PRAIRIE

Prairie Middle Market Perspective

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Tacoma Electric Supply

Overall M&A Market Commentary

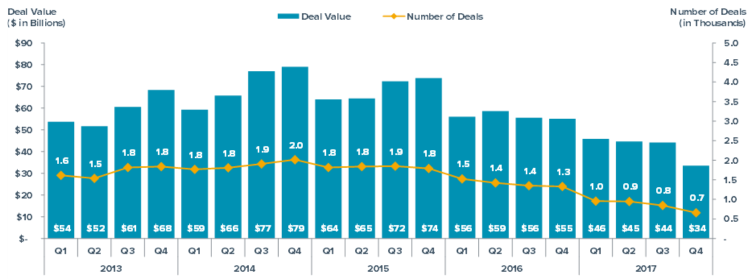
Middle market M&A activity continued its decline through the end of 2017, recording another quarter of lower deal volume and lower dollar value in 4Q17. While the ten quarter negative trend in M&A activity which began in 2016 continues, there is reason for optimism. Growing business and consumer confidence induced by an improving economy, a new regulatory environment, and the much anticipated tax reform passed by Congress in late 2017, all are seen as positive influences on the 2018 M&A market. An aging business owner population coupled with abundant capital and the demand of strategic and private equity ("PE") buyers make for a ***fertile M&A environment***.

Large M&A deals seem to be leading the way. Late 2017 saw an escalating pace in large merger deals. Examples include: Arby's offer to buy Buffalo Wild Wings for $2.9 billion, Broadcom's $100 billion offer for Qualcomm, CVS Health buying Aetna, United Technologies buying Rockwell Collins for $30 billion, to name a few. The global investment bank Goldman Sachs is bullish on the 2018 merger market and forecasts that cash M&A spending will increase 6% in 2018.

The improvement in the global economy is providing support to a better 2018 deal market. The International Monetary Fund (IMF) improved its 2017 growth forecast for the global economy to 3.6% at the end of the year and is predicting 3.7% growth in 2018. This global economic tailwind is helping the U.S. economy and coupled with decreased regulation and significant tax reform is expected to lead to stronger growth in the U.S. economy. GDP growth in the U.S. was 3.1% in 2Q17 and 3.2% in 3Q17. Based on strong consumer spending for the holidays, a number of economists are predicting more than 3.0% growth in 4Q17 and for the full year as well. Even Jamie Dimon, the Chairman and CEO of JP Morgan Chase, in an interview with Maria Bartiromo believes that 4% GDP growth is possible for 2018. The duration of the post-recession U.S. economic expansion is now reaching record territory and will likely become the longest recession recovery in history.

Capital spending will also likely increase in 2018 because of the 100% bonus depreciation provisions in the Tax Cuts and Jobs Act of 2017. Furthermore, the growing business and consumer confidence is expected to lead to more corporate enthusiasm for making acquisitions and investments in businesses. All of these business investments are anticipated to lead to more earnings growth and further improvements in the U.S. economy.

Total U.S. M&A Deal Volume and Value <$300M Transaction Value
Q1-2013 to Q4-2017



Source: Capital IQ

There is a 6 to 12 month lag between engagement and closing for M&A transactions. Investment bankers and other advisors are reporting an escalation in middle market M&A pitch activity and many advisors have seen an increase in the number of new engagements. This new engagement activity should lead to more closed deals in 2018.

The current M&A market is a sellers' market. The demand for good quality acquisition targets remains largely unsatisfied. We encourage business owners to look at their transition goals and objectives and determine whether a company sale makes sense for their circumstances.

