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***CONTENT, DELIVERY, AND SECURITY IN A CONNECTED WORLD***

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# Robert T. Brown

Managing Director and Co-President

North America

Lincoln International





# STATE OF THE M&A MARKET



October 2014

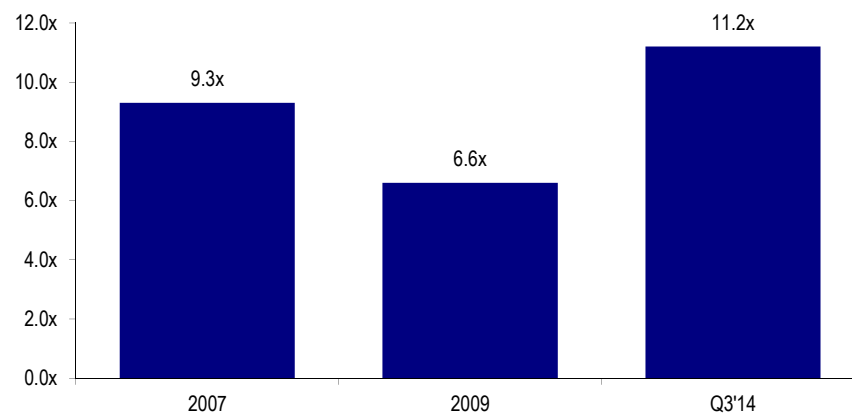
# MIDDLE MARKET M&A OVERVIEW

*Market multiples now exceed the peak levels experienced prior to Lehman bankruptcy*

## COMMENTARY

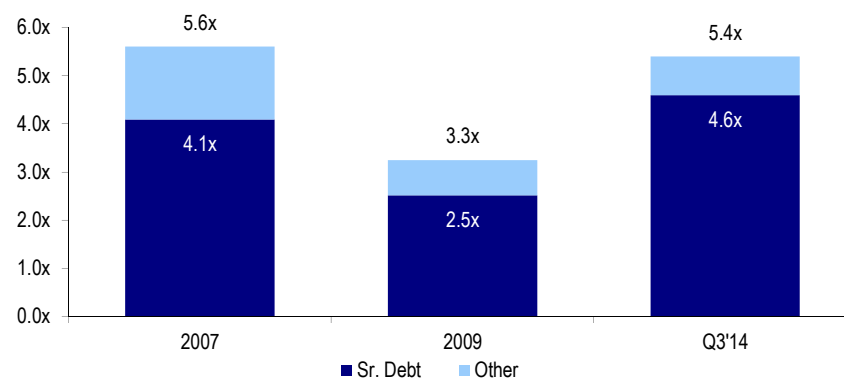
- **2007**
  - Represented peak valuations achieved since 2000
  - High leverage and easy credit in LBOs (as well as other areas in the economy, such as real estate)
  - M&A transaction volumes at all time high
  
- **2009**
  - Valuations at cyclical low post-Lehman
  - Strategic buyer activity very limited
  - Credit markets frozen, curtailing most LBOs
  - M&A transaction volumes decreased significantly
  
- **2014**
  - Despite lack of growth in the economy, valuation multiples rebounded to previous highs
  - Strategic acquirers are very aggressive in winning auctions
  - Increased competition among lenders in 2014 continues to drive leverage up and pricing down
  - Total leverage and terms are at levels not seen since 2007
  - Competitive dynamics put significant downward pressure on yields throughout the year
  - However, equity contributions are much larger than they were in 2007

