CASCADIA
CAPITAL LLC

QUARTERLY NEWSLETTER

MARCH 2020

FRESH DECADE, FAMILIAR THEMES

Though we have just stepped into a fresh decade, we expect many of the big headlines that dominated 2019 to persist as key themes in 2020. Last year, we saw a pronounced flight to quality, with buyers beginning to reassert power in what had previously been a seller's market. Buyers became increasingly disciplined against a backdrop of mounting uncertainty. They took a very close look at unique micro factors—those specific to a company, industry, or situation—that ultimately had the most influence on deal processes and outcomes. They were more willing to walk away if diligence did not support the implied transaction multiples. Given the more intense scrutiny, deals took longer to get over the finish line, and in some cases debt shortfalls led to changing deal terms very late in the process.

Sector focus was another prominent theme in 2019. Buyers with deep industry expertise—primarily private equity (PE) firms that continued their rise as the new strategic buyers—had a stronger understanding of business models and industry dynamics, and so were better able to see through the noise inherent in the financials of lower middle market businesses, enabling them to become comfortable with higher valuations. For more on this trend, turn to page 3, where our Technology team discusses the increasing focus and influence of PE firms in the technology sector. Meanwhile, we saw the same theme play out with sellers: companies with a laser focus on a growing end-market or geography attracted more interest at higher valuations.

"Given how long we have been in this bull market, we think it is prudent for companies to give serious consideration to an essential truth: if I am not selling my business, I am re-buying my business."

WHAT'S ON DECK IN 2020

- The economy is healthy and growing, but a lot of risk related to exogenous events—political uncertainty, foreign trade, coronavirus, rising interest rates, and more—could dampen the deal market
- With the M&A cycle nearing its close, businesses owners must make a decision to either sell or "re-buy" their own business
- 2020 is an inflection point year, when knowing your true market value and making purposeful decisions will be vital

RAMPED UP RISK

We anticipate these themes will remain relevant in 2020. However, we are also expecting some critical shifts—in particular, a greater investor focus on macro or exogenous events, from geopolitical relations with Iran and North Korea to continued tariffs with China and the outbreak of the coronavirus. The upcoming U.S. presidential election is a significant source of uncertainty, ramping up volatility and market risk. While we remain bullish through the first half of 2020, we think markets will be sensitive to the election, particularly given the potential economic and tax ramifications if there is a liberal Democrat elected to office.

In our view, 2020 will be an inflection point year. While there may be a natural temptation to charge ahead into the new decade, we think now is the moment to pause and reflect. Given how long we have been in this bull market, we think it is prudent for companies to give serious consideration to an essential truth: if I am not selling my business, I am re-buying my business. As a business owner, are you comfortable with that? To accurately answer that question, you need to know your company's true market value so you can make the right decision as a shareholder. The end of the bull market may prevent a business from selling at their desired valuation. If an owner does not sell, they may need to prepare their balance sheet to ride—or grow even more aggressively—if there is a downturn.

THREE RESOLUTIONS FOR 2020

Given this backdrop, there are three resolutions that Cascadia recommends company owners make during this inflection point year:

1. **Do a thorough SWOT analysis of your business**. Owners need to know their business, understand its valuation, and have a firm grasp of strategic options so they can make informed and purposeful decisions. One way to do this is by gathering third-party feedback so you can understand what your business is really worth, untainted by emotions or bias. Where do people see value in your company? Where do buyers see opportunities and threats? Here at Cascadia, we speak to buyers about our clients' and potential clients' businesses on a no-name basis to gauge perceived strengths and weaknesses. We also help companies set up informal meetings with PE firms as a source of feedback on everything from valuations to where to take the business strategically in the coming years. Many of our relationships report that this exercise was of significant value to their strategic and liquidity planning processes.
2. **Filter all the noise**. With so much news flying around and geopolitical events unfolding so quickly, understanding what news will dissipate and what is a bona fide and durable trend will be essential. Cascadia helps our clients navigate the news cycle and identify sustainable trends so they can stay both focused and nimble, and avoid unnecessary panic.
3. **Prep for the best**. In 2020, pre-deal preparation is more important than ever. The most successful processes will continue to be the ones in which the owners are patient, prepared, and positioned for a successful outcome. That means planning ahead, going to market after fully completing internal due diligence and all tax analysis and essential market preparations. This will ensure your company is optimally situated and prepared to stand up to heightened buyer scrutiny.

This year will be an important crossroads for many business owners. As always, we're excited to work closely with entrepreneur-owned and family businesses to help you be best-positioned to thrive in the coming months—and decade. We hope you are having a fantastic start to the year and look forward to sharing more insights with you in the spring.

Best regards,

Michael Butler
CEO, Cascadia Capital

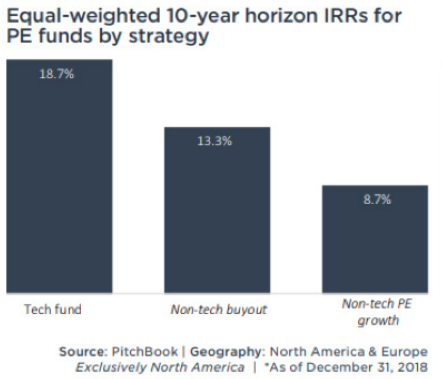
IN FOCUS: PE FLOURISHES IN THE TECH SECTOR

Cascadia's first newsletter explored the rise of private equity (PE) firms as buyers—one of the most noteworthy dynamics in the market we have seen in recent years. In this edition, we are double clicking on a sector where PE interest and investment continue to swell: Technology.