M&A Market Activity

Closed M&A deal activity has experienced a ten consecutive quarter decline in deal volume starting in the middle of 2015 and continuing through 4Q17. Both dollar volume and number of deals showed declines in 4Q17 which might mark the low water mark of the current middle market M&A swoon. The passage of The Tax Cuts and Jobs Act of 2017 could be a turning point. The provisions of this new tax law will be given a thorough analysis but it is generally expected that the new tax law will benefit businesses and business owners and will spur interest in new growth activities like acquisitions. Furthermore, improved small business optimism is expected to further entice new sellers into the market. Private equity funds and investment bankers are reporting increased activity levels suggesting more business owners are considering a sale. Lower taxes, abundant capital and unsatisfied strategic and PE buyer acquisition demand is expected to continue the sellers' market.

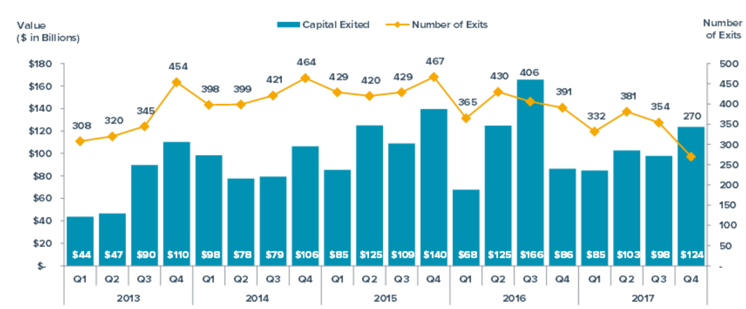
PE firms, unlike private business owners, are less "attached" to their holdings and are quicker to take advantage of the market's elevated valuations. Over the last few quarters, PE exit activity has maintained relatively high volumes reflecting the PEs continuous review of their portfolios for saleable companies. Larger companies attract higher valuations which might explain the recent trend of the increasing average size of the PE company sold.

Deal valuations remained at historically high levels. Strategic and PE buyer demand for new deals, the availability of debt capital and the lack of supply of quality companies for sale is expected to continue to support elevated valuations. The current seller's market conditions are further enhanced by the new elements of lower taxes and reduced business regulations. Business owners should take this opportunity to consider their strategic alternatives, including a company sale.

- The $34 billion of middle market deals recorded in 4Q17 reflects a 23% reduction in dollar value from 3Q17. Furthermore, the FY2017 dollar value of deals was down 25% compared to levels experienced in FY2016.
- The number of middle market deals recorded in 4Q17 declined 13% from the number of deals in 3Q17 and the number of deals closed during FY2017 was 39% lower than the number of deals closed in FY2016.
- The average middle market deal size of $49.7 million in FY2017 was up from the average $40.4 million deal size closed in FY2016.

PE exit activity showed a different story. While the number of exits in 4Q17 decreased about 24% from the 3Q17, the capital exited increased 27% during the same period. PEs are opportunistic sellers and this group has been consistently taking advantage of the higher business valuations, particularly on larger deals.

Private Equity Exits
Q1-2013 to Q4-2017



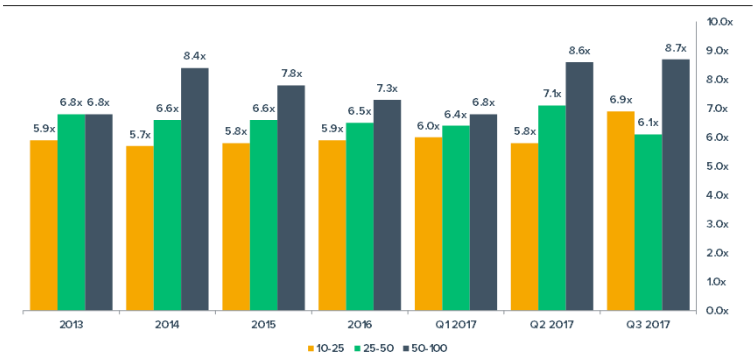
Source: Pitchbook

Middle Market Deal Valuations

Middle Market M&A valuations remain in elevated territory. The lack of supply of company sale candidates, improving economic conditions, new tax policy and the trend in reduced business regulation are leading to even more aggressive behavior by both strategic and PE buyers. While the current valuation data cut by company size is particularly volatile at low M&A activity levels we are seeing evidence that valuations may be moving somewhat higher. Although an increase in the supply of saleable companies coupled with higher interest rates could lead to declines in M&A valuation multiples later this year. However, better corporate earnings induced by the improving economy, coupled with slightly lower multiples will still result in elevated M&A deal dollar value. We believe middle market company values are still at or near a market peak and it is an excellent time for sellers to enter the market.

