

“ a firm belief in the entrepreneurial spirit ”

CLEARY GULL

# MARKET MONITOR

M&A AND FINANCING UPDATE



1<sup>st</sup> QUARTER 2014

## Positive Outlook for M&A Transactions

Despite a volatile beginning of the year for the public equity markets, M&A experts expect continued strong prices and improved transaction volume. Significant uninvested private equity capital, record corporate cash balances, and aggressive credit markets continue to fuel demand for transactions.

A generally positive economic outlook, a more constructive political environment, and improved confidence may provide sellers with more comfort in pursuing a transaction in 2014.

Greater demand than supply for transactions is expected to continue through 2014.

## Economic Data Cooperating... Kind of

While Gross Domestic Product (“GDP”) grew 3.2% during the second half of 2013, much of the data in early 2014 has disappointed. Nonfarm payroll slowed in February (139,000 vs. 194,000 average during 2013), auto sales declined in February (15.4 million annual rate vs. 15.6 million during 2013), housing starts were lower (0.9 million annual rate in January compared to a 1.1 million annual rate in November), and U.S. manufactured goods fell 0.7% in January. Nonetheless, consensus economic growth estimates remain approximately 3.0% during 2014, although there is some uncertainty about second half growth.

Is weak economic data the result of the “Polar Vortex 2” or reduced Fed asset purchases? Both have clearly been factors, but only time will tell if the economic enthusiasm for the remainder of 2014 was warranted.

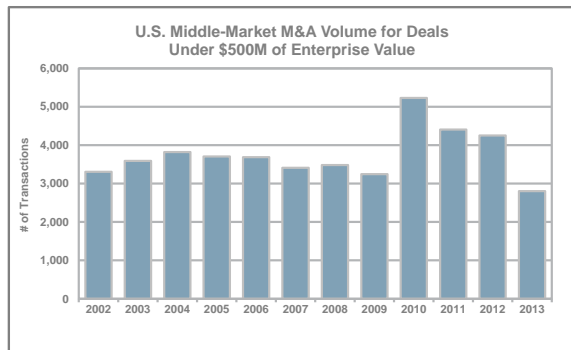
With the jobless rate declining to 6.6% in January, the political debate continues as to whether this is good news or merely a reflection of underemployment.

## KEY INTEREST RATES

	3/7/2014	12/31/2013	12/31/2012
1-Month T Bill	0.06%	0.01%	0.02%
2-Year UST	0.38%	0.38%	0.25%
5-Year UST	1.65%	1.75%	0.72%
10-Year UST	2.80%	3.04%	1.78%
30-Year UST	3.72%	3.96%	2.95%
EUR/USD	\$1.38	\$1.38	\$1.32
1-Month LIBOR	0.16%	0.17%	0.21%
Federal Funds	0.75%	0.75%	0.75%
Prime	3.25%	3.25%	3.25%

Source: Capital IQ

## 2013 DEAL VOLUME DECLINED



Source: Robert W. Baird & Co.

## A SELLER'S MARKET

### Deal Volumes Expected to Increase from 2013 Levels

Deal volume in 2013 fell short of the expectations of many experts. According to Robert W. Baird & Co., the number of middle-market transactions (enterprise values less than \$500 million) declined 21.2% compared to the year earlier period.

Several factors likely contributed. A slow start to 2013 was the result of the pull forward of transactions into 2012 to beat tax increases. Then, economic growth during the first half of 2013 was not as strong as predicted.

Transaction volumes are again expected to increase throughout 2014. The abundance of buyers (both financial and strategic) and an improving economy driving financial performance should drive volume.

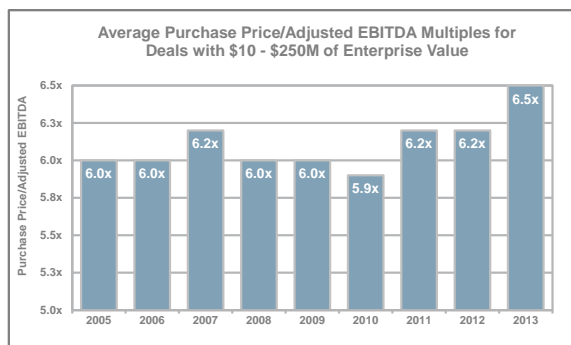
### Purchase Price Multiples Continue to Rise

Along with the decline in transaction volume, middle-market purchase price multiples increased for LBOs reported to GF Data. The average was 6.5x EBITDA for 2013 compared to 6.2x for 2012.