## AVERAGE EV / EBITDA IN U.S. MIDDLE MARKET TRANSACTIONS



Source: S&P Capital IQ Leveraged Commentary and Data

## MIDDLE MARKET DEBT MULTIPLES (LBO TRANSACTIONS)

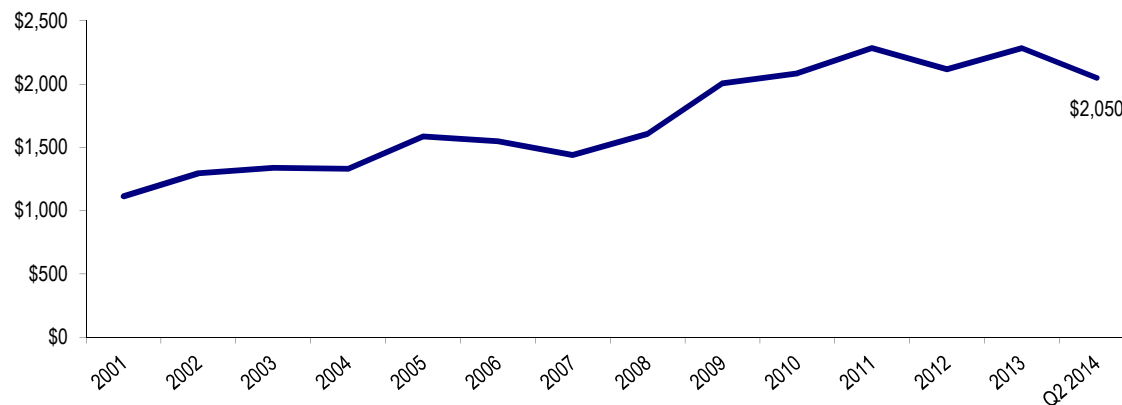


Source: S&P Capital IQ Leveraged Commentary and Data

# CORPORATE BUYERS – REMAIN ACTIVE IN CURRENT MARKET

*Cash on hand, lack of growth and stock market valuations driving activity*

## CORPORATE CASH ON HAND (IN \$BN)



## COMMENTARY

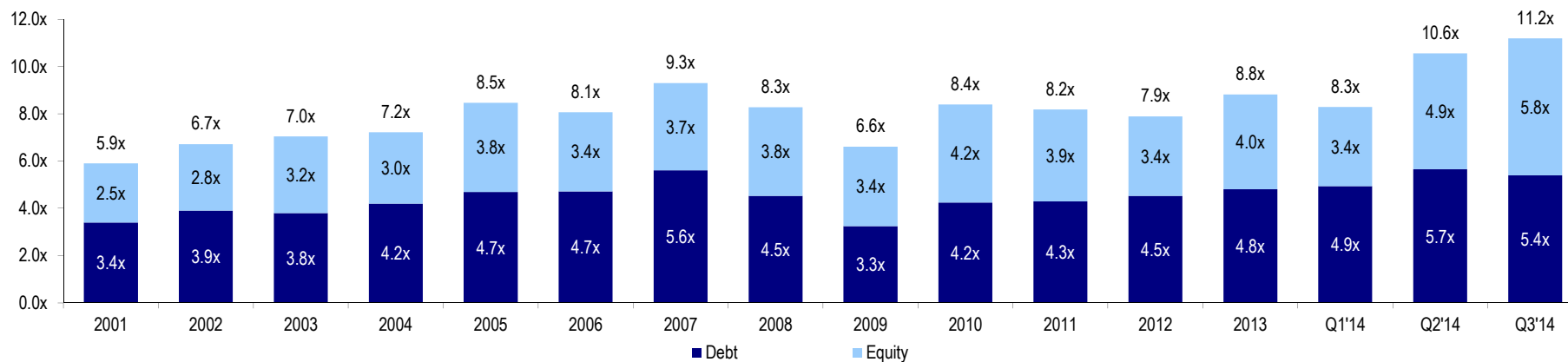
- Corporate strategic acquirers often trading at record high valuation multiples with low organic growth
- Through M&A, corporates are seeking:
  - Growth to counteract the low organic growth environment
  - To “fill in gaps” strategically important in their existing business
- Corporate buyers have significant cash reserves to deploy
- Corporate buyers are able to pay attractive purchase price multiples given their own public trading multiples

Source: S&P Capital IQ Leveraged Commentary and Data

# PRIVATE EQUITY BUYERS – DRIVEN BY RECORD FUNDRAISING

Purchase multiples and equity contributions have increased

## MIDDLE MARKET LBO PURCHASE PRICE MULTIPLE AND EQUITY CONTRIBUTION

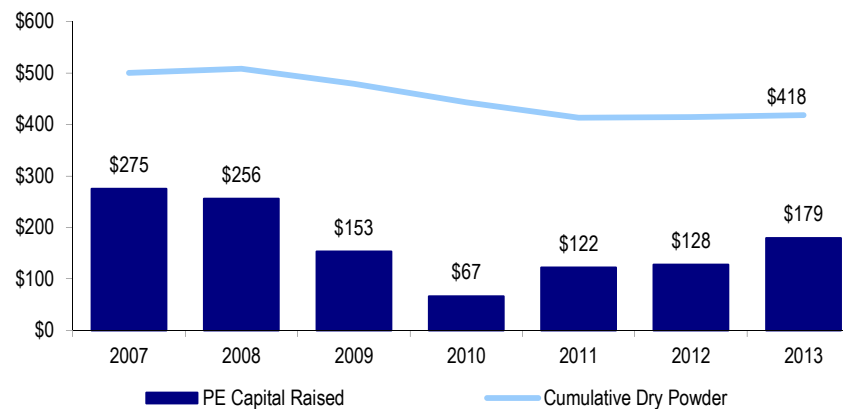


Source: S&P Capital IQ Leveraged Commentary and Data

## COMMENTARY

- PEGs are paying higher multiples and putting more equity into deals than at any time over the last 14 years
- Continued overhang in excess of \$400 billion is pressuring sponsor to put money to work
- PEGs are working harder than ever in order to win highly competitive auction processes
- The biggest challenge in the market is meeting high seller expectations