- Sub-$25 million deal valuation multiples moved higher in 3Q17 hitting a 6.9x multiple which is above the long run multiple average of 5.7x for this size category. Low volumes of 3Q17 deal activity likely skewed the multiples in this size category.
- Valuations on the large end of the middle market ($50 to $100 million segment) continue to stay at elevated levels in 3Q17 settling at 8.7x, another record high for this size group.
- Valuations in the $25 to $50 million segment moved a moved a lower in 3Q17. These odd trends in these lower end segments are likely due to low deal volumes rather than any sustained trends.
- As we have suggested in our previous reports, properly prepared, solid performing companies are always welcome in the M&A market and will continue to receive strong buyer interest and premium valuations.

TEV*/EBITDA by Deal Size ($ Millions)
2013 to Q3-2017



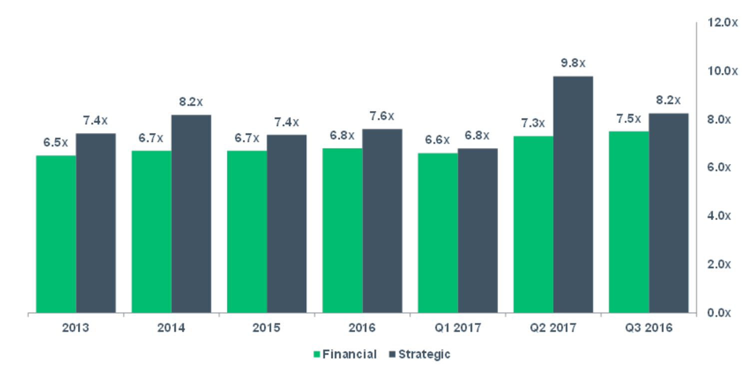
Source: GF Data
**TEV = Total Enterprise Value*

Private Equity versus Strategic Valuations

Strategic buyers are a major factor in middle market M&A. Better economic conditions, lower anticipated taxes and overall improving business sentiment are leading to more aggressive strategic buyer acquisition behavior. Acquisition synergies have resulted in a long term trend of strategic buyers paying approximately 0.5x to 1.0x of EBITDA more than the average PE buyer. Our 3Q17 data shows continued aggressive participation of the strategic buyer in M&A transactions leading to higher deal offers and increased strategic valuations.

- Strategic buyers are becoming more aggressive in making middle market acquisitions. During the first three quarters of 2017, our data shows that strategic buyer multiples averaged 8.2x which is higher than the averages for the last couple of years.
- Over the last few years, PE acquisition multiples have remained in a stable range. Our data continues to show that the PE multiples now are moving higher, above the long run trend line and increased during 3Q17 to a multiple level of 7.5x EBITDA.

TEV/EBITDA Multiple by Buyer Type ($10-250M of TEV)
2013 to Q3-2017



Source 1: Financial Buyers: GF Data ($10-250M TEV)
Source 2: Strategic Buyers: Capital IQ ($10-250M TEV; Excluding outliers defined as transactions with TEV/EBITDA of less than 3.0x and more than 14.0x)

