



Lower Middle Market and Case Study

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SteelGate Advisors, a multidiscipline investment bank located in greater Pittsburgh, Pennsylvania, USA, provides comments on the lower middle market and a current case study.

Lower Middle Market

The Lower-Middle-Market (“LMM”) is often defined in a variety of ways, but it generally includes businesses with enterprise values between \$5M and \$50M or annual revenue between \$5M and \$100M. The SBA estimates over 125,000 US companies fit into this large and growing category.

SteelGate has over 75 years of combined experience in the M&A field, and based on our size, location, and knowledge, focus on deals with enterprise value greater than \$5M. Companies/deal of this size are not always easy to work with compared to larger companies, so investment banks are generally unwilling to engage these clients. Clients of this size may lack a strong management team (often relying on a single owner), lack developed financial budgets / projections, operations are often not diversified, and other unique circumstances. The LMM often produces “hairy” deals that many bankers avoid at all costs.

Consider three recent sell-side client examples: 1) client lost a large customer (40% of revenues) during the marketing process; 2) client has a single customer currently in Chapter 11 bankruptcy; and 3) a multi-location business with one sluggish location causing recurring losses. Most investment banks stay clear of these deals (and not for pejorative reasons), as the risk is considered too high. However, we have been able to successfully fill this niche using a disciplined process with deep networks and a multidisciplinary team.

Case Study

Difficult Deal Factors

- SteelGate is currently engaged to provide sell-side representation to a machine shop (the “Company”) that services the nuclear energy industry, has approximately \$7M of annual revenue, one location, and its one customer (95% of revenue) is currently in Chapter 11 bankruptcy.
- Revenue Base / Customer Relationship –The Company has a strong relationship with its main customer and is the lone vendor utilized for many of the regularly used maintenance parts. The machined parts are necessary as part of the refueling process in nuclear power plants.
- Limited Buyer Universe – Because of the industry served by the Company, the potential buyer universe is limited.
- Owner’s Goal – The current owner of the Company desires to retire as quickly as possible post sale.
- Recent Sales Decline – Company sales decreased from over \$9M in 2014 to under \$6M in 2016.
- Unsuccessful Acquisition – The Company made an acquisition at the end of 2015, which has not been successful.



Positive Deal Factors

- Refueling occurs regularly as a matter of Nuclear Regulatory Commission (NRC) requirements; departure from NRC regulations is considered to be a very serious issue that is considered by many to be a national security issue. Summary – refueling has to happen and the Company is essentially the sole source of the critical components essential to the process.
- Barriers to Entry – The Company's compliance standards, NRC regulations, and customer relationship make it very difficult for potential competitors to enter the market.
- Workforce – The Company has a dedicated, highly skilled, and competitively compensated workforce.
- Opportunity to Expand – State of the art equipment is utilized by the Company and excess capacity exists within the operations. Because of the quality standards of the nuclear industry, expansion into aerospace and other highly regulated industries is much easier.
- Base-line Revenue – Upon further analysis, we determined that although revenue had decreased, an annual baseline revenue exists based upon the refueling needs of existing nuclear power plants.

Summary

In summary, we took on this deal because we studied the industry and circumstances surrounding the revenue stream in detail, as opposed to immediately running away from a highly concentrated (among other factors) deal. This does not completely remove the “hair” from this deal; however, we are confident in our ability to meet our client's goals based upon candid and detailed communication with him and our deep understand of the business environment.

STEELGATE ADVISORS, INC.

SteelGate Advisors is a multidiscipline investment bank specializing in buy- and sell-side representation, corporate finance, business valuation and tax planning/structuring for middle market companies. Our expertise, objectivity and individualized approach have helped stakeholders develop the important – and often challenging – business strategies that help them achieve their professional and personal financial goals.

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