## PRIVATE EQUITY BUYOUT FUNDRAISING / INVESTING (IN \$BN)

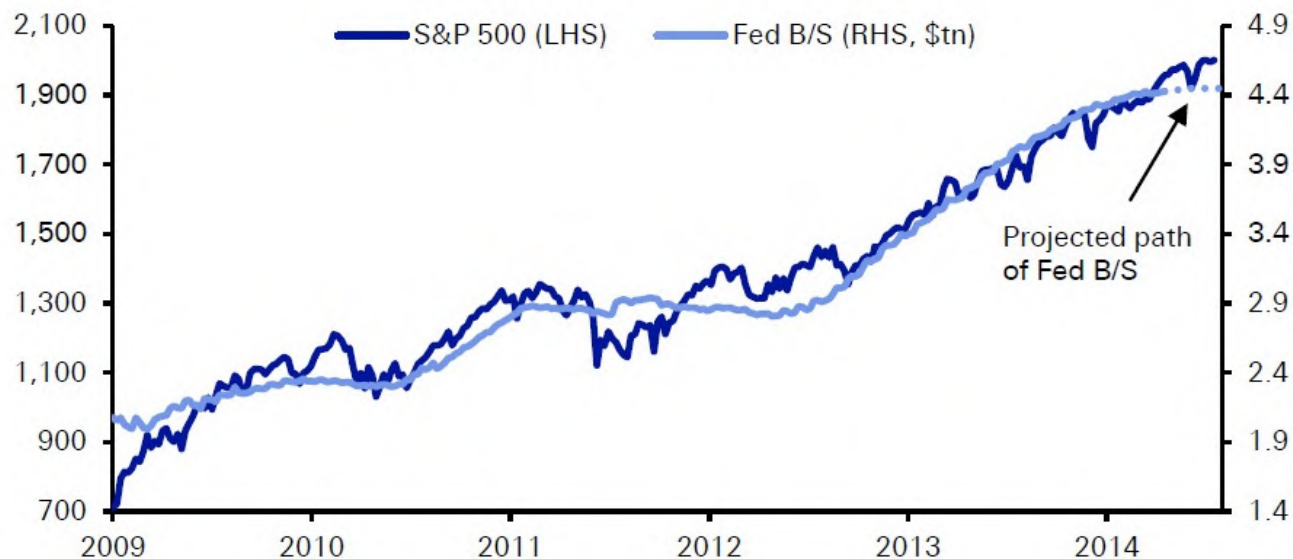


Source: PitchBook

# ARE VALUATIONS AT THE TOP?

The S&P 500 is currently at an all time high

## S&P 500 VS. SIZE OF THE FED BALANCE SHEET



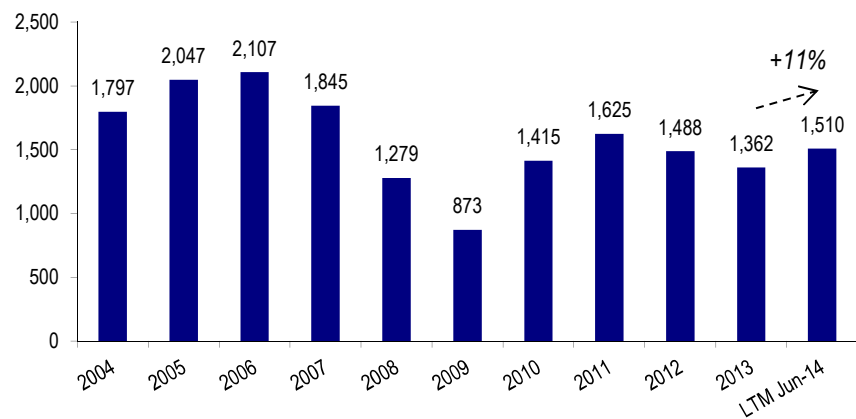
Source: Deutsche Bank, Bloomberg Finance LP

## COMMENTARY

- Since the Fed balance sheet was used as an aggressive policy tool post the financial crisis, the S&P 500 has been well correlated with it.
  - Movement in the S&P 500 has generally lagged the size of the Fed balance sheet by about 3 months.
- With the Fed balance sheet soon becoming "static", the S&P 500 (and by extension, the overall economy) is in danger of a pullback.

