

“ a firm belief in the entrepreneurial spirit ”

CLEARY GULL

# MARKET MONITOR

M&A AND FINANCING UPDATE



3rd QUARTER 2016

## This Time is Different!

Unlike in some prior election years, our clients are not pushing us to close their transaction before the election. Since our client base appears to be indifferent to the outcome of the Presidential election, we decided to analyze deal volume over the last 25 years to determine if Presidential elections influenced lower middle market M&A activity.

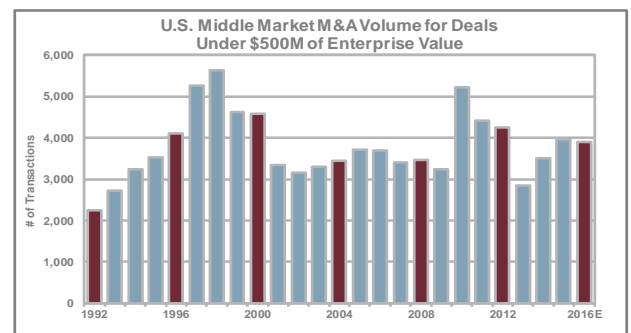
Our conclusion is that middle market deal volume in the year of, preceding or following Presidential elections has been remarkably consistent and influenced by economic and not political factors, based on data compiled by Robert W. Baird for deals under \$500 million enterprise value. The one notable exception was 2012, when deal volume declined 33% in the year after the election. In retrospect, it appears the 2012 election served as a catalyst for business owners to accelerate sales before the Bush capital gains tax cuts expired in 2013. Thus, while there could be good reasons to “time” a transaction in relation to an election for any particular company, it appears the M&A markets are generally nonplussed by Presidential elections.

## Favorable Economic Outlook – More of the Same

The U.S. economy continues to experience modest growth and, more importantly for M&A markets, many economists believe it is expected to continue. As an example, economist Brian Beaulieu of ITR Economics recently said during a presentation in Milwaukee that he believes the U.S. economy will continue to expand through 2018, then experience a slight recession in 2019 (similar to 1991), and continue its expansion in 2020 and beyond. While acknowledging the U.S. economy may seem overdue for a correction based on historical patterns, Beaulieu said there are few economic indicators signaling a contraction in the near future.

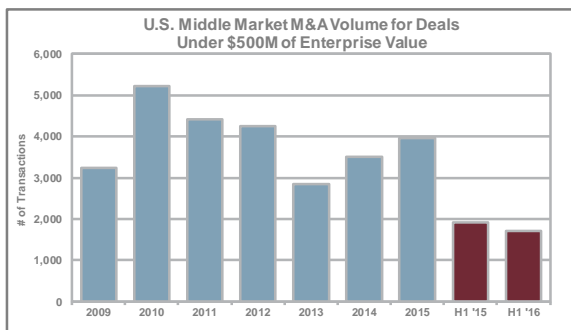
The best economic conditions for M&A markets are stability and predictability. If Beaulieu and fellow economists are correct, middle market deal volume should continue to remain healthy absent an external shock or a significant change in domestic monetary or tax policy.

## MIDDLE MARKET DEAL VOLUME NOT CORRELATED TO MAJOR ELECTIONS



Source: Robert W. Baird & Co.

## M&A DEAL VOLUME REMAINS SLOW DURING FIRST HALF OF 2016



Source: Robert W. Baird & Co.

### Slow Start to 2016

Middle market deal volume for the first half (“H1”) 2016 lagged behind 2015. According to Robert W. Baird, the total number of U.S. transactions declined 12.6% in H1 2016 compared to the same period in 2015. However the amount of the slowdown in activity varied considerably by type of seller.

Much of the slowdown can be attributed to corporate divestitures. According to S&P Capital IQ, through 2015 corporate divestitures declined 30% from their peak in 2012, and an additional 22% in H1 2016 compared to H1 2015. Sales of private equity portfolio companies also declined, by 12.6%, in H1 2016 compared to H1 2015. By implication, the number of sales by other sellers, including entrepreneurs, actually increased in H1 2016.

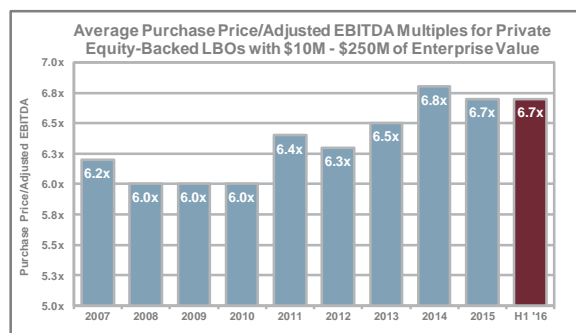
The “tone” of the middle market, based on our transaction volume and what we have heard from private equity professionals, indicates an increase in volume during the remainder of 2016 and into 2017.