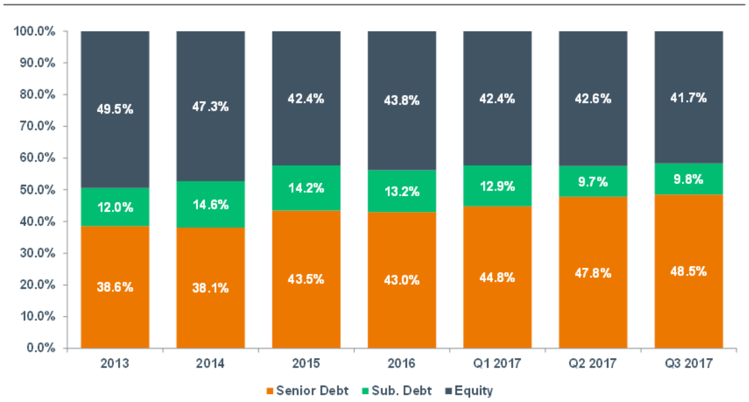
- The increase in valuations indicate that the supply demand imbalance continues in the middle market. Well-prepared, attractive sellers can still take advantage of interest in M&A deals by both strategic buyers and PE funds and achieve reasonably high valuations.
- The data reflect valuation multiples for all size deals. Prairie estimates that for middle market deals below $50 million, valuations are generally 1.0x to 2.0x multiples of EBITDA lower than the levels reflected in the chart above.

Middle Market Leveraged Buy Out Capitalizations

The continued economic recovery, a more upbeat business outlook and abundantly available debt capital has gradually lead to more leverage in middle market LBOs. The amount of equity capital invested in the typical leveraged buyout ("LBO") deal has continued to become a declining component of the LBO capital structure.

- Growth in the number of lending sources, low interest rates and greater sophistication of borrowers has made the decision on the amount and type of debt capital used an important part of the LBO process. With very high valuations, PEs use debt leverage to offset the negative effects high valuations have on their expected investment returns.
- The wide variety of debt sources and the resulting increased demand for new lending opportunities has kept borrowing costs low. While borrowing costs are low, more stringent leveraged lending regulatory oversight and a more discerning lending community has kept LBO deal structures in a conservative zone. As such, equity still is in excess of a third of the capital structure.
- The mezzanine funds continued to aggressively pursue deal opportunities in 2017. The use of this type of funding in leveraged transactions remains an important part of the LBO capital structure. While interest only and payment in kind structures still dominate the markets, warrants have started to return to the mezzanine return structure, particularly in smaller or more leveraged deal structures. Mezzanine funds continue to pursue equity co-investment opportunities to improve their returns and increase their investment amount in deals.

Equity and Debt Capitalization
2013 to Q3-2017



Source: GF Data

Overall Comment on the Financing Markets

According to the Wall Street Journal on January 2, 2018 "Business-loan growth fell to its lowest levels since the aftermath of the financial crisis in the final weeks of 2017, a puzzling development that could weigh on bank earnings later this month." Middle market loan issuance remains anemic but may start to show some positive signs as consumer and business optimism improves and the tax law changes permeate through the business community. With lower tax rates, businesses will have more cash flow to invest in capital equipment and make more acquisitions. The new tax policy of being able to claim 100% bonus depreciation of capital expenditures in the year made is expected to drive capital investment and could enhance loan growth as more companies take advantage of the new tax laws.

However, limits on the deductibility of business interest expense will likely offset some of the benefits of 100% bonus depreciation. It will likely be several quarters before we see the total effects of the new tax laws.

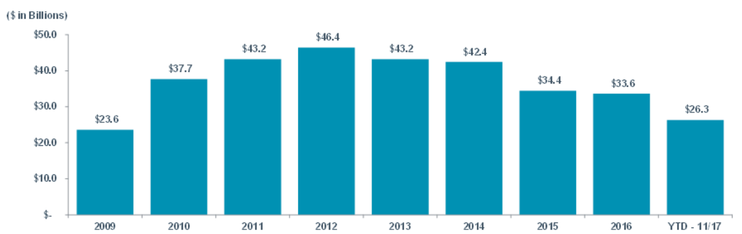
Even with the Fed's continued desire to increase interest rates, we remain in a low interest rate environment with low borrowing costs for businesses. Credit worthy companies with a need for long term debt capital are well received in the lending market. The current environment presents companies with an opportunity to borrow at a low interest rate.