US and Europe-based tech-focused PE funds raised a record $68.3 billion in 2019[1] and are sitting on an unprecedented amount of dry powder. In particular, the software sector continued its meteoric rise, accounting for 17.3% of total PE deal value in 2019, up from just 5.6% a decade earlier.[2] Dealmaking in the middle market also flourished, with 21.1% of 2019 deal value coming from the technology sector.[3]

What is driving this massive—and mounting—PE investment in the tech sector?

- **Relatively sticky software solutions**. SaaS (software as a service) companies have subscription-based business models, meaning revenue tends to be highly standardized and recurring, with annual contracts becoming the norm and multi-year contracts not uncommon. That delivers a predictability that one does not see with other transactional models. This tends to support financial leverage—highly attractive to PE firms.
- **Serious scalability**. Tech companies distinguish themselves from their non-tech counterparts by often being asset-light businesses requiring relatively little capital to scale. They have the ability to achieve rapid, linear growth for prolonged periods of time—all without making big investments ahead of demand.
- **High gross margins**. A well-run software business can generate gross margins in excess of 90% as compared to consumer businesses that typically generate much lower margins.[4] Many PE firms get excited about software as a utility with high customer dependency and retention. So, they are willing to fund the growth of a company with high gross margins that is not yet profitable, knowing that in time it will transform from a growth engine into a profitability engine. The proof is in the performance. Over the past 10 years, tech-focused PE funds have produced IRRs that are more than five percentage points higher than those of non-tech buyout funds and more than twice those of non-tech growth funds.



- **Recession resistance**. The necessity and stickiness of software companies' products and services make them potentially less susceptible to recession than those in other sectors. In fact, it was during the Great Recession that investors first noticed budget-constrained companies kept purchasing their mission-critical software. Prior to that, many investors thought of software as a discretionary purchase. As the end of the bull market and a potential recession weigh on the minds of dealmakers and founders alike, PE funds are widely expected to reallocate capital away from cyclical industries in favor of technology and healthcare.
- **Reduced headcount and hiring pressures**. With national unemployment historically low, it is getting harder to hire IT talent, especially at non-tech firms. Meanwhile, there is pressure for companies to become more productive with the same or less headcount. As companies in industries that were historically reluctant to adopt technology—such as law and government—now recognize it is a must-have, not a nice-to-have, using third-party software solutions delivers better functionality at a far lower annual cost while helping address labor shortages.

[1]PitchBook, 4Q 2019 Analyst Note: Overview of Tech-Focused PE Funds (November 12, 2019).
[2]PitchBook, 2019 Annual US PE Breakdown.
[3]PitchBook.
[4]Capital IQ.

BENEFITS BEYOND CAPITAL

Despite all of the PE enthusiasm for tech companies, many entrepreneurs still think a sale to a strategic buyer is their only means of getting liquidity. This is an unfortunate misperception, especially as PE firms are increasingly outbidding strategic buyers. Plus, PE firms offer an additional range of benefits beyond capital that can usher a growing business to the next level. Entrepreneurs should first understand their personal and transaction objectives to identify a PE partner with capabilities that map to their needs, including:

- **Delivering helpful strategic advice**. Many business owners in the middle market are first-time entrepreneurs. A PE firm can offer you practical guidance to avoid pitfalls and navigate growing pains.
- **Making useful introductions**. Many PE firms have robust networks to help build your team and introduce your company to potential customers and strategic partners. PE firms can also help recruit top talent.

"PE firms offer an additional range of benefits beyond capital that can usher a growing business to the next level."

- **Providing add-on capital**. Entrepreneurs often have a hard time stomaching the risk involved with making game-changing acquisitions. PE firms can help by supplying funding for the acquisition of adjacent solutions or growth capital to invest in organic expansion opportunities.
- **Professionalizing your operations**. Not only can PE firms help you understand your key growth and profitability drivers, they can also help you implement critical operational improvements to make your company a more attractive asset.

PE firms also give business owners the advantage of control. While strategic buyers typically want to own 100% of a company, a growing proportion of PE firms are comfortable participating as minority shareholders. This means business owners can de-risk the illiquid equity interests they hold in their companies, while preserving meaningful upside—all without having to hand over the keys to a big enterprise. Business owners who have diversified their wealth and reduced their personal risk can become more aggressive and take some incremental risk that could potentially drive their company to the next level.

GETTING INTO THE PE GAME

Given all of this upside, how can tech business owners benefit from PE firms' burgeoning interest in the sector? We recommend companies do four things:

1. **Get up to speed on PE**. At Cascadia, many of our clients have never taken institutional capital before. We help them gain a strong grasp of the overall PE market, how their company will be valued, and how the PE investing process works.
2. **Understand that all PE firms are not created equal**. Some firms are financial engineers while others bring something to the table as value-added partners. Doing your homework—including speaking with a firm's portfolio companies, as well as past and present CEOs—is vital. At Cascadia, we focus on introducing our clients to PE firms that are committed to adding specialized, strategic value to their portfolio companies beyond capital alone.
3. **Do not respond to the mass PE outreach**. There are a vast number of PE firms, many of which use junior resources to "dial for dollars." Expect your phone to ring—but be selective about which calls you take. Look for signs of personalized and tailored outreach, such as demonstrated knowledge of your company, a keen awareness of the underlying trends and developments impacting your market segment, and/or hearing from a senior member of the firm.

