

Market Observations

Q4 2025 Lower-Middle-Market M&A + Capital Markets Wrap

(Prepared by Numa Wayne Capital Advisors for founders, investors, and operators across the LMM)

STATE OF LOWER MIDDLE MARKET (LMM) M&A — H1 2025

Policy Shocks Stalled the Rebound

Entering 2025, expectations pointed toward a rebound in M&A activity. After two years of muted volume, a stabilizing macro backdrop and record levels of private-credit dry powder set the stage for a broader recovery—particularly in the LMM. Sellers sought liquidity, lenders were open for business, and buyers were ready to deploy capital.

That recovery never materialized. Deal flow through the first half of the year fell short as renewed trade and fiscal uncertainty weighed on confidence. Persistent inflation and elevated borrowing costs kept leverage conservative and valuations disciplined, delaying many processes that were expected to launch earlier in the year.

What Actually Happened

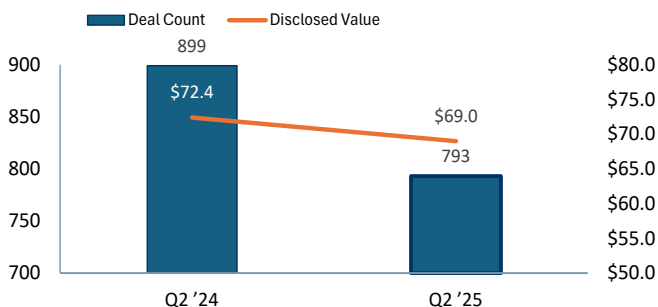
In the U.S. LMM:

- As shown in **Exhibit 1**, U.S. LMM deal count fell to 793 transactions in Q2 2025, down from 899 a year earlier.
- Total disclosed value slipped to \$69 billion, compared with \$72 billion in Q2 2024.
- Larger deals moved the other way: transactions above \$2 billion rose from 45 to 64, and total value nearly doubled to \$380 billion.

That contrast defines 2025 so far — scale buyers with strong balance sheets remain active, while smaller sellers are waiting for clearer pricing and financing visibility before re-engaging.

Exhibit 1 – U.S. LMM M&A Activity

A clear YoY drop in count and modest dip in value.



Source: ION Analytics/Mergermarket, "Midmarket M&A slumps amid Trump policy shifts – Dealspeak North America," Sept. 2, 2025.

LMM deal flow missed early-year expectations. Tariff uncertainty and widening valuation gaps softened activity, while large-cap buyers accelerated—completing 64 deals totaling \$380 billion (vs. 45 / \$204 billion a year earlier).

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Why Volume Dropped

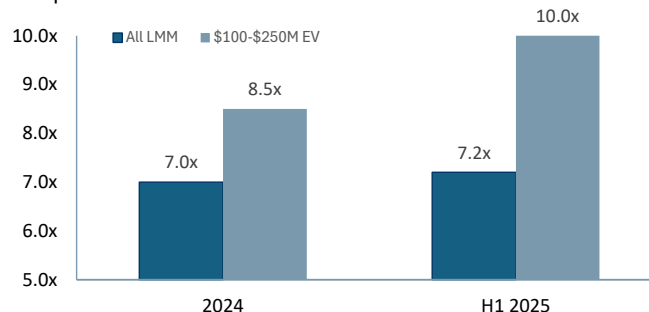
- **Policy and tariff overhang.** The FY25 reconciliation bill and renewed tariff actions disrupted visibility on cash taxes and input costs. The result: longer diligence cycles and selective repricing as buyers reassessed forward assumptions.
- **Financing costs remain elevated.** Even with limited easing, borrowing costs for mid-market credits remain near decade-highs, keeping leverage conservative and return hurdles elevated. Higher funding costs continue to tighten deal structures and slow closings.
- **Valuation gap persists.** Sponsors are pricing off risk-adjusted cash flow, while many founders remain anchored to 2021 benchmarks. The result is a persistent bid–ask spread, typically bridged through earn-outs, seller notes, or minority structures rather than outright price concessions.

Valuations: Steady for Profitable, Predictable Companies.

- **Pricing proved more resilient than volume.** Across sponsor-backed LMM transactions, the average valuation remained near 7.2x EBITDA (**Exhibit 2**), roughly unchanged from 2024. Buyers continue to pay for cash-flow visibility and scale rather than growth alone.
- **Premiums concentrated at scale.** Companies with enterprise values between \$100 million and \$250 million traded closer to 10x EBITDA, reflecting a scarcity premium for larger, financially transparent assets.
- **Sector dispersion widening.** Manufacturing multiples eased slightly due to cost pressures, while healthcare and business services gained modestly as buyers prioritized recurring-revenue models.