# M&A VOLUME IS BUILDING, BUT REMAINS BELOW HISTORIC PEAKS

## MIDDLE MARKET M&A TRANSACTION COUNT

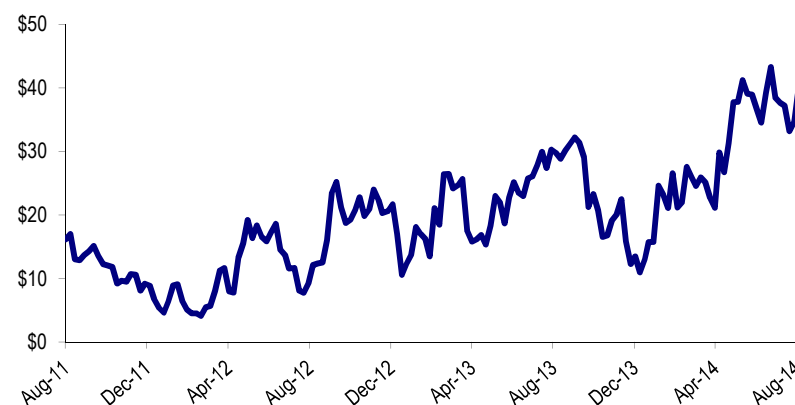


Source: Factset Mergerstat  
Note: Only reflects deals with disclosed values

## COMMENTARY

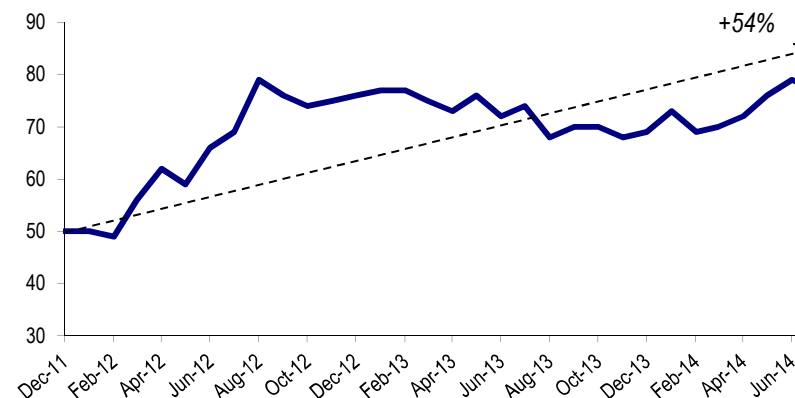
- Increased M&A activity in the second half of 2013 continued into 2014 and the pipeline for new transactions is robust
  - The forward calendar has risen sharply throughout 2014, rising to a high point of \$43.3 billion from a low point of \$11.0 billion in December 2013
  - Strong backlog, solid exit performance and easy access to capital are driving M&A activity
- The leveraged loan market is expected to be driven largely by M&A activity through the rest of 2014

## M&A FORWARD CALENDAR (IN \$BN)



Source: S&P Capital IQ Leveraged Commentary and Data  
Note: Companies transactions which arrangers are still working, or that arrangers have announced but no yet launched

## LINCOLN'S U.S. LAUNCHED DEAL FLOW (ROLLING LTM BASIS)



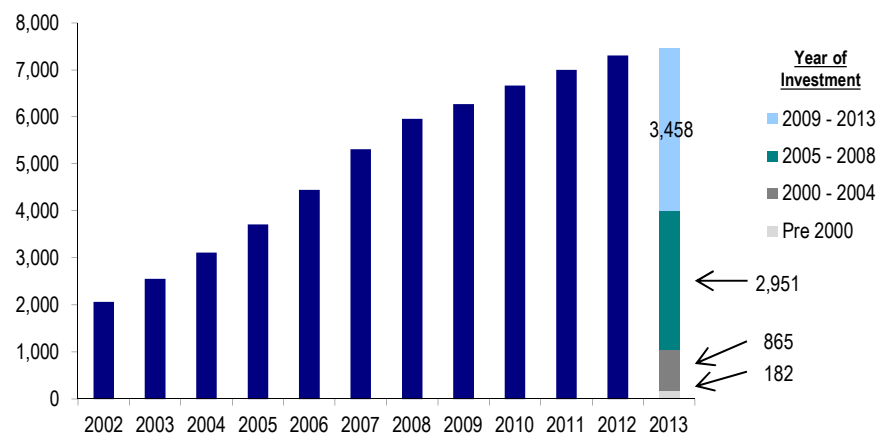
Source: Lincoln International



# M&A OUTLOOK

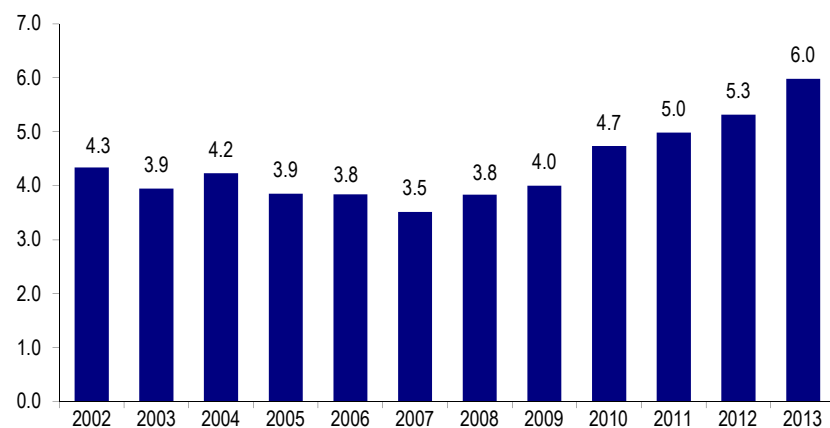
*Aging private equity portfolios will increase the supply of companies for sale*