4. **Consider more than one PE firm**. A company will partner with a PE firm for three-to-five years with the potential to significantly shape its future. Finding the right fit is crucial. Business owners should turn the tables and interview the PE firms, asking them questions such as: Why should we work with you? What will you do in the first 90 days? Have you ever fired a CEO?

A trusted banking partner can help "coach" you through the PE process, setting expectations, helping maximize your valuation, offering guidance on selecting the optimal PE partner, making valuable introductions, being the "bad guy" during negotiations, and increasing the likelihood of deal closure.

WHAT'S NEXT FOR PE IN TECH?

Looking ahead, we expect M&A activity and investment in the tech sector will continue to flourish in 2020. Given the sheer volume of PE tech dry powder, firms have significant capital to put to work. After a strong fundraising year in 2019, many large, tech-focused PE firms will be in capital deployment mode in the coming year. At the same time, the sector is more attractive than ever. The incorporation of intelligent automation continues with companies across industries that are adopting technology to drive efficiency and help differentiate themselves. We still see a lot of runway for SaaS solutions to revolutionize industries that have never used technology or still use old technology—further expanding the pool of tech companies likely to capture PE firms' attention.

Recent Cascadia Technology Clients with PE Partners

influenster has been acquired by bazaarvoice	AbsenceSoft has been recapitalized by Bow River Capital Partners	Emergency Reporting has been recapitalized by polarispartners	UMT360 has been acquired by Teleo Capital	Travis CI has been acquired by Idera, Inc. a portfolio company of HGGC / TA Associates	complí has been acquired by KPA / Providence Equity	CosmoLex has been acquired by Tabs3 a portfolio company of Thompson Street Capital Partners
August 2019	April 2019	April 2019	April 2019	January 2019	December 2018	September 2018

Cascadia's Technology Group

Cascadia Capital's Technology group comprises domain experts who are able to uniquely position clients—including their people, business models, and technology—to the most appropriate buyers, investors, and strategic partners.

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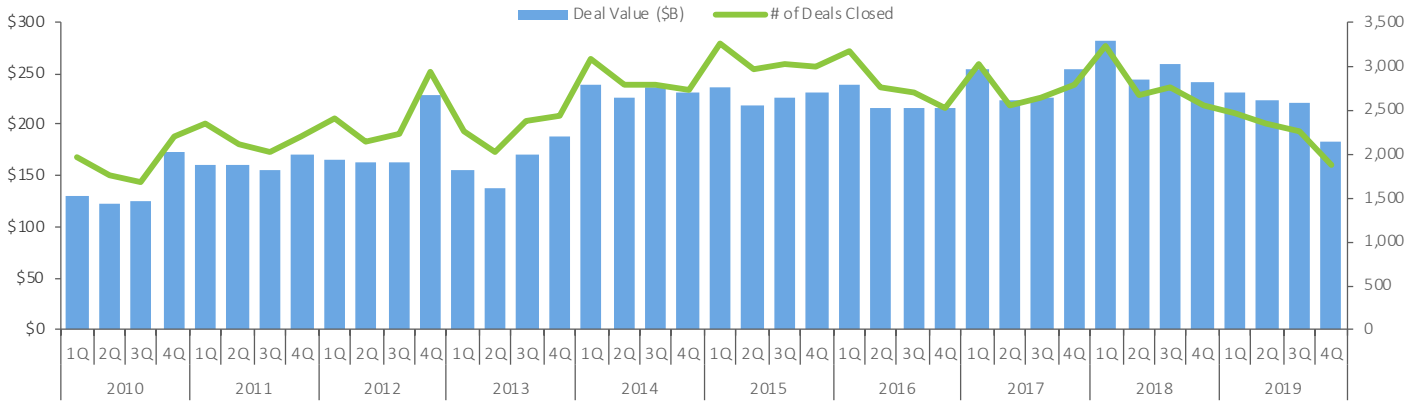
MARKET DATA – Q4-2020

The following market data is sourced from PitchBook and reflects middle market activity, defined as transactions less than $1 billion value.

