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After back-to-back quarters of 3 percent gross domestic product (GDP), U.S. economic growth remains on track to expand by better than 2 percent in 2017. Meanwhile, retail sales data shows an economy that is expanding into the critical U.S. holiday shopping season, and there are early signs inflation may be beginning to percolate with core inflation (excluding food and energy) rising for the first time since January.

The housing recovery appears to have stalled on the back of tighter lending standards, at least by historical standards, and supply constraints, with housing starts increasing at a 1.25 million unit pace on an annualized basis.

The domestic manufacturing sector rebound is continuing and has also picked up on a global basis. The primary risks in the U.S. are the slowing demand for autos and the potential impact of U.S. dollar appreciation on exports. Meanwhile, the labor market continues to tighten. Unemployment is at 4.1 percent and our forecast is for it to decline below 4 percent in the first quarter of next year.

**Mergers and acquisitions**

The term structure of interest rates remains somewhat unfavorable to mergers and acquisitions (M&A) activity. While we anticipate the Fed will lift rates by another 25 basis points in December, the combined impact of safe haven moves into dollar denominated positions and chasing of yield by international investors continues to suppress rates at the long end of the curve. Thus, conditions remain in favor of sellers as opposed to buyers in the market.

**Industrial products and manufacturing**

Manufacturing is showing signs acceleration amid solid new orders data and as the effects of the major hurricanes begins to fade. Corporate earnings have improved modestly and there are signs fixed business investment is accelerating as well. Even so, there are real concerns about auto production and the divergence between aerospace and even food and beverage manufacturing is growing. One area to monitor is related to agriculture production. A tight labor market affected the harvest season and this may lead to higher food prices later this year.

**OTHER RESOURCES**

**The Real Economy**

A monthly publication to help the middle market anticipate and address the unique issues and challenges facing their businesses and the industries in which they operate. We also release a Global Edition on a semi-annual basis that addresses issues affecting business on a global scale. [Read more](#).

**The RSM Middle Market Business Index (MMBI)**

The RSM Middle Market Business Index developed in partnership with Moody’s Analytics, is designed to accurately reflect business conditions in the U.S. middle market, while providing a statistically significant measure of the health and outlook for these businesses. [Read more](#).
Relative strength in B2B

- PE activity remains strong, despite pricing headwinds. Total value is on pace for its biggest showing since 2007, despite a dip in overall volume.

- Purchase price multiples remain high. Valuations that would have been deemed unreasonable only a few years ago have become the accepted norm throughout much of the business to business (B2B) space.

- Optimism in the industry remains strong, despite continued competition for deal flow, stagnantly low growth and historically high valuations. B2B companies are more focused on short-term goals and less concerned about the broader regulatory and political environment.

- That said, many B2B firms have ongoing concerns around unresolved tax issues. Clients are anxious about what legislation will be passed and what impacts any new taxes will have on their businesses. Answers may arrive as soon as the fourth quarter.

- M&A deal volume continued down in Q3, part of a broader decline that began in Q1 2016. Value, however, was strong in Q3, totaling nearly $80 billion in combined investments.

- Private equity’s involvement in the M&A market has picked up. About 34 percent of all Q3 2017 transactions were PE-sponsored, compared to about 26 percent as recently as H2 2015.
Down but not out

M&A volume continued to slide in Q3, though value was in line with prior quarters. Almost $80 billion was spent in the third quarter via 1,221 completed transactions; total value represented a 4 percent increase over Q2 2017 while volume was down 18 percent. The story was roughly the same across North America and Europe, which both saw declines in volume but strong value overall. Large transactions pushed the average deal size to $333 million in Q3, marking the second time since 2013 that transactions have averaged over $300 million. The median was also historically high at $34.5 million, the highest quarterly mark in over four years.

Values by subsector were mixed. Commercial products activity slid to just under $24 million, one of the lower totals in recent memory. Commercial services, however, popped back up to $42 million after three relatively slow quarters, at least on a value basis. Transportation, meanwhile, saw about $14 million worth of activity; no quarter in 2016 saw more than $4.7 million. One trend worth keeping an eye on in transportation is an upswing in self-driving technology platforms. According to Harshad Khurjekar, principal of transaction advisory services at RSM US, self-driving technology should prove an advantage to the B2B space. “If fully and properly implemented, self-driving truck technology should eventually reduce the number of accidents and improve productivity, since we can expect to have trucks driving 24-7,” says Khurjekar, adding that it remains to be seen how well the technology is implemented.
Nearing record territory, despite headwinds

PE deal flow largely mirrored the overall M&A market in Q3. Volume declined a second straight quarter to 491 transactions, but the quarter’s combined value rose 11 percent to $75 billion, one of the highest single-quarter marks dating back to the financial crisis. Heading into Q4, total value in 2017 ($98 billion through Q3) is within shouting distance of last year’s $113 billion and not far off 2015’s record of $121 billion. While other industries are seeing muted PE activity due to multiples and broader uncertainty in the market, the B2B sector may be looking at a record year in terms of value. Overall activity is in line with expectations this, according to Khurjekar, and we may see even higher numbers next year. “PE activity should be strong in 2018 and should be comparable to this year’s numbers, if not more. There is significant dry powder in the market as well as more buyers, i.e., more family offices, new funds, international strategic buyers and more limited partners investing directly. Buyers are focused on risk-adjusted returns, and they’re assuming they may need to hold their investments through recessionary periods as they deploy their capital this year and next.”