## PRIVATE EQUITY PORTFOLIO INVENTORY BY DEAL YEAR



Source: PitchBook

## MEDIAN HOLDING PERIOD OF PRIVATE EQUITY INVESTMENTS (YEARS)



Source: PitchBook

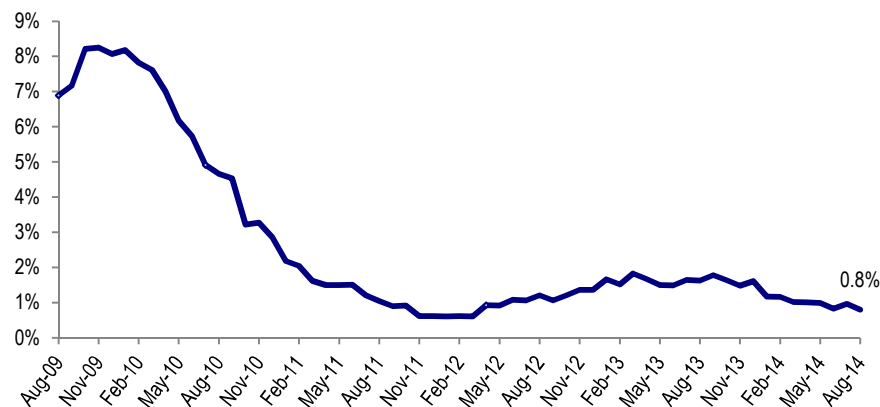
## COMMENTARY

- With almost 54% of portfolio company investments aged 5 years or greater and a median holding period of 6 years, it is anticipated that private equity firms will look to divest many assets in the near term
- Companies sold coming out of the downturn in 2010-2011 are approaching their natural cycle of realization or divestiture
- Prevailing market conditions for debt continue to support seller valuation expectations

# SHADOW DEFAULTS MAY BE LURKING BENEATH THE SURFACE

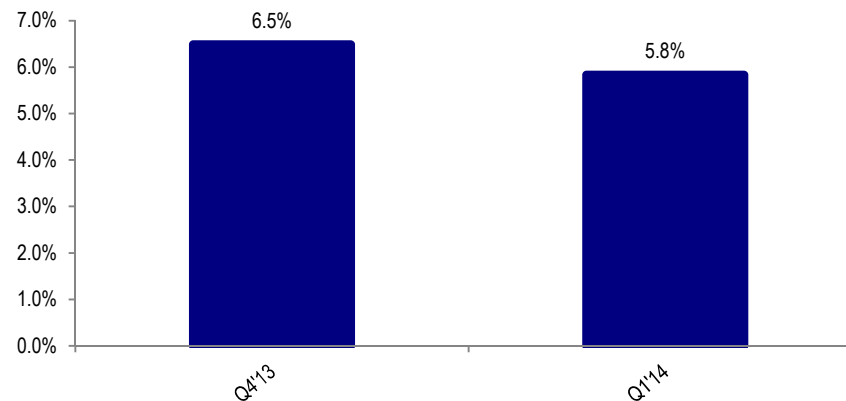
*Could slow credit markets, thus impacting M&A activity and valuation multiples*

## LOANS OUTSTANDING UNDER DEFAULT (PERCENT OF ISSUERS)



Source: S&P Capital IQ Leveraged Commentary and Data

## TOTAL PUBLIC BDC DEBT INVESTMENTS MARKED BELOW 80% OF PAR



Source: S&P Capital IQ Leveraged Commentary and Data

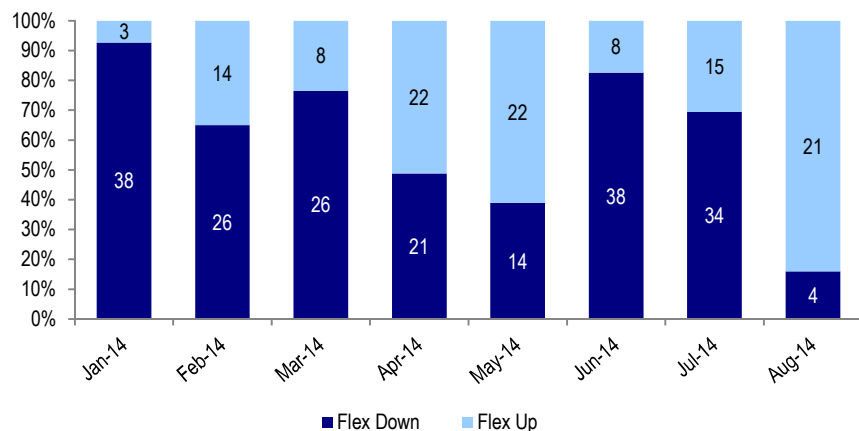
## COMMENTARY

- Published default rates remain very low, with less than 1.0% of issuers in default during the past year
- Within the middle market, 5.8% of publicly-traded BDC debt investments were marked below 80% of par value in Q1 2014 public filings