### Purchase Prices Remain Strong

Purchase price multiples for LBO transactions reported to GF Data® remain strong due to the continued supply/demand imbalance in the \$10 to \$250 million transaction market. With an abundance of capital chasing fewer quality deals, the average purchase price multiple for these LBOs held firm at a lofty 6.7x EBITDA during H1 2016, the same average multiple achieved in 2015.

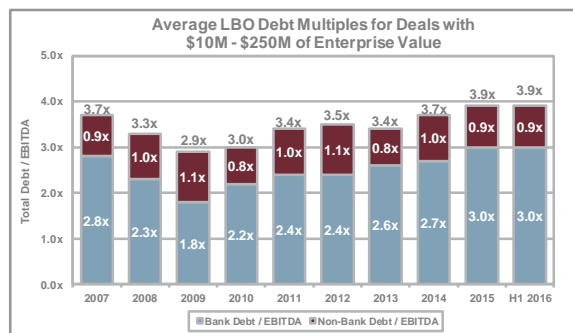
In contrast, average multiples for slightly larger middle market LBO transactions, with enterprise values between \$100 and \$250 million, declined to 7.5x EBITDA compared to 9.0x in 2015. This decrease is likely due to tighter credit standards implemented during late 2015/early 2016. A rebound in the credit markets may return these multiples back to 2015 levels.

### PURCHASE PRICES REMAIN STRONG



Source: GF Data®

## TOTAL LEVERAGE STABLE; SENIOR DEBT DECLINES



Source: GF Data®

### Senior and Subordinated Debt Availability Remains Strong

According to GF Data®, average senior debt/EBITDA multiples for \$10 to \$250 million enterprise value private equity-backed buyouts was flat at 3.0x during H1 2016, consistent with 2015 levels.

The subordinated debt market was strong as well, with total debt/EBITDA for H1 2016 remaining consistent with 2015 levels at 3.9x EBITDA.

### Strategic-Financial Buyer Category is Here to Stay

Strategic buyers and financial buyers bring different advantages and disadvantages to a transaction.

Financial buyers often compete on price and purchase agreement terms and position themselves as supportive of management, employees, and the acquired Company's strategy. On the other hand they may have more extensive diligence requirements, more financing risk, and a longer timeline to close, than strategic buyers.

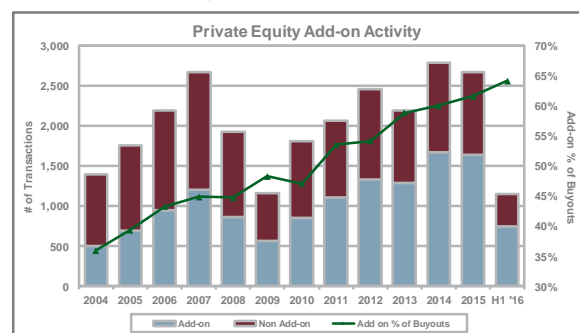
Strategic buyers typically compete with faster and/or lower cost financing, speed to close, and cost and/or growth synergies. However, strategic buyers can have less

favorable (to sellers) purchase agreement terms, may require board or other approvals, and may need to make disruptive changes in the acquired company in order to capture synergies.

While portfolio companies of private equity funds have always been active acquirers, the "strategic-financial" category is gaining acceptance as a distinct, and often preferred buyer. According to Pitchbook, strategic financials are winning a larger percentage of transactions. During H1 2016, private equity add-on activity accounted for 64% of all private equity transactions.

Strategic-financial buyers can often provide sellers and their advisors with the best of both alternatives, combining the transactional advantages of private equity buyers with the diligence and financing advantages of strategic buyers. Consequently, the strategic-financial category is becoming a preferred buyer in many auction processes.

### PRIVATE EQUITY ADD-ON ACTIVITY



Source: Pitchbook

## FIRM OVERVIEW

Cleary Gull Inc. is an employee-owned financial services firm providing high-quality financial services to private equity funds, entrepreneurs, and middle market companies. “A Firm Belief in the Entrepreneurial Spirit” is our core ideology and the foundation for all of our client engagements.

Cleary Gull’s investment bankers help clients throughout the U.S. achieve their financial and business goals with advice on exclusive sales, mergers, acquisitions, raising debt and equity in private capital markets and other transactions, working through complex financial, legal, tax, accounting and other technical issues.

## GLOBAL REACH

Cleary Gull is a member of the International Association of Investment Bankers. The IAIB ([www.iaib.org](http://www.iaib.org)) is an affiliation of investment banking firms from Australia, Africa, Asia, Europe, and North America working together to broaden their reach and leverage their expertise.



## CONTACT

The Cleary Gull Investment Banking team has completed more than 120 transactions since 1995, representing over \$6 billion in transaction value.

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