Exhibit 2 – Sponsor-Backed LMM Valuation Multiples (TEV/EBITDA)

Flight to quality assets is shown by premiums for \$100-250M EV companies



Source: Forvis Mazars

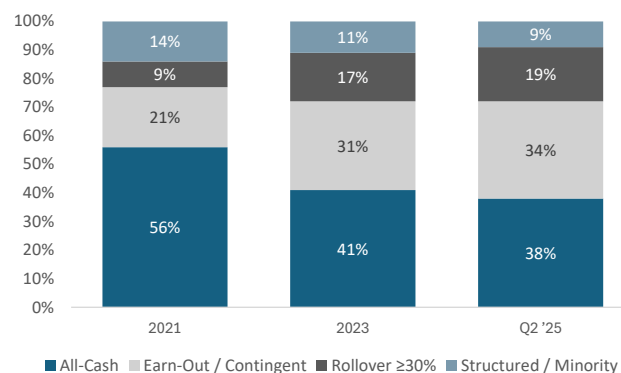
Banker's View — Valuation stability masks how heavily deal terms have shifted. With fewer buyers willing to stretch on price, structure—not multiple—has become the key determinant of who gets deals done.

Deal Structure: Terms Doing the Heavy Lifting

With headline multiples holding firm, deal terms have taken on greater weight. Earn-outs, rollovers, and minority stakes are being used to align incentives and bridge valuation gaps without stretching price. The data in **Exhibit 3** highlight how deal consideration has shifted—cash usage continues to decline, while earn-outs and rollovers rise as alignment tools.

Exhibit 3 – Transaction Structure Mix (Share of LMM Deals, 2021, 2023, Q2 '25)

Contingent and rollover structures remain elevated as buyers balance valuation uncertainty with alignment.



Source: GF Data, Q2 2025; PitchBook.

Preliminary Q3 term-sheet data show **earn-outs in > 70% of control transactions > \$50 million EV.**

CAPITAL MARKETS: EQUITY & DEBT CONDITIONS

Equity Markets: Cautious Re-Engagement, Concentrated Capital

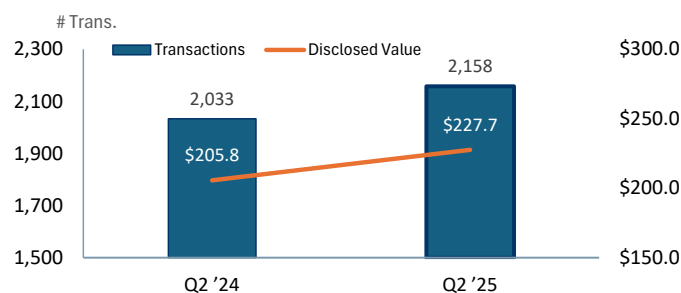
- **Fundraising and deployment**
Private-equity and growth investors have returned selectively, with transaction volume and value roughly stable year-over-year (**Exhibit 4**). U.S. PE deal flow totaled approximately 2,158 transactions in Q2 2025 (-5% Q/Q, +6% Y/Y) with about \$228 billion in aggregate value (-18% Q/Q, +11% Y/Y).
- **Capital concentration.**
Most of that value sits in the upper-middle and large-cap tiers, where scale assets and proven cash flow justify full pricing. Smaller funds remain disciplined on entry valuations and are increasingly using structured or minority equity to manage valuation risk.
- **Investor posture.**
Growth and buyout managers emphasized capital preservation and downside protection over headline valuation. Preference stacks, performance ratchets, and continuation vehicles remained common tools to maintain flexibility.

Themes Shaping Equity Terms

- **Structure instead of stretch.**
Minority, preferred, and continuation vehicles are absorbing valuation friction; roughly one-quarter of all PE growth deals under \$250 million now use hybrid or structured equity.
- **Quality rotation.**
Investors are rewarding audited visibility and durable gross margins; growth stories without cash conversion continue to face valuation compression.
- **Exit expectations reset.**
Holding periods are extending as sponsors underwrite to operational value creation rather than multiple expansion.

Exhibit 4 – U.S. PE and Growth-Equity Deal Activity (Q2 '24 vs Q2 '25)

Deal value rose despite lower volume, reflecting larger average check sizes and concentration in upper-market transactions.