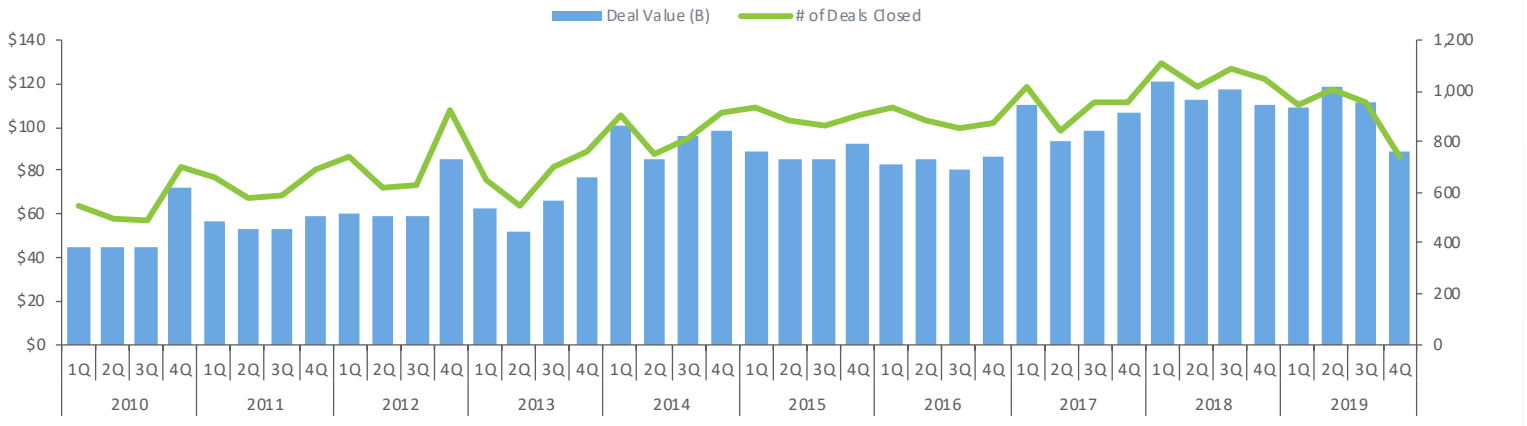
U.S. M&A ACTIVITY BY QUARTER



Middle market deal volume and deal value have seen declines of 16% and 12% respectively in LTM Q3 2019, and preliminary LTM Q4 2019 data shows declines of 21% in deal volume and 17% in deal value

Graph data source: PitchBook

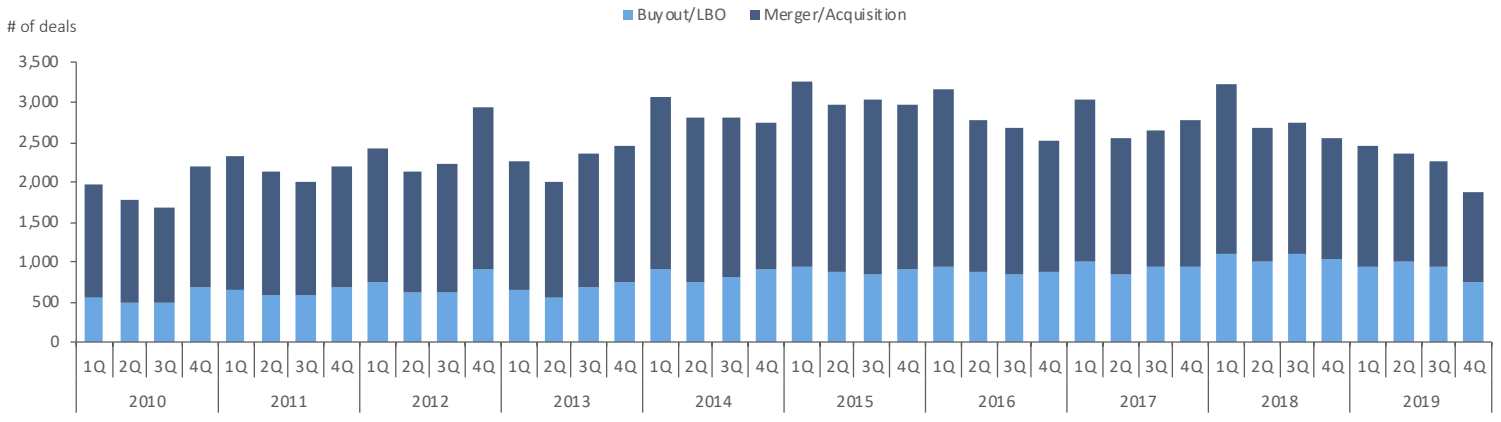
U.S. PRIVATE EQUITY ACTIVITY BY QUARTER



Private equity deal volume has seen a slight decrease of 5% while deal value has decreased by 2% in LTM Q3 2019, and preliminary LTM Q4 2019 data shows declines of 14% in deal volume and 7% in deal value

Graph data source: PitchBook

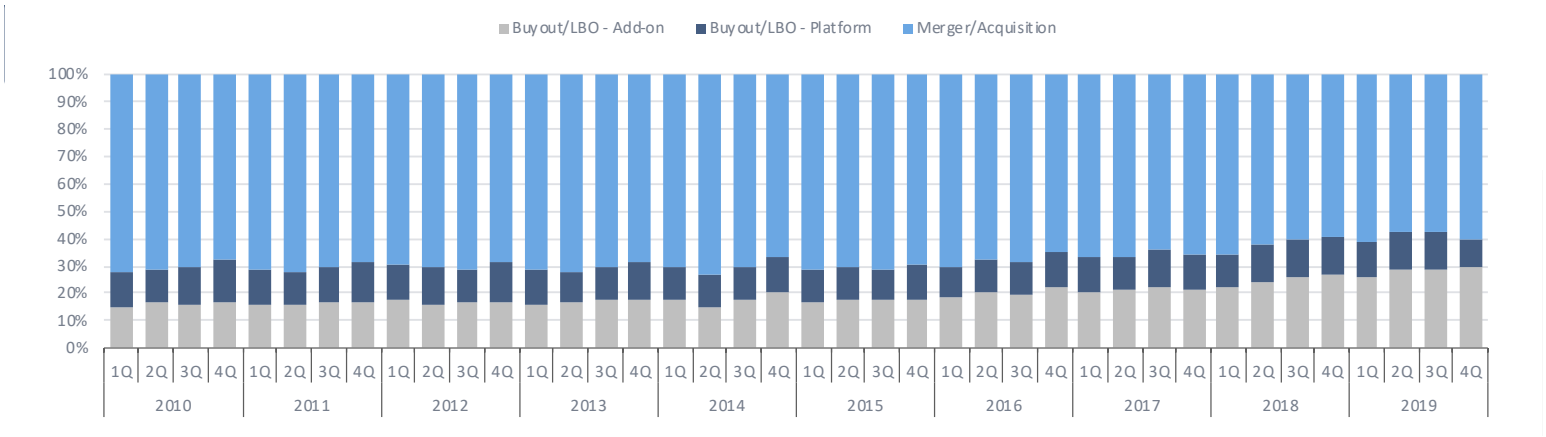
U.S. PRIVATE EQUITY VS. OVERALL M&A ACTIVITY



