

What's Driving Valuations? Five Reasons EBITDA Multiples Remain Elevated in 2016

After a record-breaking year for deal-making in 2015, merger and acquisition activity is off to slow start in 2016. Global deal volumes fell 23 percent through the end of June, making this the slowest first half to the year for global M&A since 2013.¹

However, this recent contraction in global deal activity doesn't exactly come as a surprise given the ongoing global economic instability and political turmoil. Britain's decision to exit the EU, the United States' contentious presidential race, an increase in antitrust scrutiny and the threat of rising interest rates have inevitably led to some uncertainty among deal-makers. And, as we very well know, uncertainty is the enemy of deal-making. The failure of several large, high-profile transactions has also put a damper on M&A activity this year. In the first half of 2016, the total value of withdrawn M&A was more than double the level reached in 1H 2015, and the highest since 2007.²

Despite an overall drop in deal volume this year, premiums for high-quality targets are rising. Valuations have reached the highest multiple since 2007, with acquirers paying an average of 11.1 times EBITDA to make acquisitions.³ For U.S. targets, valuations are even higher. The median EBITDA multiple for U.S. targets this year sits at 15.7 times EBITDA—a tremendous markup to say the least.³

A prime example of these elevated levels is the proposed acquisition of U.S. organic food company WhiteWave Foods by Paris-based Danone. The deal, which was done at approximately 39 times 2016 projected EPS of White Wave and approximately 20.5 times 2016 projected EBITDA, is expected to bolster Danone's U.S. portfolio.⁴ What's most interesting about this deal is not only the high price and premium, but also the fact that Danone's stock closed up following the announcement of the deal. With shareholders pushing up the stocks of not just takeover targets but acquirers as well, CEOs may feel that the market is rewarding growth through acquisitions, giving them the confidence to pursue mergers and acquisitions.

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All things considered, however, M&A deal activity has remained relatively robust in 2016, as many key drivers of a healthy deal-making environment remain. For example:

1 **Equity markets remain at all-time highs.**

A run-up in global stocks added more than \$4 trillion to the value of equities worldwide between June 27 and July 14, 2016, on speculation central banks in major economies will boost stimulus.³ At a time when valuations for equities are on the rise, it allows companies to use their own high-valued stock to purchase a target's equity and achieve growth through M&A.

2 **Boards and CEOs remain confident in both the economy and M&A landscape.**

Looking ahead, we can also expect corporate confidence to continue to grow alongside the U.S. economy, which expanded an annualized 1.1 percent in the first three months of 2016. That is higher than a second estimate of 0.8 percent, according to final figures released by the Bureau of Economic Analysis, largely due to consumer spending, which continued to boost growth.⁵

3 Corporations are still facing difficulty in achieving acceptable levels of organic growth.

In a climate where organic growth is increasingly difficult to come by, there is growing pressure on companies to make acquisitions in order to raise revenue and profit. M&A has proved to be a far more attractive and much easier pitch to shareholders than building growth organically, which not only takes more time to result in profitability than making an acquisition, but may also require an increase in expenses.

4 Leverage levels remain at all-time highs due to cheap and available credit.

Continued favorable credit markets and lending environment have enabled higher leverage levels. Even with the Federal Reserve's decision to raise interest rates in late 2015, it appears that any additional rate increases will occur at a fairly slow pace in small incremental step-ups.

5 PE firms sit on record levels of dry powder ready to be deployed.

Global callable reserves ("dry powder") of private equity funds continue to increase, reaching a record high of \$1.37 trillion in March 2016, as pension funds, endowments and sovereign wealth funds increase their allocations to private equity in hopes of above-average returns.⁶ Meanwhile, high prices and limited opportunities are keeping a lot of PE capital on the sidelines. The deals that are being closed are coming at an extremely high cost.