Total U.S. Middle Market Loan Issuance

- New loan issuance for middle market companies decreased in the first 11 months of 2017 continuing a slide that began in 2012. It is generally believed that this is a demand side issue because there is an abundant supply of credit available for middle market companies. An improving economy and better business owner sentiment will likely contribute to more loan demand and therefore new loan issuance in 2018.
- The Federal Reserve increased its benchmark interest rate another 25 basis points in December 2017. This was the third 25 basis point increase in 2017 and the fifth 25 basis point increase since the end of the recession. The overnight funds rate target range is currently at 1.25% to 1.50%. Expectations remain for two to three additional increases in 2018 moving closer to a more normalized target range of between 2.00% to 4.00%.
- Bank lenders continue to focus on relationship banking, corporate borrowers' lines of credit and areas where they have a competitive advantage like operating business needs, including payroll and checking accounts. Due to regulatory scrutiny, banks continue to be selective in making new loans and are very selective in new leveraged transactions.

- The non-bank BDC ("Business Development Company") lenders, due to their problems in attracting new funding, have reduced their participation in the leveraged loan market and have become more conservative in their lending practices.

Loan Issuance for the Middle Market <$100M
2009 to YTD - 11/17



Source: Thomson Reuters

Interest Rate Environment

- The short end of the yield curve (Prime and 1 month LIBOR) are about 70-80 basis points higher in year-over-year comparisons reflecting the three additional 25 basis point Fed rate hikes orchestrated in 2017. The market expects two to three additional Fed rate increases in late 2018, which will likely further shift the low end of the curve higher in 2018.
- The yields of the five and 10 year U.S. Treasuries in year-over-year comparisons has not increased as much as the short end of the yield curve. This flattening of the yield curve is a source of concern for some analysts especially when the yield curve inverts. An inverted yield curve is a predictor of recessions. At the end of 2017 the spread between the two to 10 year treasury was about 50 basis points (compared to 125 basis points at the end of 2016), still positively sloping but an area to watch in the future.
- The unemployment rate remains below 4.5%, currently at 4.1%. Job growth in the U.S. has been trending higher across many sectors of the economy. The new tax bill's lower corporate taxes and reduced regulation is leading to a more positive market psychology which is expected to lead to more robust job growth in 2018.

KEY INTEREST RATES

	12/30/2016	12/29/2017	1/12/2018
Prime Rate	3.75%	4.50%	4.50%
Libor - 1 Month	0.77%	1.56%	1.56%
Libor - 3 Month	1.00%	1.69%	1.70%
U.S. Treasury - 2 Year	1.20%	1.89%	1.92%
U.S. Treasury - 5 Year	1.93%	2.20%	2.25%
U.S. Treasury - 10 Year	2.45%	2.40%	2.46%

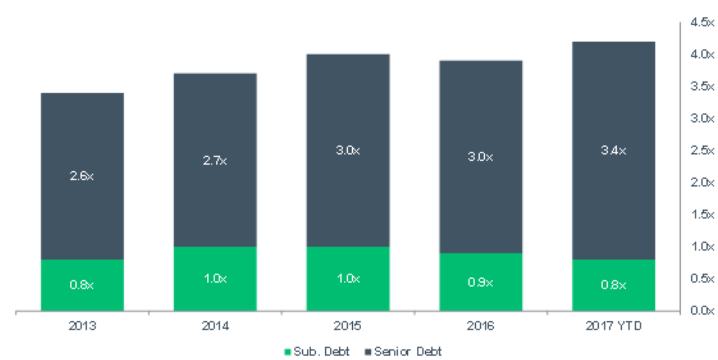
Source: Capital IQ

- Low LIBOR base rates coupled with stable lending spreads make this an attractive market for borrowers.