Private equity activity has remained steady on an actual basis, and has been increasing relative to overall M&A activity

Graph data source: PitchBook

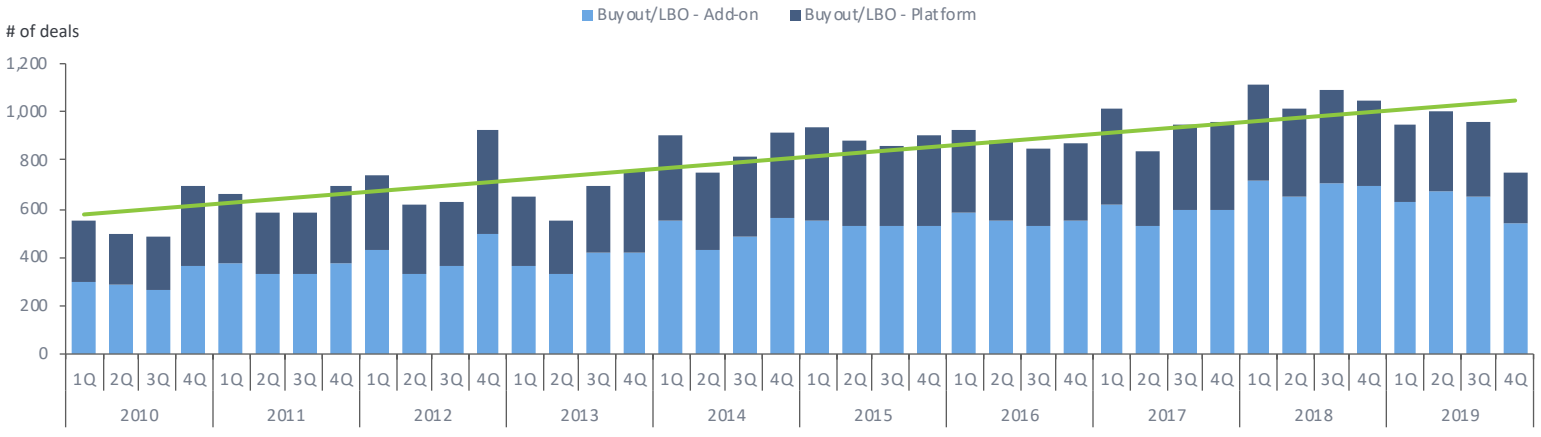
PORTION OF U.S. PRIVATE EQUITY VS. OVERALL M&A ACTIVITY



The portion of platform investments has been steady, while the portion of add-on investments has been increasing. PE has increasingly captured higher market share with Q3 2019 hitting 43%, and preliminary Q4 2019 data showing a 40% share

Graph data source: PitchBook

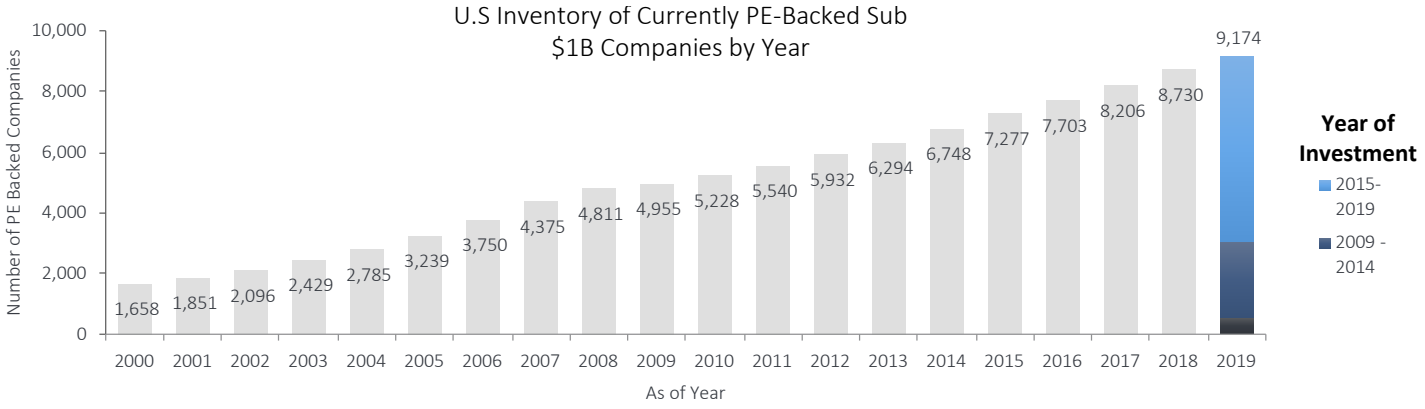
U.S. PRIVATE EQUITY ACTIVITY BY QUARTER



Private equity activity has been increasing relative to overall M&A and remained elevated in absolute terms

