THE M&A ADVISOR

THE M&A ADVISOR SYMPOSIUM REPORT

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Featuring

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2014 - The Year Ahead in M&A

At The M&A Advisor's 12th annual Mergers and Acquisitions Summit in New York late last year, David Sanders, a Partner and Co-Chair of Transactional and Securities Practice at Foley & Lardner moderated an insightful exploration of the outlook for M&A in 2014.

A panel of active investors, consultants and key service providers to the M&A industry discussed the factors at play in the M&A environment since the financial crisis and how these factors may affect deal flow, valuation and transaction priorities over the next twelve months. The fast-paced session addressed:

- PwCs' 2014 M&A Outlook Report
- Citizens Bank's middle-market Business Owners' Survey
- Why there aren't more M&A deals in the current environment
- Value creation versus financial engineering in M&A
- The role of technology as a change agent

A reduction in quantitative easing and recent poor performance for IPO share prices post-offering suggest that more investors will look to M&A for liquidity in 2014. In this exclusive report, industry veterans explore the range of opportunities and the key drivers of valuation and timing.

Presented by

pwc

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PwC's Deals practitioners help corporate and private equity executives navigate transactions to increase value and returns. In today's increasingly daunting economic and regulatory environment, our experienced M&A specialists assist clients on a range of transactions from smaller and mid-sized deals to the most complex transactions, including domestic and cross-border acquisitions, divestitures and spin-offs, capital events such as IPOs and debt offerings, and bankruptcies and other business reorganizations. We help clients with strategic planning around their growth and investment agendas and advise on business-wide risks and value drivers in their transactions for more empowered negotiations, decision-making and execution. We help clients expedite their deals, reduce their risks, capture and deliver value to their stakeholders and quickly return to business as usual. Our local and global deal strength is derived from over 1,500 deal professionals in 35 cities in the U.S. and over 13,400 deal professionals across a global network of firms in 75 countries. In addition, our network firm PwC Corporate Finance provides investment banking services within the U.S.

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EXECUTIVE SUMMARY

The stage is set for several years of strong M&A activity if there is budgetary peace, the job numbers remain positive, and regulatory uncertainty clears. Private equity exits are at a six-year high. A reduction in quantitative easing and recent poor performance for IPO share prices post offering suggest that more investors will look to M&A for liquidity. Value creation, not financial engineering, has been a key goal for portfolio companies, and over the next 12-18 months many of these investments will reach the pivot point where sellers can deliver the confidence in earnings needed to bring a business to the market.

INTRODUCTION

Those with short memories may think that M&A activity in recent years has been weak to moderate. However, as measured by volume, M&A activity has been quite strong over the past three to four years according to PwC's 2014 M&A Outlook.

At the 2013 M&A Advisor Summit in New York, David Sanders, Partner & Co-Chair of Transactional and Securities Practice, Foley & Lardner moderated a panel discussion of experts with deep insights into current trends in M&A transactions in the middle market.

The symposium session participants included:

David S. Sanders, Partner & Co-Chair of Transactional and Securities Practice, Foley & Lardner (Moderator)

Garrett Baker, President, Waller Capital Partners

Jim Kuster, Head of M&A and Corporate Finance, RBS Citizens

John Potter, Partner, PwC

The topics discussed included:

• PwCs' 2014 M&A Outlook Report

• Citizens Bank's middle market Business Owners' Survey

• Why there aren't more M&A deals in the current environment

• Value creation versus financial engineering in M&A

• The role of technology as a change agent

John Potter, a Partner in PwC's deal practice, opened the session by putting the M&A market into perspective, "Looking at the past three to four years, we've seen what has been a very solid market. We know people are hesitant to say that because they are remembering back to 2006-2007 and believing that if those years were strong, the past four years must not be. But 2006 and 2007 were bubble years."

"Now there is clearly capacity in the market, but the volume of M&A activity over the past four years has been very consistent with the historical average outside of the bubble years of 1999-2000 and 2006-2007."

He notes that part of the perceived slowness of the M&A markets is due in part to relatively slow GDP growth of 2-2.5% out of the Great Recession, "But if you look globally at M&A activity the U.S. has been very resilient compared with the rest of the world. The real drop in M&A volume and valuations occurred outside the U.S."

> "People are hesitant to say that we've had a good M&A market in the past few years because they look back at 2006-2007. But those were bubble years."
> *– John Potter*

Fiscal policies have helped strengthen the U.S. economy and M&A markets, as has the change in energy, "which has fundamentally shifted our competitiveness" and the increased consumption coming out of the recession.

