

“ a firm belief in the entrepreneurial spirit ”

CLEARY GULL

# MARKET MONITOR

M&A AND FINANCING UPDATE



2<sup>nd</sup> QUARTER 2013

## SUPPLY/DEMAND IMBALANCE HAS CREATED A SELLER'S MARKET ... FOR NOW

Demand for middle-market companies is presently very strong. With the stock market at record highs and interest rates at record lows, investors are looking for other asset classes to achieve their returns. Pension funds, banks, family offices, and other investors are returning to the private equity market.

Many private equity funds, which were raised in the late 2000s, are also approaching the end of their investment periods and have significant pressure to spend their remaining capital. According to PitchBook, the amount of committed, but uninvested, private equity capital is now \$348 billion.

Additionally, cash balances of corporations in the U.S. have grown to more than \$1.7 trillion. As a result of these trends there are many buyers for middle-market companies.

The supply of companies to acquire is also currently quite low (see Page 2) but likely to increase over the next several years. Private equity funds are likely to sell their already aging portfolio companies and baby boomers who have built companies are expected to monetize their life's work.

This current supply/demand imbalance is more pronounced than we have seen in decades and, although it is likely to persist for the next several quarters, we all know the pendulum can (and will) swing back.

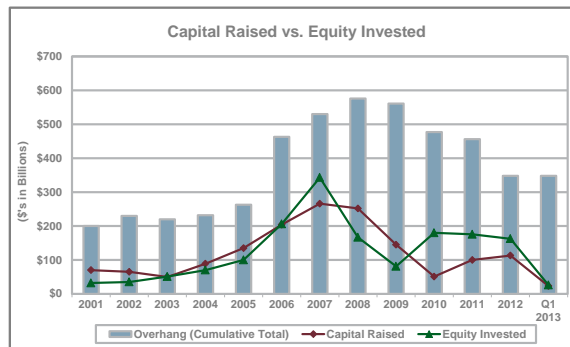
In the interim, if you are an entrepreneur looking to sell your private business or a private equity fund interesting in seeking liquidity at the end of your investment period, the supply/demand equation would suggest taking advantage of the current market dynamics before this situation changes.

### KEY INTEREST RATES

	6/11/2013	12/31/2012	12/31/2011
1-Month T Bill	0.04%	0.02%	0.01%
2-Year UST	0.32%	0.25%	0.25%
5-Year UST	1.10%	0.72%	0.83%
10-Year UST	2.17%	1.78%	1.89%
30-Year UST	3.33%	2.95%	2.89%
EUR/USD	\$1.33	\$1.32	\$1.30
1-Month LIBOR	0.19%	0.21%	0.30%
Federal Funds	0.75%	0.75%	0.75%
Prime	3.25%	3.25%	3.25%

Source: Capital IQ

## DECLINING PRIVATE EQUITY OVERHANG



Source: PitchBook

## SLOW START TO 2013

### Deal Volume Down Significantly

The first quarter of 2013 has proven to be one of the slowest quarters for middle-market transactions since the great recession. According to Robert W. Baird & Co., the number of middle-market transactions (enterprise values less than \$500 million) declined 22.4% compared to the year earlier period.

Several factors likely contributed to the decline. Many transactions were pulled forward into 2012 to beat tax increases. And, the modest economic recovery resulted in a slow start to 2013, delaying many transactions.

Momentum is building in 2013 and most bankers expect volumes to increase each quarter as the year progresses. With low interest rates, a stable economic outlook, and a modest supply of quality companies, purchase price multiples for quality companies are very strong.

### Seller Contract Terms Continue to Improve

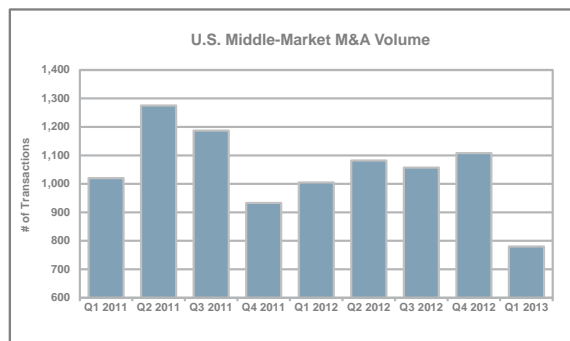
Price is not the only important element of a successful transaction. Other terms and conditions, as well as qualitative factors, are also critical.