Graph data source: PitchBook

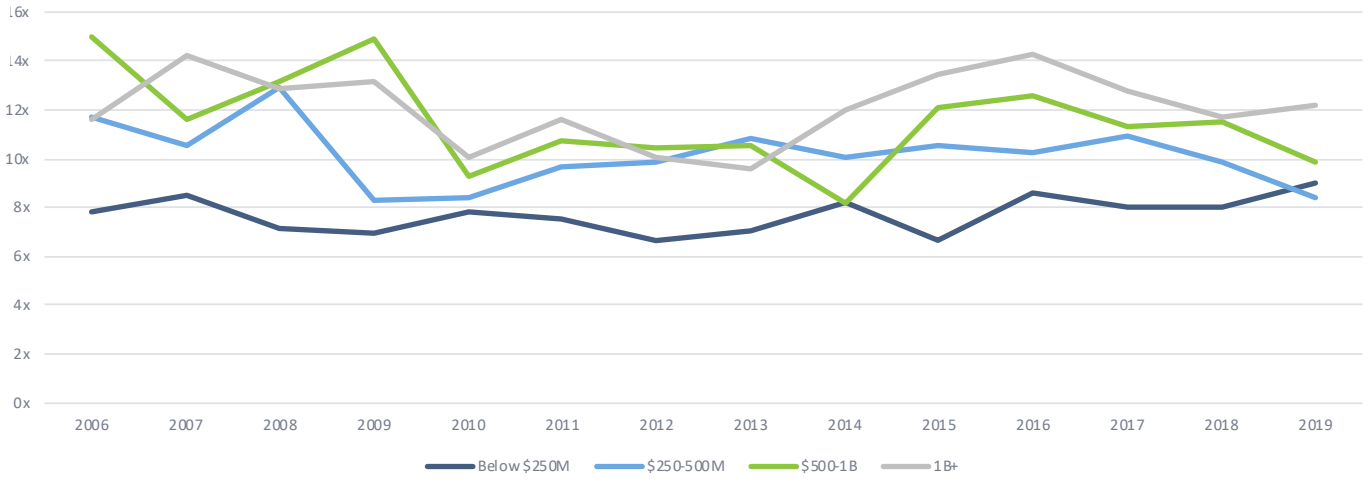
U.S. PRIVATE EQUITY SUB $1B COMPANY INVENTORY



Cascadia expects private equity to act as a backstop for the overall M&A market; definite fund lives will drive M&A activity as firms deploy record levels of dry powder and also need to exit aging portfolio companies