Overall M&A transaction volumes for 2013 were roughly flat with 2012. Because of the changes in the tax laws, "We all rushed into Q4 of 2012 to do deals, and volumes slowed somewhat in Q1-Q2 of 2013. However, as we look at Q4 2013, the transaction market is incredibly busy." He continued, "The difference between now and last year is that it is driven by increased confidence in forward estimates and earnings growth."

"Valuations are increasing. Yet, the availability of capital and the broader circumstances certainly make it viable to do transactions right now," Potter opined.

Potter pointed to remarks from John K. Castle, CEO and Chairman of Castle Harlan, Inc. who believes that sellers "expect very high prices" in the M&A market. Potter commented, "At the same time, the equity markets create an environment where it is very difficult to take a company private given the valuations and an expected control premium."

The market for private company transactions is more positive. Potter observes, "While the valuations for private companies in many sectors are back to the levels of 2006-2007, the discussion of whether the market is overvalued is less consistent. What we are seeing is greater confidence in the forward earnings. That confidence in being able to achieve earnings goals is what is driving the market now."

Deal goals have changed as well. Whereas many deals before and during the Great Recession emphasized cost-cutting, "We are seeing more transformative deals. Successful transformative deals may create more deals by investors who have greater confidence in their ability to execute a transaction; however, it may cause other investors to decide to wait," notes Potter.

Potter pointed to several factors that bode well for increased volume in the M&A market including: increasing economic stability in Europe which is an important region for M&A; stabilization in China at economic growth rates of 6% versus the overly-ambitious 8-9%; and while the currency fluctuations in Brazil are causing trouble, "You cannot ignore the economic growth in South America around population growth, income growth and fundamental demand."

The year 2014 may not have a M&A market that raises all boats, but, "The economic conditions are set, confidence is there, and businesses that have shown the discipline and ability to create value over the past three to four years are well-positioned to search for that revenue growth which ultimately drives long-term value. This is where the market and executives under pressure are focused."

David Sanders, Partner & Co-Chair of Transactional and Securities Practice, Foley & Lardner LLP and panel moderator followed up to Potter's comments asking, "So you read a lot about private equity firms and venture capital with all of these portfolio companies, many bought during the bold years of 2006-2007, and I believe there is still a perception out there that we are still waiting for this 'firehose' sell-off from the investment companies. Are the factors right for this private equity sell-off? Is it something that is happening little by little, and we won't see a flood of deals? What indicators should we look for in the transaction climate as precursors to that sell-off?"

"There is still a perception out there that we are still waiting for this 'firehose' sell-off from the investment companies."
– David Sanders

Garrett Baker, President of Waller Capital Partners and a specialist in technology, media and telecom answered, "You will have to wait for the firehose. There has been consistent activity over the past few years, although at our firm and in our sectors, activity has been well above historical trend."

He cited here two factors in private equity that have slowed a broader portfolio company sell-off. The first is the availability of cheap capital. The second is access to the IPO market. "A number of our portfolio companies have looked to achieve liquidity and as they have gone out to market to sell their businesses, have weighed the opportunity to sell their businesses against the opportunity to recapitalize at extremely favorable interest rates and terms, and have chosen instead to keep the businesses private and pay themselves a dividend."

"The same thing is happening for the IPOs. The IPO market has come back in recent years and offered an attractive alternative to the sale of a business. Baker continued, "However.... I would point out that many of those IPOs have not traded well post transaction. So if you look at what is going to happen to those two alternatives –

IPOs and recaps – I think there is evidence that they will not be as attractive going forward. People are a little more reluctant to go public based on how the stocks are trading post IPO, and as quantitative easing goes away, the dividend recap option becomes less productive."

Jim Kuster, Head of M&A and Corporate Finance, RBS Citizens, agreed that 2013's M&A volume was reduced to some extent by the IPO and dividend recap options, noting that some 75 portfolio companies chose the IPO route over M&A in 2013.

For the past three years, Citizens Bank has surveyed its middle market clients about their M&A intentions. In this year's survey, Citizens found that a greater number of clients were currently involved in an M&A transaction in Q4 2012 than in Q4 2013; however, they noted that a greater proportion expected to be in an M&A transaction shortly – boding well for the 2014 M&A outlook.

> "...as quantitative easing goes away, the dividend recap option becomes less productive."
> *– Garrett Baker*

Pointing to the current trend towards megadeals such as the Verizon/Vodafone transaction, Kuster noted that his survey found that middle market companies were also likely to be acquisitive in 2014 and that these plans were driven by the same factors found in PwC's survey – particularly increased confidence in earnings. "Projections have more credibility now when you look out a year than they had a year ago. So if you are a buyer, although you are looking at largely higher multiples, you can get more confidence in what you are basing your forward purchase price on."