# ARE THERE INDICATIONS THAT LIQUIDITY MAY BE TIGHTENING?

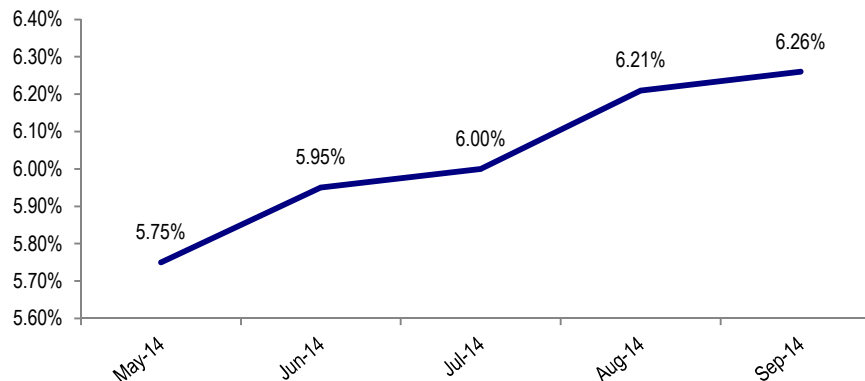
*Lenders may start to push back*

## MIDDLE MARKET PRICE FLEXES



Source: Thomson Reuters

## MIDDLE MARKET NEW-ISSUE FIRST-LIEN YIELD TO MATURITY

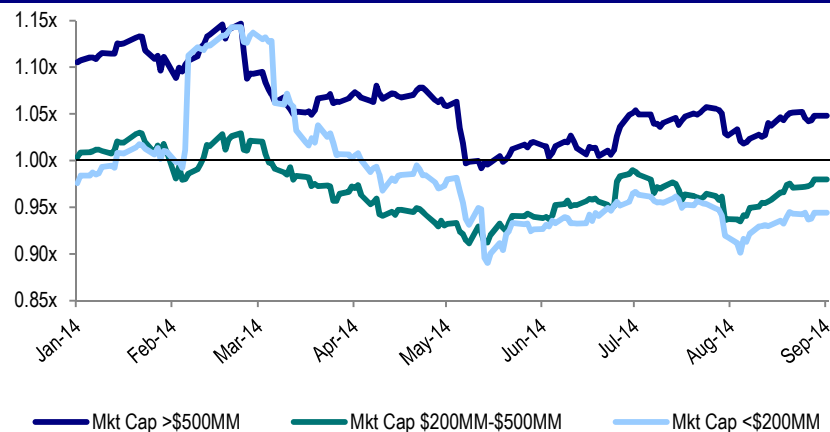


Source: S&P Capital IQ Leveraged Commentary and Data

## COMMENTARY

- In the middle market, upward price flexes spiked during August 2014 as lenders pushed back on borrower-friendly terms
- Loan pricing has increased steadily through the summer from historic lows due to:
  - Increased demand for capital as deal flow has picked up
  - Stagnant company performance
- Smaller BDCs are trading below 1.0x price-to-book value; they make up only ~15% of total BDC capital
- Even though larger BDCs are trading above 1.0x price-to-book value, they're below the levels seen earlier

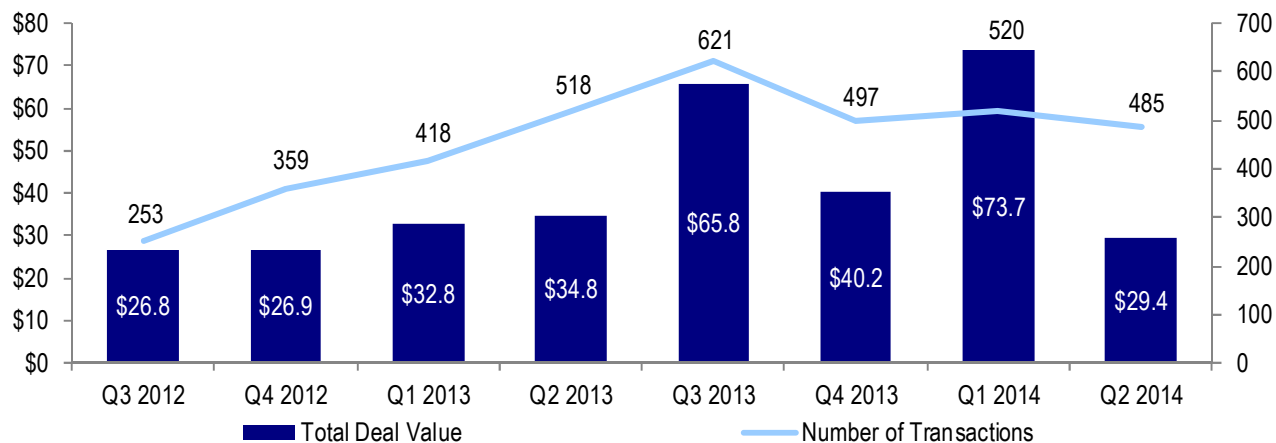
## PRICE / BOOK VALUE OF EXTERNALLY-MANAGED PUBLIC BDCs