Broken down by subsector, the B2B space shows pockets of growth. Commercial transportation has already seen more dollars invested this year than all of 2016 ($10.8 billion versus $9.3 billion last year).
Commercial services, historically the strongest niche in the sector, has closed on $136 billion worth of deals through Q3, not far off the $157 billion recorded last year or, for that matter, the record $167 billion invested in 2014. The only subsector off last year’s pace is commercial products. Checking in at nearly $70 billion, commercial products would need a strong fourth-quarter push to go past last year’s $101 billion, but should end the year with a strong showing, regardless.

Valuations aren’t expected to come down any time soon. Mark Gaines, partner of business and professional services at RSM US, says the market has accepted today’s historically high price tags. “Frankly, we’re in an environment where multiples that were considered a bit shocking in the past are just generally accepted today.” Investor mindsets have also adjusted: “If someone comes along and really loves your business and thinks it’s a perfect fit for them, those buyers are probably going to pay a premium for it right now, as opposed to buying a platform simply to add it to their portfolio.”
Seller's market dissipating, SBOs on the rise

B2B PE exit activity has waned over the last several quarters. A seller’s market across all PE-related industries has affected B2B all the same, though it’s worth noting B2B’s decline has been less severe than other sectors. Q3 saw 175 PE exits in total, including a near-split between strategic acquisitions (89) and secondary buyouts (80). Historically, strategic acquirers have been behind more than half of all PE exits, but there are signs that secondary buyouts are becoming a more significant offramp in terms of volume. The M&A cycle has slowed relative to its peak in 2015, but the past several quarters have seen near-record-setting levels of fundraising by PE investors. Eager to put fresh funds to work, it’s likely that PE buyers will present more exit opportunities than strategic buyers, despite high valuations and increased competition among financial sponsors.
IPO ACTIVITY

No PE-backed IPOs in Q3

Initial public offering (IPO) activity took a breather in Q3, logging two offerings for a combined $30 million of capital raised. Both numbers were well below Q2 totals, which recorded 10 offerings for a combined $1.97 billion. The quarter-over-quarter slowdown is partly attributable to no PE-backed offerings in Q3; the four PE-sponsored IPOs in Q2 accounted for $1.6 billion of all capital raised last quarter. This is likely a simple timing issue, as B2B has been reliable among sectors with regard to public listings. While other major industries are being heavily affected by some type of transformation—especially consumer products and healthcare—B2B companies have focused on short-term metrics irrespective of the broader economy. Business products and services have also experienced less impact with regard to regulatory changes and fast-moving tech advances, making the B2B sector a more consistent bet for shareholders looking to take their companies public.

U.S. IPOs in the B2B industry

Median U.S. IPO size ($M)

B2B IPO PIPELINE

<table>
<thead>
<tr>
<th>Company name</th>
<th>Sponsor(s)</th>
<th>Sector</th>
<th>Amount ($M)</th>
</tr>
</thead>
<tbody>
<tr>
<td>SendGrid</td>
<td>500 Startups, Bessemer, Bain Capital, Founders Fund</td>
<td>Communications</td>
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<tr>
<td>Globoforce</td>
<td>Atlas Venture, Balderton Capital, Benchmark Capital</td>
<td>Media Services</td>
<td>$471</td>
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</tbody>
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Source: PitchBook
PUBLIC-TO-PRIVATE ACTIVITY

PE taking a larger share

PE continues to account for a larger and larger share of overall M&A activity. 34 percent of all Q3 acquisitions were financially sponsored, a notable jump from 26 percent in Q4 2015. Financial buyers are also accounting for a large share of take-private acquisitions; through Q3, PE sponsors are responsible for 44 percent of such transactions, a percentage that has trended in the mid-30s range for the past two years. One underlying reason for this trend goes back, again, to a B2B industry that is inherently more predictable than its counterparts in health care and consumer, where stocks are hit hard by mere announcements that imply significant regulatory or technological changes in the works. Business-related stocks have performed more consistently this year on account of the sector’s predictability, a trend that doesn’t look to change in the near-term.

SELECT B2B Q3 2017 M&A/PE TRANSACTIONS

<table>
<thead>
<tr>
<th>Company name</th>
<th>Buyer</th>
<th>Sector</th>
<th>Amount (SM)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sullair</td>
<td>Accudyne Industries, BC Partners, Carlyle Group</td>
<td>Machinery</td>
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<tr>
<td>CPI International</td>
<td>Odyssey Investment Partners</td>
<td>Electrical Equipment</td>
<td>$800</td>
</tr>
<tr>
<td>Stewart &amp; Stevenson</td>
<td>Kirby</td>
<td>Machinery</td>
<td>$744</td>
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<tr>
<td>Chromalox</td>
<td>Spirax–Sarco Engineering</td>
<td>Electrical Equipment</td>
<td>$415</td>
</tr>
</tbody>
</table>

Source: PitchBook
The value of RSM’s middle-market leadership

Focusing on the middle market, RSM US provides integrated transaction advisory, tax, assurance and consulting services. Our work with 4,300 middle-market business and professional services companies gives us a deep understanding of the key trends impacting the industry. In addition, we have performed due diligence on more than 2,000 deals in the past five years, over 300 of which were business and professional services transactions. This in-depth knowledge provides our private equity and strategic buyer clients with industry-specific due diligence considerations.

The following list shows a detailed breakdown of the PitchBook industry codes for the B2B industry.

1. BUSINESS PRODUCTS AND SERVICES (B2B)

1.1 Commercial products
1.2 Commercial services
1.3 Transportation
1.4 Other business products and services