The middle market survey also signaled a shift in what buyers are looking to achieve with a transaction. The survey asks how companies plan to grow, particularly if it is not through organic growth. "Last year, it was mostly about adding growth to your core product. This year it is about adding additional sources of revenues – perhaps geographies, perhaps technologies, but maybe other products. Look at the Avago/LSI deal. They are both in semiconductors, but there isn't much overlap. For Avago is it a big expansion into a new client base, products etc. I think that's what's going to dictate what happens in M&A next year," notes Kuster.

So while the volume of M&A transactions has been relatively stable, "if you consider the full range of options, from M&A to IPO to recap, it's clear that exit activity has picked up on a strong trajectory," noted Potter. "The private equity exits are the highest they've been in six years. The optionality [including IPOs and recaps] is fantastic!"

"The other thing that is keeping the M&A pipeline low is that a lot of the investment in portfolio companies in recent years has been about value creation – not just financial engineering [as in the early 2000s]. It's not just about preserving the bottom line. It's about growing the business and changing the value of that business."

Potter continued, “ When I see private equity holding onto portfolio companies at this point, it is because the pivot point for that value creation is still 12-18 months off, the point of being able to deliver that business for sale where there is the confidence in the forward earnings. They think, ‘The market is good now, but the time to sell is later.’”

The conversation next moved to which sectors might see M&A activity in 2014. Sanders began by saying, “ We know which sectors are hot – real estate, healthcare, energy – What sectors that we are not generally focused on will be interesting in 2014?”

“The challenge with the U.S. is that M&A activity is so diverse it is hard to pick one area,” noted Potter. “An overarching theme is M&A of technology, not as a sector but as a fundamental driver of investment innovation and advancement. Technology is intersecting companies that can drive value change in business. I am thinking of technology investments being made by seed companies, mobile device concepts for healthcare providers. These technologies are applicable to a wide variety of industries and investment concepts.”

> “Packaging is still a fragmented industry...and valuations in the sector have lagged.”
> – *Jim Kuster*

Sanders added, “One theme that I see that crosses industries and investment concepts is an interest in data and analytics, in particular managing the data – not just gathering it, but also interpreting it. It doesn’t seem to matter if a company is in healthcare or in energy, the interest in data analytics and the companies that provide this knowledge is enormous. There are now people who graduate with a degree in web behavioral psychology.”

Kuster agreed on the importance of technology to drive change and offered up a more specific recommendation, “Packaging is still a very fragmented industry and it crosses over into many types of technologies, industries, customers and packaging types – flexible packaging, paper packaging, packaging for healthcare applications. There is technology being imbedded into packaging. Even though the economy has come back, valuations in the packaging sector have lagged. There will be expansion in multiples and growth in this segment and I think growth in M&A activity, too.”

Baker focused his analysis on the TMT sector. “The sector that jumps out at us is cable. We’ve all watched Liberty/Charter’s attempt to buy Time Warner Cable. That has largely frozen what was a hot market in 2012. In 2012, five of the seven largest transactions that had happened over the past decade happened over the course of a few short months. Valuations traded up two or three turns of EBITDA. When John Malone bought into Charter, everybody stopped trading cable assets to see what he was going to try to do. What he did was try to buy Time Warner, and everyone has been waiting to see how that situation resolves. After that, we expect to see assets free up.”

Finally, Sanders asked each panelist their view of Washington and its impact on M&A. As a Washington DC native and resident, who says that he has "learned to tune out all of the political stuff," Sanders is positive on the current political gridlock, "The prospects for long-term budgetary peace are for real this time – at least through the next election. We will not have to play the budget game every three months. If there is long-term budgetary peace, if positive job numbers stick, what does the M&A market look like in 2014, 2015?"

Kuster led off. "I believe the effect that the government has [on the M&A market] is tremendous. Look at the traditional banking market, which is facing incredible amounts of regulation. J.P. Morgan Chase hired 5,000 additional people just to comply with regulation. What I worry about with the government is the lack of clarity for fiscal policy. But even if fiscal policy becomes more certain, I worry about regulatory uncertainty and the onerous nature of regulation, both of which are still dampening M&A activity and the economy in general."

Added Baker, "On the margins, this stability and its continuation is everything to the M&A markets. The economy and its perceived stability is the key to holding the M&A markets because transactions depend on whether buyers can rely on predictions."

"The first question is, 'Are we confident enough in our own businesses to make the M&A decision?' In 2010-11, the answer was no. Now things are turning around and if we can avoid further fights about the budget, M&A will accelerate. But things have to stay stable for two years for business to really turn around."

Potter also agreed. "I think we are at a point where we are really going to start moving forward if we keep the government at work. Having a functioning and coherent policy that allows you to look forward is the key to that confidence in making decisions."