Almost all contract terms improved for sellers during 2012. According to a recent GF Data study, average rep and warranty indemnification limits for LBOs with less than \$250 million enterprise values declined during 2012 to 16.9%, compared to 19.0% in 2011.

Escrow/holdbacks declined slightly to 6.6% compared to 6.9% during the same two periods. And, average “baskets” increased slightly to 0.8% from 0.7% in the year earlier period.

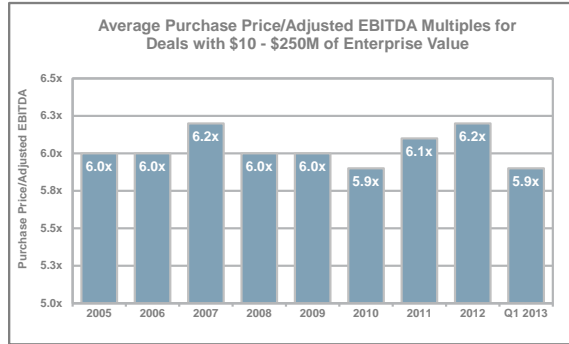
The average indemnification period is the only contract term that increased slightly to 18.9 months during 2012 compared to 18.6 months during 2011.

## DEAL VOLUME DOWN IN Q1 2013



Source: Robert W. Baird & Co.

## PURCHASE PRICE MULTIPLES REMAIN SOLID



Source: GF Data Resources

### Purchase Price Declined Slightly

Average middle-market purchase price multiples for LBOs decreased to 5.9x EBITDA in the first quarter of 2013, compared to 6.2x for the full year of 2012, according to GF Data.

It is our opinion that the transaction market has remained stable and not declined. Only the limited data and, possibly, limited economic weakness, might explain the reduction in multiples.

Larger transactions continue to realize significantly higher multiples. Average enterprise value/EBITDA multiples reported for LBO transactions with enterprise values between \$50 million and \$100 million were 6.2x EBITDA during 2012 compared to 5.7x EBITDA for transactions with enterprise values between \$10 to \$50 million in EBITDA.

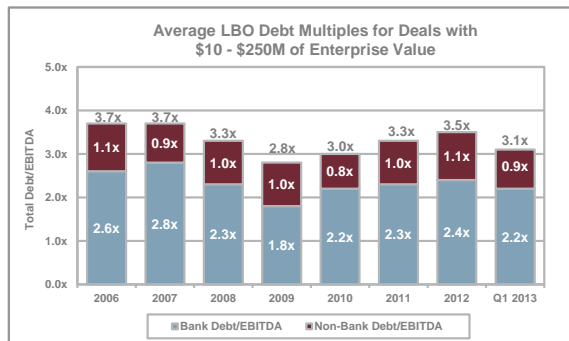
### Attractive Market for M&A and Financing Transactions

Total debt market support for lower middle-market M&A transactions (enterprise values less than \$250 million) declined modestly during the first quarter of 2013 compared to 2012. According to GF Data, average total debt/EBITDA multiples declined to 3.1x during the quarter, compared to 3.5x during 2012. We believe the difference was more likely due to limited transaction data than a change in the underlying leverage market.

With banks still struggling to increase loan outstandings and an increasing number of new middle-market lenders including BDCs, SBICs, and middle-market banks, competition for middle-market loans is significant.

Low interest rates, an improving economic outlook, and stable to expanding lending criteria make it an attractive time for companies to borrow money.

## STABLE DEBT MARKETS



Source: GF Data

## 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 our 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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## CONTACT

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

Contact us for more information on Cleary Gull and our Investment Banking services.

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