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2018 UPWARD TRENDS

The Micro-Small Cap Market

Rich Valuations, Increased Competition & Finding Value

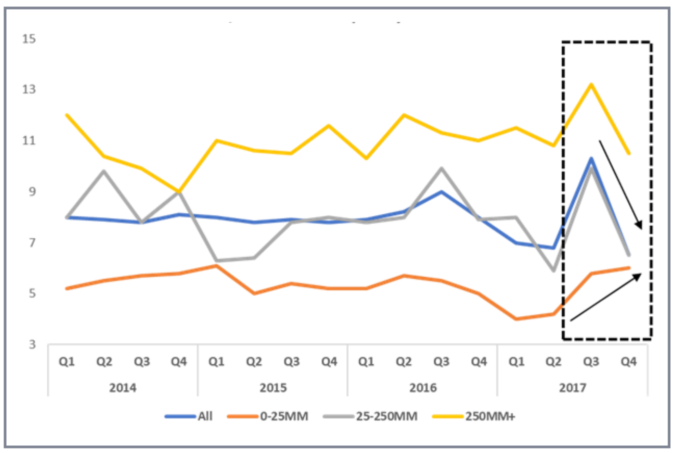
Rising multiples may be headed for correction, but it is not evident in the lower end of market. Looking across private equity transactions, 2017 saw continued high valuations, with a third-quarter peak and subsequent year-end decline. Across all private equity transactions, median enterprise value-to-EBITDA (EV/EBITDA) multiples came down significantly from 10X in the third quarter of 2017, to 6.3X in the fourth quarter. This movement could suggest a coming correction beginning to take shape for at least some of the investment landscape as we continue forward through 2018. Such indicators are not reflected in the micro-small cap space, suggesting that rich multiples will persist for at least the near-term, and that any correction in this space could potentially lag the broader private market. Main Line Equity Partners' investment approach and executional strategy is strongly positioned in such environments to ensure that any opportunities pursued are poised to create optimal value. While other firms may get caught up in valuation momentum and fear of losing a highly sought-after deal, Main Line Equity Partners' rigorous diligence process, coupled with patience and discipline to pass on expensive opportunities sets the firm apart as a focused, value-oriented investor with commercial and operational expertise to successfully grow investments.

Persisting Rich Valuations in Micro-Small Caps

Relative to the broader PE investment landscape, the micro-small cap space (companies with revenues less than $25MM) was the only category that saw consistent multiple expansion across every quarter in 2017, starting at 4X EBITDA in Q1, to 5.8X in Q3 and ending at 6X in Q4, reflecting a 3% final quarter increase, while midcaps ($25-$250MM in revenues) saw a 34% decline for the same period from 9.9X to 6.5X. Large caps (revenues greater than $250MM) followed a similar trend, with multiples contracting by 20% in the final quarter from 13.2X to 10.5X. Further, the fact that multiples for micro-small caps are approaching those of its mid cap peers reflects the growing challenge investors face of finding value and deploying capital in deals that make sense. Both the steady, albeit small, rise in transaction multiples in the micro-small cap space, coupled with its convergence with those in the mid cap space is likely an indication of increased competition in the lower end of the market.

While the downward trend in multiples at the upper end of the market in late 2017 could indicate the start of a market correction, rich multiples in the lower end are continuing with increased competition in this space, making it challenging for PE firms to put dollars to work in a value-creating and ROI-optimizing manner. It would seem that while valuations in the mid and upper end of the market are becoming less decoupled from their underlying intrinsic value, this detachment persists in the lower end and ultimately will become unsustainable.

Median EV/EBITDA Multiple by Transaction Size



Data source: Pitchbook.com. Q4 2017 as of 12/15/17

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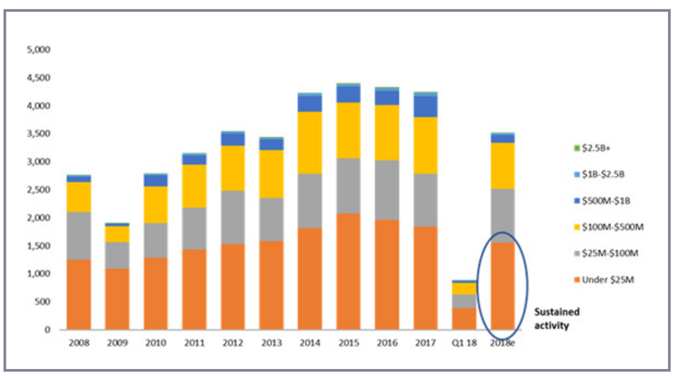
Slowing Deal Activity, But Less Evident in Lower End

Additionally, a slowdown in private equity deal activity could be further indication that PE investors are beginning to react to the persistence of high valuations and increased competition in the private markets by waiting to put their money to work in the current environment. Total deal activity fell by 2% from 4,335 total deals in 2016 to 4,248 in 2017, the largest decline in activity over the last 5 years. Q1 2018 saw a further decline to 881 total deals, reflecting an annual run-rate of 3,524 deals, and a 17% decline over 2018. Despite the slowing trends in the broader market, activity in the lower end of the market remains robust. Micro-small caps comprised 43% of all deals in 2017 and 44% in Q1 2018, the largest driver of total activity.