Graph data source: PitchBook

US M&A MULTIPLES

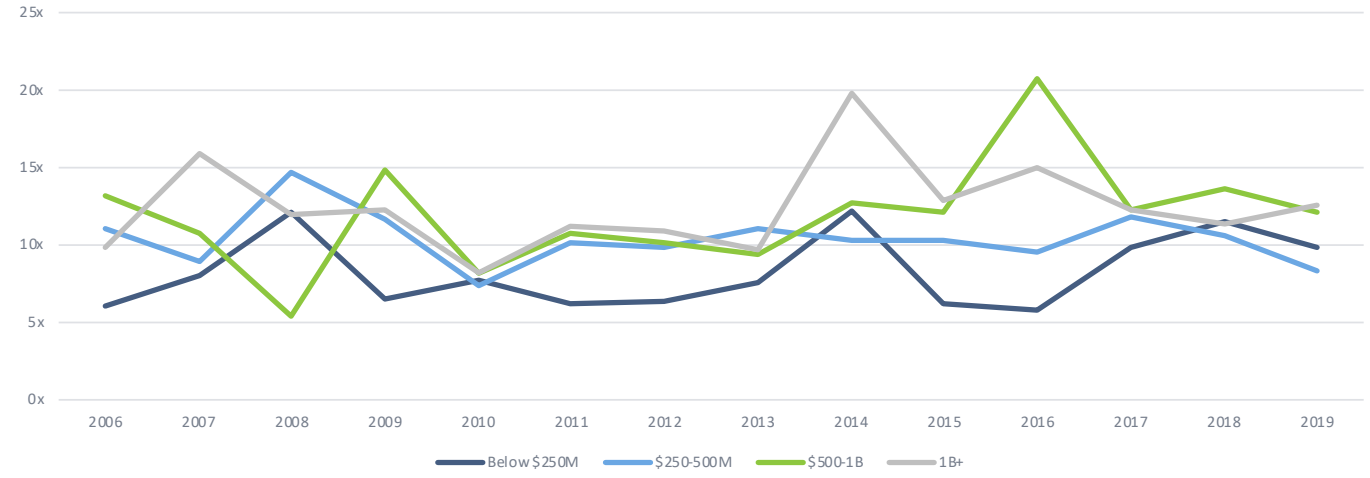


	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
All	10.8x	10.5x	10.7x	9.3x	8.4x	9.5x	9.1x	9.4x	9.4x	10.0x	10.7x	10.5x	9.8x	10.5x
Below $250M	7.8x	8.5x	7.2x	6.9x	7.8x	7.5x	6.7x	7.1x	8.2x	6.7x	8.6x	8.0x	8.0x	9.0x
$250-500M	11.7x	10.5x	12.9x	8.3x	8.4x	9.7x	9.9x	10.8x	10.1x	10.6x	10.3x	10.9x	9.9x	8.4x
$500-1B	15.0x	11.6x	13.2x	14.9x	9.3x	10.8x	10.5x	10.5x	8.2x	12.1x	12.6x	11.3x	11.5x	9.9x
1B+	11.6x	14.3x	12.8x	13.2x	10.1x	11.6x	10.0x	9.6x	12.0x	13.4x	14.3x	12.8x	11.7x	12.2x

* As of 12-16-2019

Graph data source: PitchBook

U.S. PRIVATE EQUITY MULTIPLES

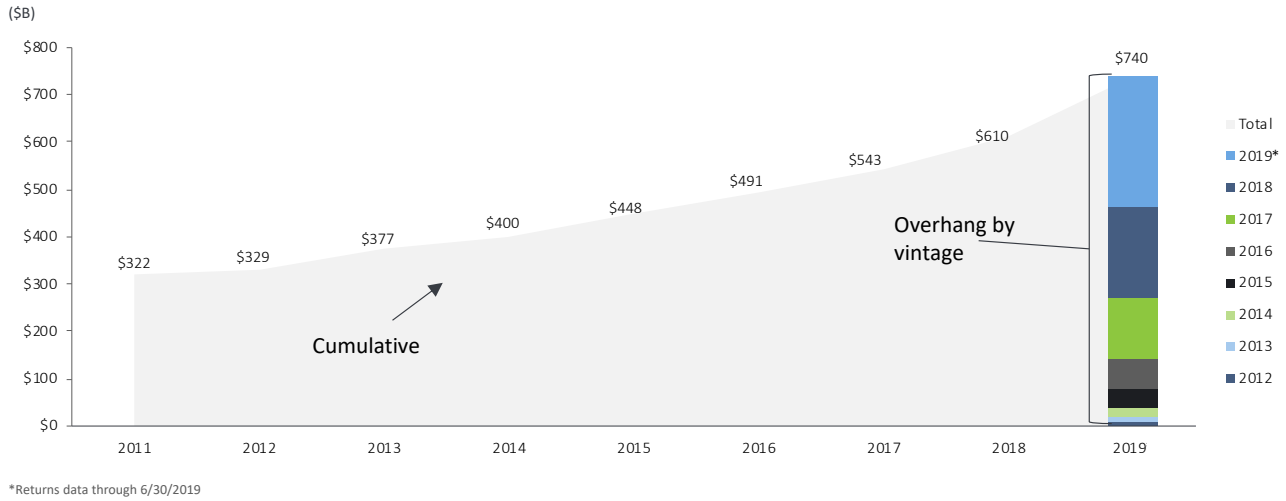


	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
All	9.9x	10.2x	12.1x	8.0x	8.0x	8.8x	8.4x	9.7x	12.8x	10.0x	10.5x	12.1x	11.5x	11.2x
Below $250M	6.1x	8.0x	12.1x	6.6x	7.7x	6.2x	6.4x	7.5x	12.2x	6.2x	5.8x	9.8x	11.5x	9.9x
$250-500M	11.0x	9.0x	14.7x	11.6x	7.4x	10.1x	9.8x	11.0x	10.3x	10.3x	9.5x	11.7x	10.6x	8.4x
$500-1B	13.2x	10.8x	5.4x	14.9x	8.2x	10.8x	10.2x	9.5x	12.6x	12.2x	20.7x	12.3x	13.6x	12.2x
1B+	9.9x	15.9x	12.0x	12.3x	8.2x	11.2x	10.9x	9.6x	19.8x	12.9x	15.0x	12.2x	11.4x	12.5x