Source: Forvis Mazars

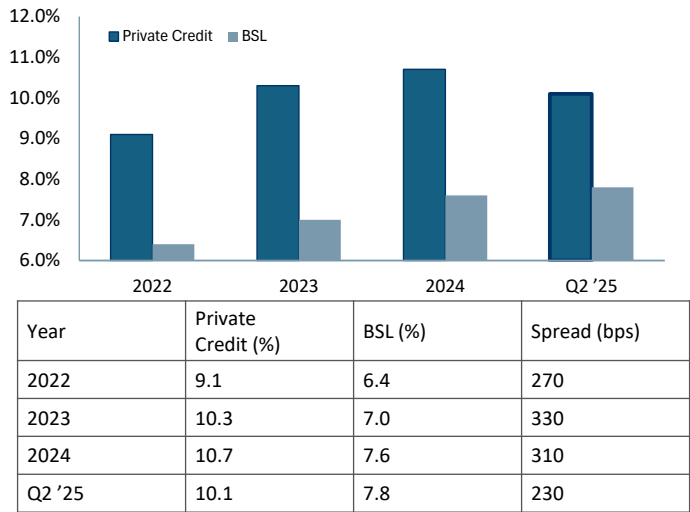
Banker's View — Equity remains available but increasingly bespoke. Managers are prioritizing capital preservation and structured alignment over headline price.

Debt Markets: Liquidity Intact, Terms Tight

- **Pricing and leverage.**
Credit markets have stabilized but remain materially more expensive than pre-2022 levels. Private-credit yields averaged approximately 10.1% in Q2 2025 (10.7% in 2024), while BSL loans priced near 7.8%, narrowing the spread to about 230 bps (**Exhibit 5**).
- **Fundraising momentum.**
Capital formation remains concentrated in large-cap funds. Mid-market managers, facing slower primary inflows, increasingly turn to continuation vehicles to deliver liquidity, preserve AUM, and sustain investor relationships between fund cycles.
- **Structure and terms.**
Unitranche dominates—used in >70% of sponsor-backed LMM financings—typically priced at SOFR + 600–650 bps. Lenders continue to tighten covenants, liquidity triggers, and hold sizes (-15% vs. 2022) to manage exposure.

Exhibit 5 – Private-Credit Yield vs. Broadly Syndicated Loan Market (BSL)

Private-Credit spreads have tightened as abundant fund capital fuels competition among direct lenders, narrowing the premium over syndicated loans.



Source: S&P LCD/LSTA; Lincoln International U.S. Senior Debt Index; Preqin.

Banker’s View — Credit is open, but lenders are rewarding simplicity, visibility, and relationship history; the market will fund strong stories, not speculative ones.

2026 OUTLOOK & FOUNDER PLAYBOOK

Macro Outlook: Gradual Normalization Ahead

- **Rates to ease, but incrementally.**
Consensus projects Fed funds near 3.9 % by mid-2026, implying only 75–100 bps of additional cuts. Policy remains data-dependent, with the Fed signaling limited urgency to accelerate easing.
- **Inflation decelerating, not done.**
Headline CPI is tracking approximately 2.9%, core about 3.1% year over year, keeping the Fed cautious on pace.
- **Policy volatility the wild card.**
The U.S.–China tariff cycle and renewed cross-border tax discussions continue to delay diligence for buyers with international exposure.
- **Liquidity still abundant.**
U.S. corporates hold roughly \$2.2 trillion in cash, and private-credit dry powder totals about \$550 billion—positioning buyers to re-engage once rate visibility improves.

Market Mechanics: Structure and Timing Define the Next Cycle

- **Structure over stretch.**
Expect continued reliance on earn-outs, seller notes, and preferred equity through at least mid-2026 as buyers manage valuation risk.
- **Timing advantage.**
Acquirers able to move before rate cuts will face less competition; expect repricing once the cost of capital compresses.
- **Sector rotation.**
Industrial technology, healthcare services, and regulated niches should lead volume; discretionary consumer remains range-bound until real-income growth stabilizes.
- **Exit pacing.**
Holding periods continue to lengthen as sponsors underwrite to operational value creation rather than multiple expansion.

Founder Playbook: How to Position for 2026

Even with softer throughput in 2025, the next 12 months will favor companies that treat preparation as strategy—not delay. Buyers are paying for proof of resilience, clarity of earnings, and flexibility in structure.

For founder-led businesses, that means three imperatives:

- **Stay transaction-ready** even if timing the market feels premature.
- **Quantify external shocks**—tariffs, rates, supply inputs—rather than explaining them after the fact.
- **Negotiate on structure, not hope**—bridge valuation gaps through alignment mechanisms instead of headline discounts.

As summarized in **Exhibit 6**, the *2026 Readiness Checklist* distills five practical actions that drive premium positioning.

Exhibit 6 – Founder Playbook: 2026 Readiness Checklist

Private-credit spreads have tightened as abundant fund capital fuels competition among direct lenders, narrowing the premium over syndicated loans.

Action	Strategic Rationale
Refresh diligence	Current financials and KPIs anchor buyer confidence; stale data erodes momentum.
Quantify tariff and tax exposure	Clear cash-tax modeling reduces risk-adjustment discounts.
Optimize capital mix	Balance equity and fixed-rate debt ahead of expected rate cuts.
Use structure as bridge	Earn-outs and minority recaps preserve valuation alignment.
Lock-in key people	Retention planning protects post-close value realization.