On a global scale, it's safe to assume that Brexit will likely impact M&A moving forward. Thus far, it has increased market volatility and negatively impacted the global economic outlook. Ongoing uncertainty will inevitably lead to a more cautious approach to M&A for the rest of the year. Aside from Brexit, there are a number of other factors that have the ability to derail momentum of M&A activity this year, including an unexpected acceleration in rate increases, geopolitical/exogenous events such as terrorist attacks and the failure of companies to meet or exceed earnings expectations.

However, the purchase price for high-quality targets will likely continue to rise this year, as strategic buyers focus on paying premiums for growth and financial buyers scramble to put committed capital to work. Particularly this will be seen in industries defined as "high growth," such as healthcare/pharma and technology.

With both strategic and private equity acquirers on the trail for acquisitions, purchase price multiples and deal activity are likely to see an upward trend through the remainder of this year and into 2017.

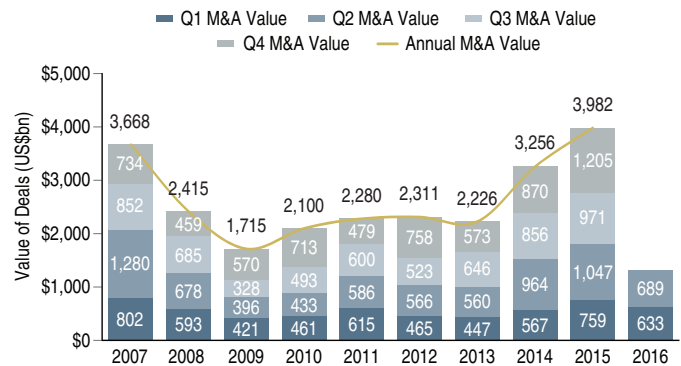
1. Financial Times
2. Dealogic
3. Bloomberg
4. S&P Capital IQ
5. U.S. Bureau of Economic Analysis
6. Private Equity Growth Capital Council

Market Snapshot: Middle-Market M&A

Substantial Uptick in the Global M&A Market

- Global M&A deal value reached \$3.98 trillion in 2015, making 2015 the highest annual value on record. North American-targeted M&A deal value also experienced a record year in 2015, reaching \$2.04 trillion.
 - Strategic buyers are increasingly turning to acquisitions as a source for future growth, while the private equity community has also been aggressive in deploying significant “dry powder,” thereby driving deal activity.
 - Stagnant top line growth coupled with cheap debt and record cash levels also continues to make M&A very attractive for corporate acquirers.
- In Q2 2016, both global and North American-targeted M&A were softer compared to the same period last year.
 - Global M&A stood at \$688.7 billion in Q2 2016, compared to \$1,047.1 billion in Q2 2015.

Quarterly Global M&A Comparison

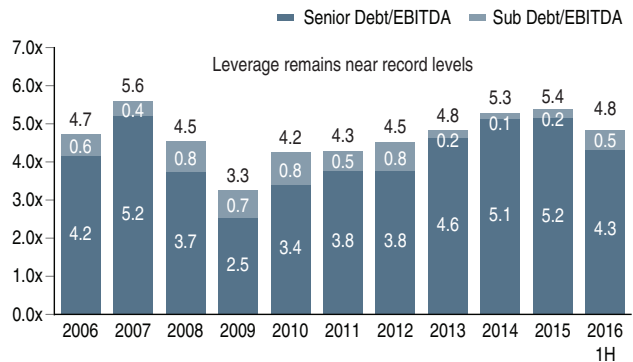


Source: MergerMarket

Significant Opportunities Exist to Capitalize on the Favorable Financing Environment

- Amid low interest rates and loose covenant protections, borrowers continue to capitalize on the favorable financing environment.
- Total leverage in 1H 2016 for middle-market issues with less than \$50 million of EBITDA averaged 4.8x, which is down slightly from the 2015 average of 5.4x, but still well above historic levels.
- Senior stretch loans (hybrid asset-based and cash flow loans) are prevalent given current market dynamics.
 - Conditions exist for debtors to cover all leverage needs with senior debt at senior debt pricing (versus higher mezzanine debt pricing).