* As of 12-16-2019

Graph data source: PitchBook

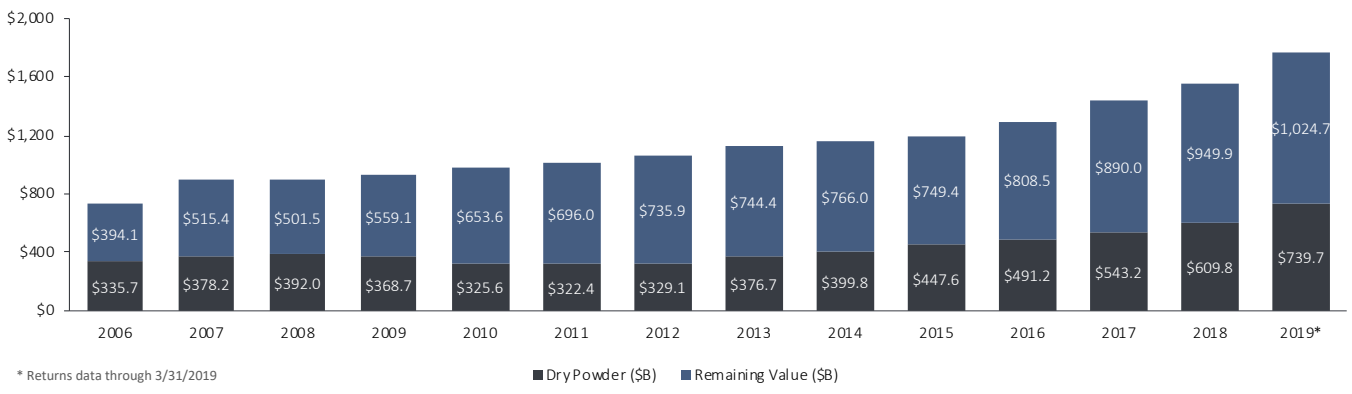
U.S. PRIVATE EQUITY CAPITAL OVERHANG



*Returns data through 6/30/2019

Graph data source: PitchBook

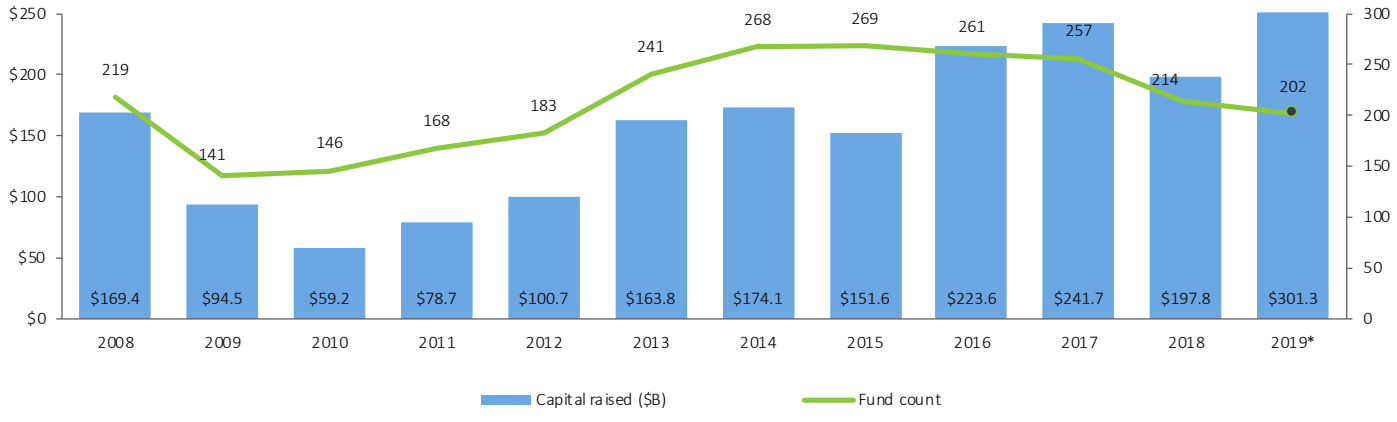
U.S. PRIVATE EQUITY ASSETS UNDER MANAGEMENT



Overall U.S. private equity assets also have continued to grow on a consistent basis year-over-year.

Graph data source: PitchBook

U.S. PRIVATE EQUITY FUNDRAISING



Private equity fundraising continues at record levels with fewer, larger funds

Graph data source: PitchBook

CASCADIA CAPITAL

In 2019, Cascadia Capital celebrated 20 years of serving entrepreneurs and family business owners. We marked the milestone year by closing a record 35 deals during the year, adding to the over 350 transactions closed with more than $12 billion of transaction value since the firm's founding in 1999. We enhanced our team with new team members, including two new Managing Directors, and we continued to dive deep into the sectors we cover to offer supreme industry expertise to our clients. Over two decades our mission has remained unchanged—to help business owners and fellow entrepreneurs achieve their goals of growing and maximizing the value of the companies they've spent years, a lifetime, or generations building.

2019 TRANSACTIONS

has been recapitalized by VISIOCAP / BEACH POINT — December 2019	has been acquired by HARRIS — December 2019	has been acquired by encore consumer capital — December 2019	has divested one of its propane business units (APP Propane) to THOMPSON GAS — November 2019	has received a growth investment from — November 2019	has sold stake in AquaBounty TECHNOLOGIES to TS Aquaculture, LLC managed by — October 2019
Fairness Opinion — October 2019	has been acquired by zoetis — October 2019	has been acquired by — September 2019	have been acquired by BRS and ROSSER — September 2019	has been acquired by Microsoft — September 2019	has received an equity investment from FIERA COMOX — August 2019
has been acquired by — August 2019	has sold a majority interest to AJINOMOTO — August 2019	has been acquired by Providence St. Joseph Health — July 2019	has been acquired by — June 2019	has received a growth equity investment from A leading energy private equity firm — May 2019	has been recapitalized by — April 2019
has been recapitalized by polarispartners — April 2019	has been acquired by DCC PROPANE, LLC — April 2019	has been acquired by TELEO — April 2019	has received an investment from COOL JAPAN FUND — April 2019	a portfolio company of encore consumer capital has been acquired by Ceva — March 2019	has received a strategic investment from BON SECOURS MERCY HEALTH — March 2019
has been acquired by J.B. HUNT — February 2019	has been acquired by Ingredion — February 2019	has received an investment from abry partners — January 2019	has sold a minority interest to EXCELLERE PARTNERS — January 2019	has merged with QUEST PRODUCTS a portfolio company of PROMUS EQUITY — January 2019	has been acquired by Idera, Inc. a portfolio company of HGGC / TA ASSOCIATES — January 2019

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