Further, 2018 run-rate activity based on Q1 2018 numbers, reflects a decline in micro-small cap activity by only 15%, half of the 30% decline expected for the rest of the market. So, while activity is slowing across the PE market broadly, the lower end of the market is comparatively strong and the slowdown less evident. As the lower end of the market seems to be moving counter to the rest of the PE market with persisting high valuations supported by continued deal activity, it would seem that any correction in the micro-small cap space will lag any broader market correction that may be coming.

PE Deal Activity (# of Deals)

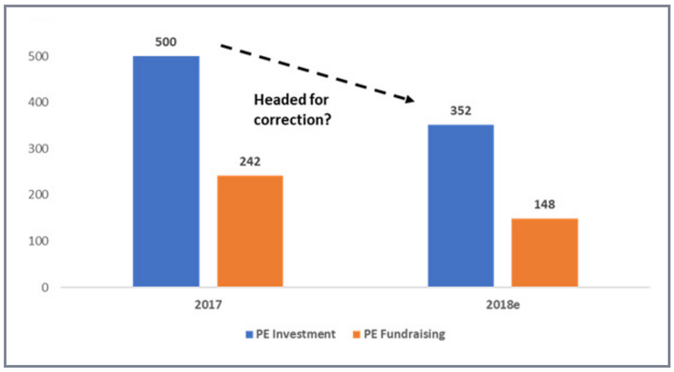


Data source: Pitchbook.com

Mind the Gap: Investment Far Outpacing Fundraising

Private equity investment relative to capital raised would also seem to indicate a frothy "pre-bubble"-like market that is beginning to show signs of an impending correction. In 2017, PE firms invested $500BN, while total capital raised was just $242BN. The fact that firms are investing twice the amount of capital that they are raising likely reflects an unsustainable situation that at a certain point will have to correct itself. We may be seeing the beginnings of a correction as in Q1 2018 we saw $88BN invested and $37BN raised, indicating an annual run-rate of $352BN invested, a 30% decline in investments from 2017.

PE Investment vs. Capital Raised ($BN)



Data Source: Pitchbook.com, 2018 estimated reflects Q1 2018 annualized run-rate

While it is too early to tell whether a correction has begun, given continued high valuations in micro-small caps relative to comparative multiple declines across the rest of the market, a slowdown in total deal activity, along with the outsize gap of investment versus dollars raised, a correction is likely imminent. We would expect to see private equity firms become more cautious about putting money to work, more discerning in their vetting processes, and should be seeking to identify those opportunities where price expectations are more in-line with underlying value to ultimately return more value to investors. Over time, valuations will normalize and investment dollars should flow at a pace more in-line with fundraising.

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Conservatively Identifying and Unlocking Value

More important now than ever during this period will be for firms to employ rigorous due diligence, thoughtful deal structuring, and active participation in portfolio companies to ensure value realization. It is easy for funds with capital to deploy to get caught up in valuation momentum, yet exponentially more difficult in turn to realize value for their investors. In such environments, firms who patiently seek out the right opportunities, and who know how to execute operationally will be the ones who perform.

These are the defining characteristics of Main Line Equity Partners. Since 2005, we have been building active, long-term financial and operational partnerships with forward-thinking management teams to transform their innovations into market-leading businesses, in turn creating superior value for both the company and shareholders. Main Line Equity Partners maintains a systematic and disciplined approach to vetting, diligence, , valuation, deal structuring, and growth strategy execution, to invest in stable companies with strong foundations and growth opportunities where we can leverage our networks and deep functional expertise to add significant value.

We continue to invest with rigorous discipline through this frothy period as it always has been—and are strongly positioning our investments and in-turn our investors, for possible market correction and broader uncertainty.

About Main Line Equity Partners

Funding. Flexibility. Forward Thinking.

Leveraging broad skills sets, domain expertise, and capital through our *Alternative Asset Fund I*, we make strategic equity and debt investments in companies ready to transition their business or partner for the next stage of growth.

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