Average Debt Multiples of Middle Market LBO Loans (Issuers with less than \$50M of EBITDA)



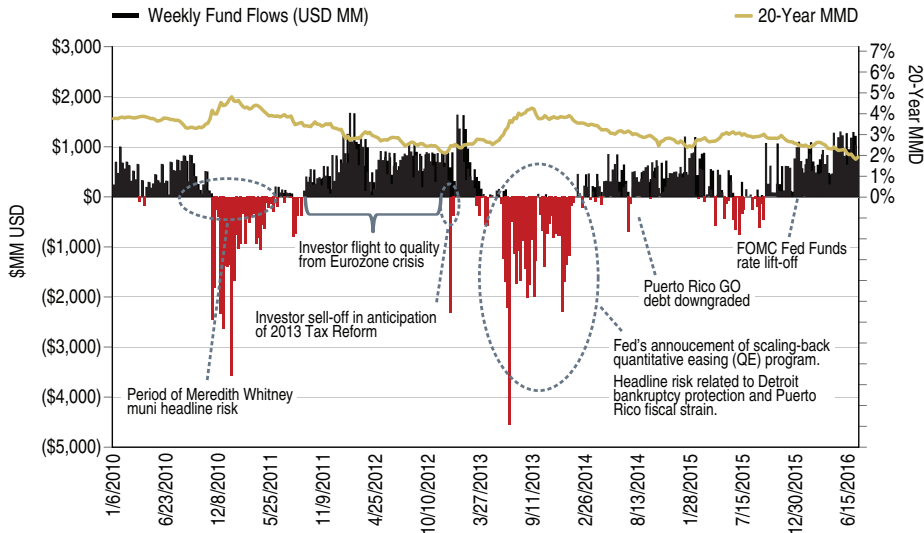
Source: S&P Capital IQ LCD

Market Snapshot: Municipal Bonds

Municipal Bond Fund Flows and MMD

Over the last several months there have been positive fund flows averaging more than \$800 million per week. 20-year MMD has remained attractive based on a historical basis. We expect future Fed decisions to have an impact on weekly fund flows going forward.

Municipal Bond Fund Flows and 20-Year MMD



As of the weekly reporting date of 7/13/2016
Source: EPFR Global Fund Flows and Allocations Data – All Muni Funds (Retail and Institutional Funds)

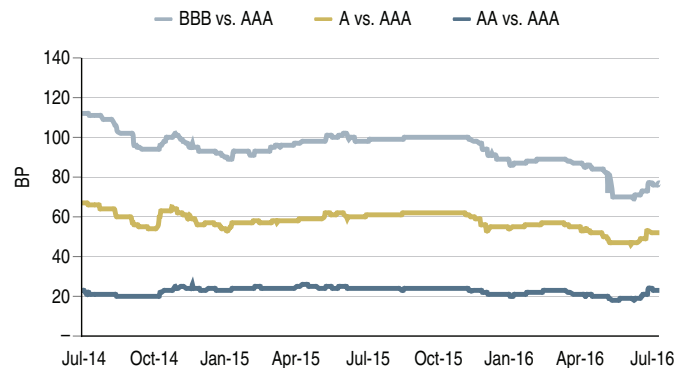
Trailing 16-Week Data

Muni Fund Reporting Date	Weekly Fund Flow (\$MM USD)	20-Yr AAA MMD (%)
3/30/2016	654.72	2.48
4/6/2016	834.31	2.34
4/13/2016	246.98	2.31
4/20/2016	463.64	2.29
4/27/2016	1,279.06	2.38
5/4/2016	958.00	2.29
5/11/2016	1,189.01	2.22
5/18/2016	1,303.29	2.24
5/25/2016	1,226.88	2.25
6/1/2016	818.15	2.25
6/8/2016	639.80	2.07
6/15/2016	824.07	2.02
6/22/2016	1,166.40	2.04
6/29/2016	743.76	1.89
7/6/2016	1,031.04	1.80
7/13/2016	814.48	1.90