Source: Capital IQ

# DIGITAL MEDIA M&A ACTIVITY

## DIGITAL MEDIA MARKET DYNAMICS (IN \$BN)



Digital Media M&A deal activity increased approximately 66% in 2013 compared to 2012, and is up 7.4% in the first half of 2014 compared to the first half of 2013

Source: Deal Maven

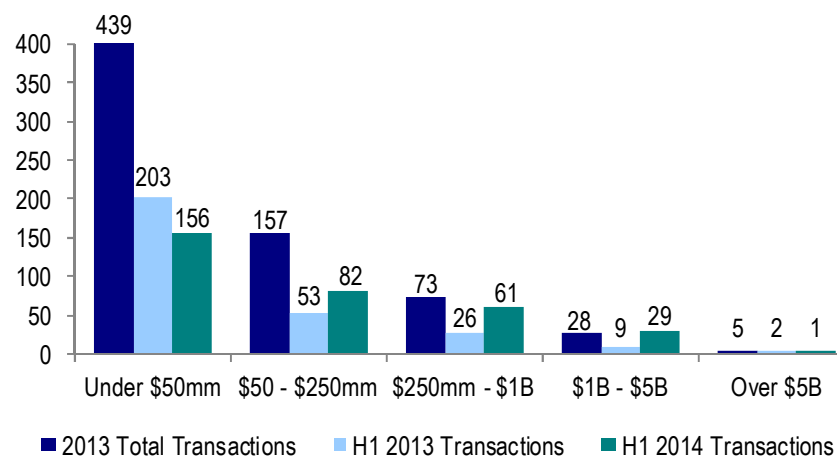
## ATTRACTIVE INDUSTRY DYNAMICS

- Digital media M&A was highly active in the first half of 2014
- Digital media companies are expected to increasingly consider reinvesting cash to grow through M&A
  - Acquisitions are the preferred growth strategy due to liquid capital market and low interest rates for well-capitalized buyers
- Mobile, Digital Content and Software accounted for the three highest sub-sector transaction values in the first half of 2014
- Ad Tech & Services, Social Media and Software exhibited the highest sub-sector growth in deal activity in the first half of 2014
- Changes in consumer behavior drive growth in the digital media sector
  - Improved availability and functionality of mobile internet connections
  - Increased percentage of activities conducted online
  - Growing impact of social media on consumer decisions

Sources: Deal Maven and IBISWorld Industry Reports



## M&A TRANSACTIONS BY SIZE – FIRST HALF OF 2014



Source: Deal Maven

# DIGITAL MEDIA SECTOR ACTIVITY & ACQUIRERS

## M&A TRANSACTIONS BY SUB-SECTOR

Digital M&A Transactions Comparison			
Segment	Transactions in H1 2013	Transactions in H1 2014	Transaction Growth - H1 2014 vs. H1 2013
Ad Tech & Services	34	45	32.4%
Agency & Marketing	206	197	-4.4%
Digital Content	150	158	5.3%
eCommerce	96	102	6.3%
Information	183	175	-4.4%
Mobile	128	134	4.7%
Social Media	36	67	86.1%
Software	103	127	23.3%
<b>Total</b>	<b>936</b>	<b>1,005</b>	<b>7.4%</b>

## MOST ACTIVE DIGITAL MEDIA ACQUIRERS IN THE FIRST HALF OF 2014

H1 2014 Top Digital Acquirers	
Acquirer	Transactions
WPP plc	20
Google, Inc.	19
Yahoo! Inc.	9
Omnicom Group, Inc.	9
Dentsu, Inc.	7
Facebook, Inc.	7
The Interpublic Group of Companies, Inc.	7
Twitter, Inc.	6
Dropbox, Inc.	6
Oracle Corporation	5
<b>Total</b>	<b>95</b>