Middle Market Debt Multiples

- Deal market debt leverage levels moved higher in 2017. Total leverage reached 4.2x with the senior bank component of the total leverage reaching 3.4x. More aggressive lender behavior, particularly on larger transactions, and improving economic conditions are providing support to deal market participants using increased leverage.
- Mezzanine capital remains an important part of a buyout capital structure. Over the last few years, mezzanine debt has represented a little less than 1.0x EBITDA which has remained consistent over the last few years.
- The use of debt leverage helps sustain high middle market M&A valuations. If interest rates rise significantly, the use of senior debt may decline somewhat putting downward pressure on M&A valuations.

Senior Debt and Sub. Debt/EBITDA – TEV of $10-250 Million
2013 to 2017 YTD



Source: GF Data

- Bank lenders continue to maintain credit discipline largely to satisfy their regulators. The regulators limit the amount of HLT ("Highly Leveraged Transactions") exposure that a bank can hold. Bank provided senior credit facilities remain at the relatively conservative 3.0x EBITDA senior debt ratio, so the slight increase in the use of senior debt is likely due to more aggressive, unregulated BDC lenders.

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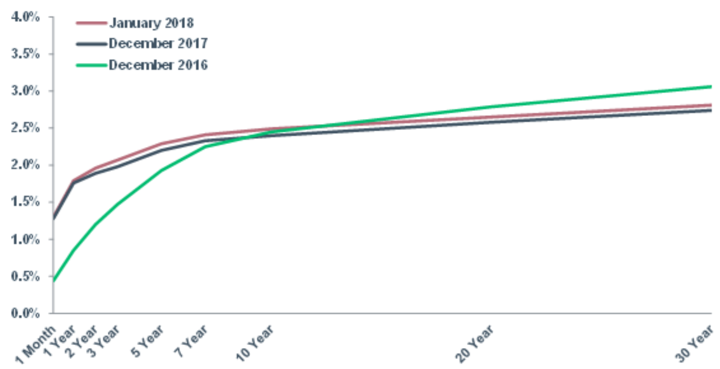
Yield Curves – U.S. Treasuries



Source: Capital IQ

Financing Pricing

Bank Financing	Upfront Fees	LIBOR Spread
Asset Based Loans	25-50 bps	150-200 bps
Cash Flow Loans		
EBITDA less than $10M:		
Unleveraged Loans	0-50 bps	150-250 bps
Leveraged Loans	75-150 bps	300-425 bps
Cash Flow Loans		
EBITDA more than $10M:		
Unleveraged Loans	0-50 bps	150-250 bps
Leveraged Loans	100-150 bps	350-475 bps

Mezzanine Debt	<$10M EBITDA	> $10M EBITDA
Upfront Fees	2.00%	2.00%
Current Pay Coupon	11.00%-13.00%	10.00%-12.00%
Payment-in-Kind (PIK) Interest	0.00%-3.00%	0.00%-2.00%
All in IRRs	14.00%-17.00%	10.00%-13.00%

Source: Pricing is based on guidance provided by a number of commercial and mezzanine lenders

Note: Warrants and other yield enhancements comprise the incremental return required to meet the all-in internal rate of return ("IRR")

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Transaction Highlight

About Bettcher Industries

Bettcher Industries is a leading developer and manufacturer of innovative precision cutting and trimming tools for the food processing and industrial manufacturing sectors. The company also manufactures food preparation equipment for restaurants and commercial kitchens in the food service industry.

About Tacoma Electric Supply

Founded in 1981 in Tacoma, Washington, Tacoma Electric Supply is a full-service electrical distributor with locations in Tacoma and Puyallup. Tacoma Electric is consistently listed in the top 200 largest distributors in the nation in *Electrical Wholesaling* magazine.