Credit Spreads

- In general, credit spreads will follow investment flows, improving as more money chases available securities. Investment flows typically follow investment performance, which is generally positive in falling interest rate markets. Interest rates follow central banks, which have been forcing down rates globally (not necessarily in the U.S.) in response to weaker economic news.
- Credit spreads have come in over the last quarter in reaction to these factors. Municipal rates have followed the strengthening treasury and global credit markets, while also benefitting from high inflows for municipals and relatively reduced supply. Municipal markets spreads pulled back temporarily in response to uncertainty over Brexit and global conditions for rates, but much of that has reversed and the general downward trends are holding.
- As might be expected in a low rate and strong demand/low supply environment market, the “chase for yield” has benefitted low investment grade (BBB) and mid investment grade (A) more than high grade (AA). This can be seen by the decline in the grey and yellow curves vs. the relatively flat blue curve.

30-Year Credit Spreads



Source: The Municipal Market Monitor (TM3)

Featured Mesirow Financial Deals



\$650,000,000
 Sale-Leaseback and
 Permanent Acquisition Financing
 Multiple Tranche Structure




Corporate Headquarters
 (Tenant)

Acquisition Financing for Verizon Corporate Headquarters

Mesirow Financial successfully acquired the 133-acre, 1.4 million square-foot Verizon operations center located in Basking Ridge, New Jersey, for \$650.3 million. Verizon will lease back the full property for a 20-year term with options to extend. Mesirow Financial's Sale-Leaseback Capital group arranged for the purchase of the facility and the acquisition financing was structured in collaboration with Mesirow Financial's CTL and Structured Debt Products and Institutional Sales and Trading groups. The CTL financing involved one of the largest non-government single asset credit tenant lease transactions ever consummated. "This real estate deal provides our company with immediate financial benefits and allows us to extract significant value from this asset while continuing to occupy the entirety of its office space," said Verizon's head of global real estate.


has been acquired by



— Sell-side Advisor —

M&A Sell-side Advisor for Flexan

Mesirow Financial acted as the exclusive financial advisor to The Flexan Corporation in its sale to Linden Capital Partners, a Chicago-based healthcare private equity firm. The main objective of the transaction was to pair Flexan with a strategic or financial partner to accelerate its next phase of growth, while providing a liquidity event for shareholders. Mesirow Financial's Investment Banking group developed a compelling investment thesis for Flexan, highlighting the company's impressive growth trajectory and unique position in the market as two distinct yet complementary brands, each serving attractive end-markets. Mesirow Financial emphasized Flexan's competitive advantage of having a successful China facility that provided a leading low-cost manufacturing alternative. The process was highly competitive, with over 40 initial indications received, and Flexan sold for a strong multiple with a purchase price and transaction terms that far exceeded the expectations of Flexan's shareholders.



Sweetwater Union High School District

\$265,710,000
 Series 2016
 General Obligation Bonds

— Sole Manager —

Sole Manager for Sweetwater Union High School District

Mesirow Financial's Public Finance group priced as sole manager two series of general obligation bonds for the Sweetwater Union High School District, located in Chula Vista, California. The \$168.71 million 2016 General Obligation Refunding Bonds advance refunded the District's General Obligation Bonds, Election of 2006, Series 2008A for debt service savings, while the \$97 million General Obligation Bonds, Election of 2006, Series 2016B (the "New Money Bonds," and together with the Refunding Bonds, the "Bonds") prepaid and defeased the District's 2013 General Obligation Bond Anticipation Notes and generated approximately \$62.8 million in new money proceeds for school facilities improvements. The Bonds were rated A+/A1/AAA by Standard & Poor's, Moody's and Fitch, respectively.

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About Mesirow Financial

Mesirow Financial is an independent, employee-owned firm founded in 1937. As specialists in investment, risk management and advisory services, we are committed to helping our institutional, corporate and individual clients achieve their objectives. Our professionals are inspired by an entrepreneurial desire to develop tailored solutions that deliver measurable results. To learn more, please visit mesirofinancial.com.

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