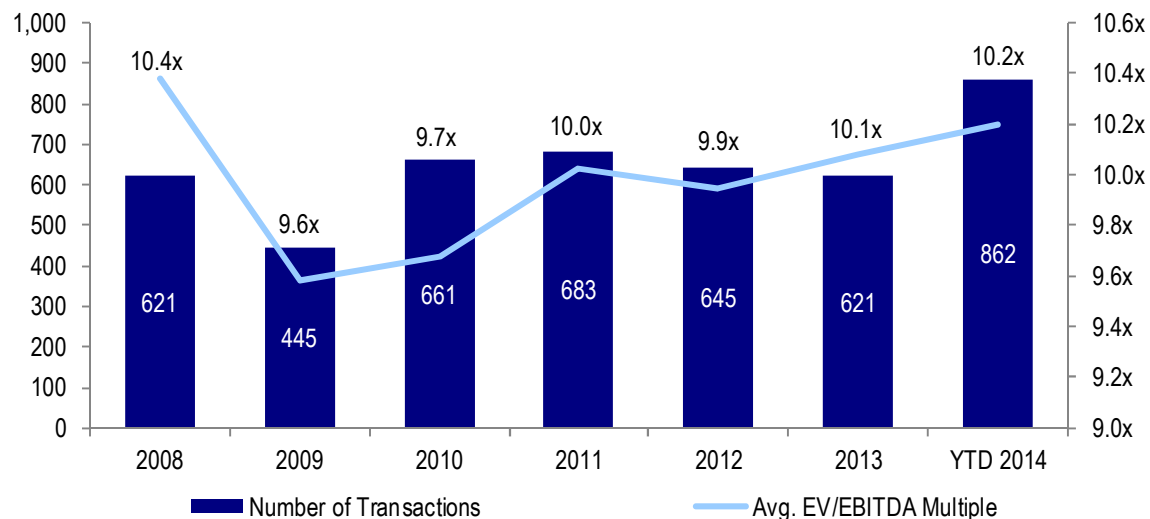
Transactions involving strategic acquirers represented approximately 90% of announced deals and 74.3% of the total aggregate reported deal value above \$50 million in the first half of 2014

Source: Deal Maven



# HEALTHCARE M&A ACTIVITY

## HEALTHCARE MARKET DYNAMICS



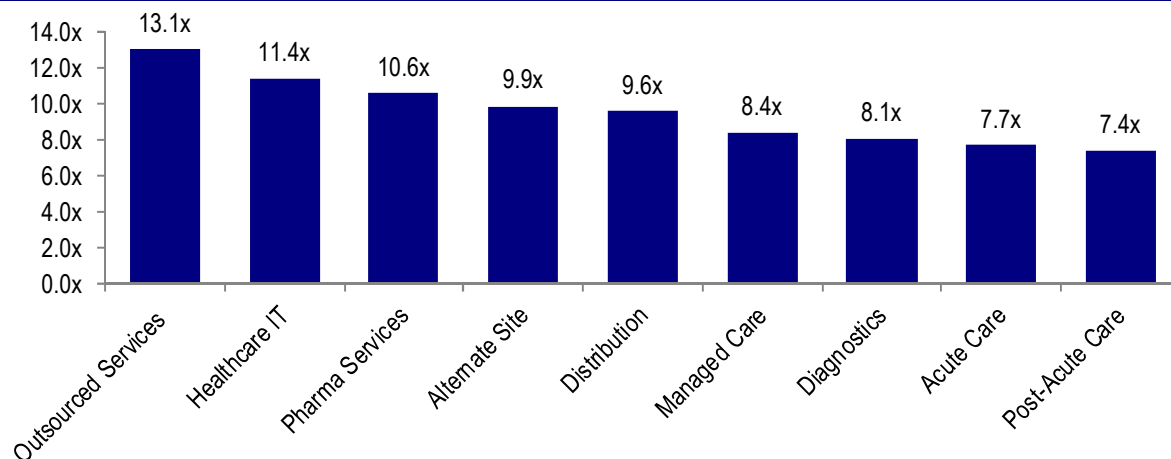
Source: S&P Capital IQ middle market healthcare deals (<\$500mm)

## FACTORS DRIVING HEALTHCARE GROWTH

- Over the next year, M&A in the healthcare sector is projected to outperform the overall market
- Effects stemming from the Affordable Care Act
  - Consumers focused on more cost-efficient, and often privatized, healthcare will lead to consolidation of long-term care facilities
  - Hospitals are experiencing decline in year-over-year admissions and are seeking to diversify into new markets such as urgent care, home health and hospice care
  - Required changes in revenue cycle management and electronic record keeping will continue to drive M&A activity in these sub-sectors

Sources: Med City News, CNN Money, Mergers & Acquisitions Magazine

## SUB-SECTORS DRIVING INDUSTRY VALUE (2013)



Source: S&P Capital IQ



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