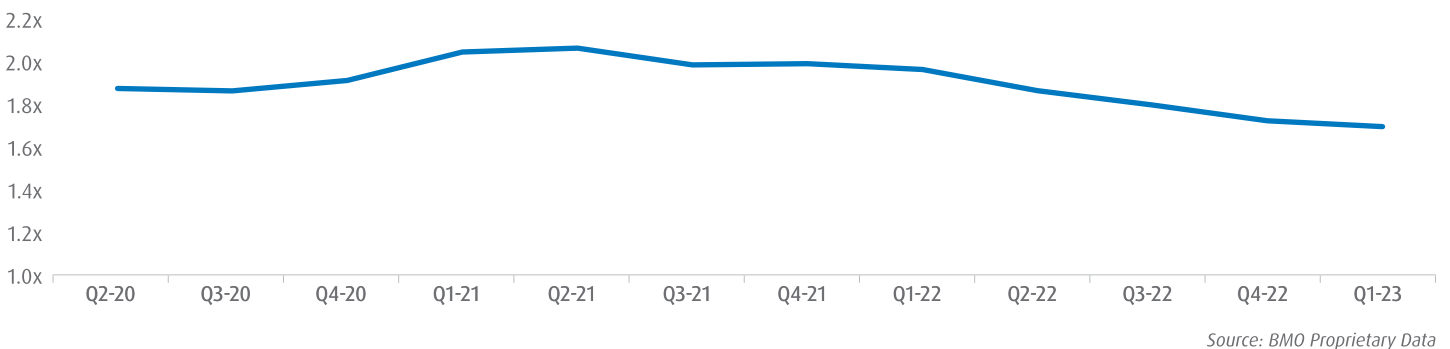
### Average Senior Leverage, Total Leverage and EV—All Transactions



### Average total leverage trends—new LBOs

- Despite growing macroeconomic headwinds, closing leverage of new LBOs has largely remained in-line with previous quarters over the last ~12-18 months.
- This is partially driven by a flight to quality by both sponsors and lenders, where highly attractive and non-cyclical assets continue to command strong lender interest with similar leverage and valuation multiples as in past quarters.
- We continue to see a bifurcated market split between high quality assets which have benefitted from “scarcity value”; where BMO has been active, as well as profiles that have experienced tremendous ramp in performance with questionable sustainability. Given the continued increase in SOFR and spreads, fixed charge coverage ratios have become a focal point for lenders on how much debt a business can support. As a result of increasing rates, we’ve seen leverage reads come in 1.0x-1.5x turns on certain businesses relative to indications ~12-18 months ago.
- Despite fixed charge coverage becoming a focus, we have yet to see it be implemented as a formal covenant within the direct lending market.

### Fixed Charge Coverage—BMO Portfolio



## A word from our Treasury & Payment Solutions (“TPS”) colleagues

At BMO, we offer a full suite of solutions to help you take control of your cash flow, including tools to help streamline your payments and collections processes, as well as services that provide the information you need when you need it. And our solutions are designed to evolve as your business grows, so you’ll always be ready for new opportunities.

**Solutions defined by client need.** Our comprehensive suite of Treasury & Payment Solutions includes, but is not limited to:



### Receivables Management

Capture and convert sales quickly to improve the efficiency of your collections processing and accelerate the availability of funds.

Lockbox Solutions  
Remote Deposit Capture  
Merchant Services  
Commercial Vault Services  
Comprehensive Receivables  
Online BillPay Consolidator  
Image Cash Letter  
Real-Time Payments



### Payables Management

Manage payments securely and efficiently with a range of solutions designed to streamline processes, reduce errors and eliminate costs.

Automated Clearing House (ACH)  
Payroll Processing  
Wire Payments  
Corporate Card  
Comprehensive Payables  
Controlled Disbursement  
Account Reconciliation  
Payments with Zelle®  
Real-Time Payments



### Deposit & Liquidity Management

Optimize your cash resources for effective management of your operating and investment funds.

Money Market Deposit Accounts  
Corporate Sweep Accounts  
Multicurrency Accounts  
Foreign Exchange  
Investment Accounts  
BMO Liquidity Portal

When evaluating options, we encourage our clients to please contact your respective Sponsor Finance coverage team or:

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### Underpinned by: Information Reporting & Risk Management

Real-time, accurate reporting gives you a clear picture of your finances, helping you better manage and monitor your cash flow.

BMO Online Banking for Business • Check Positive Pay and Payee • ACH Positive Pay • API

## BMO Sponsor Finance

Consistency, speed and surety of close are crucial when it comes to serving the needs of middle-market private equity firms. Whether it’s providing capital for mergers and acquisitions, leveraged buyouts, recapitalizations or growth capital, BMO Sponsor Finance group works with you from initial review to ongoing portfolio management for reliable execution and follow-through with no handoffs.

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