While we recognize purchase price to EBITDA multiple averages ignore the unique characteristics of each transaction and company, in this case, the data trend is indicating a slight firming of prices which corresponds with our experience last year.

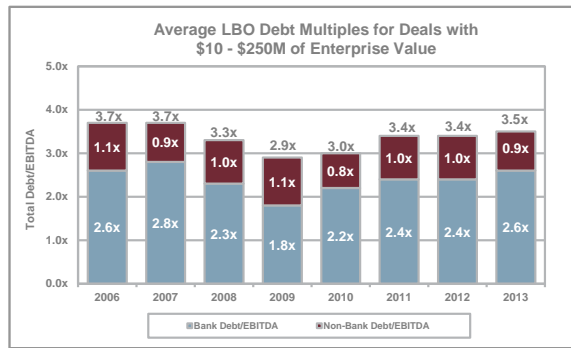
GF Data also reported that the gap in valuations between larger and smaller middle-market LBO transactions remained significant at 0.8x EBITDA, although down from 1.8x in 2011.

## PURCHASE PRICES AT RECORD HIGHS



Source: GF Data Resources

## LEVERAGE MULTIPLES INCREASE



Source: GF Data Resources

## STRONG FINANCING MARKETS

### Senior Debt Multiples Expand

Senior debt market support for lower middle-market LBOs increased during 2013. According to GF Data, average senior debt/EBITDA multiples increased to 2.6x during 2013, compared to 2.4x during 2012. The pressure to grow assets, modest transaction volume, the increase in non-bank lending, continued low interest rates, and a stable economic outlook continue to drive leverage, pricing, and terms for senior debt. These trends are likely to continue into 2014, keeping the market attractive for borrowers.

Total debt/EBITDA for lower middle-market LBOs increased more modestly to 3.5x for the full year of 2013 from 3.4x for 2012. The strong senior debt market and an abundance of equity capital continue to squeeze both the interest in, and pricing for, mezzanine debt.

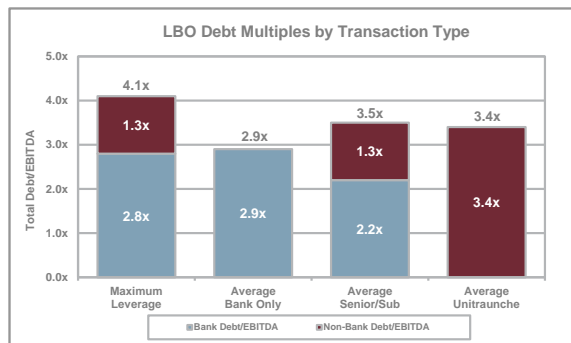
### Many Capital Structure Choices

GF Data further analyzed capital structures for lower middle-market LBOs during 2013, comparing EBITDA multiples for different types of capital structures utilized by buyers.

The maximum level of debt observed in lower middle-market LBOs was 2.8x senior debt and 4.1x total debt. For transactions where only senior debt was utilized, 2.9x bank debt was available. For transactions with an equity sponsor that used both senior and mezzanine debt, senior debt averaged 2.2x and total debt reached 3.5x. Deals with a unitranche lender had, on average, 3.4x total debt.

With new bank regulations regarding Highly Leveraged Transactions (“HLT”), non-bank lenders have the opportunity to continue to gain ground on traditional banks.

## VARIETY OF AVAILABLE CAPITAL STRUCTURES



Source: GF Data Resources

## FIRM OVERVIEW

Cleary Gull Inc. is an employee-owned firm providing specialized financial services since 1987 to individuals, institutional investors, and middle-market companies through two operating divisions: Investment Banking and Investment Management Services. *"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.

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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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