Baker went on, "Regulation clearly is hampering M&A activity in financial services. Lack of direction and the threat of regulation make it impossible to make strategic decisions. The evolution of regulation – look at the TMT and cable -- Stephen Colbert has that chart of AT&T in the 80s at the start of deregulation and thirty years later AT&T is exactly the same. It's had a gazillion changes to come back to exactly where it was. It's the similar story with airlines. When will we decide that we need more than three airlines in the U.S? When are we going to regulate that back in? Regulation can be one of the biggest disruptors of M&A activity – but it can also be the biggest catalyst."

Potter concluded, "I am particularly interested in government policies and stability outside the U.S. For example, in the EU, what is the government policy that will drive confidence so companies will make more investments? How will Brazil position its

"Regulation can be one of the biggest disruptors of M&A activity – but it can also be the biggest catalyst."
– Garrett Baker

economy to stabilize and grow? Will China's investment policy allow for 6-7% growth or will it force things to push growth higher?"

Summing up the outlook for 2014, Sanders concluded, "Fundamentals are strong – despite the government. If government can stop being an impediment, hopefully we have all learned our lessons and maybe we can experience a few to five years of continuous growth – maybe not the 'firehose' that we all dreamed of – but the growth that allows us all to grow our businesses and invest in good companies that do good things."

To watch candid interviews with industry stalwarts on "2014 - The Year Ahead In M&A" click on the photos below

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Waller Capital Partners

John Potter
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FACULTY PROFILES

David S. Sanders is a Partner with Foley & Lardner LLP. He is co-chair of the firm's Transactional & Securities Practice and co-chair of the Trade Secret/Noncompete Specialty Practice. Mr. Sanders' practice is concentrated on mergers and acquisitions, joint ventures, employment, non-compete and trade secret issues, executive employment and termination agreements, leases, license agreements, general corporate matters, and the drafting and negotiation of all types of contracts and corporate documents. He is a member of the Commercial Transactions & Business Counseling, Private Equity & Venture Capital and Real Estate Practices, as well as the Sports, Medical Devices, Technology, and Health Care Industry Teams. He also serves on the firm's Diversity Committee. Mr. Sanders counsels public and private corporations and other business entities, including corporations and limited liability companies, on corporate matters involving formation, operation, and growth, as well as employment matters. Mr. Sanders negotiates merger and acquisition transactions, joint ventures and other business contracts, leases, and agreements on behalf of clients. He frequently assists clients in negotiating, drafting, and creating various operational documents, including stock purchase, asset purchase and merger documents, employment and non-compete agreements, licensing, strategic alliance and joint venture agreements, employee termination agreements, confidentiality and non-disclosure agreements, stock option plans, and leases. His general representation of business enterprises includes corporations, limited liability companies, and partnerships. He is experienced in general corporate matters, including incorporation, organization, operating agreements and shareholders' agreements.

Garrett Baker is President at Waller Capital Partners. He initiates and executes M&A transactions for cable and telecom clients, leads Waller Capital's cable coverage, and oversees the day-to-day operations of the firm. Garrett's early career focused on telecom operators, including wireless carriers, fiber providers and ISPs. Since 2005, Garrett has been the most active M&A banker in the cable industry. Recent transactions include representing: Wave Broadband on its sale to Oak Hill Capital Partners and GI Partners, RCN on its sale to ABRY Partners; US Cable on its sale to MidContinent, Baja & Charter; MCV Guam on its sale to NTT Docomo; WideOpenWest on its sale to Avista Capital; Alpheus Comm on its sale to Gores Group; Time Warner Cable on its non-core divestiture to Windjammer Communications; American Fiber Systems on its sale to Zayo; Everest Broadband on its sale to SureWest; JetBroadband on its sale to ShenTel; Choice Cable on its sale to Spectrum Equity / Patriot Media; New Wave on its acquisition of non-strategic assets from Charter Communications; Grande Communications on its recapitalization; The Blackstone Group on the sale of Sigecom; JetBroadband on the acquisition of Suddenlink's Virginia assets; NY3G on its sale to Sprint Nextel; Providence Equity on the sale of Northland Cable to Metrocast/Harron; Alameda Telecom on its sale to Comcast; Vision Communications on its sale to Eatel. Prior to Waller, Garrett was an M&A banker at Bear Stearns & Co. During his career, he has completed over 70 M&A transactions valued at over $15 billion. Garrett has been recognized by MultiChannel News as one of the cable industry's "40 Under 40" top executives. He is a member of the Young Presidents' Organization (YPO).

Jim Kuster is Managing Director, M&A and Corporate Finance at RBS Citizens. Jim joined RBS Citizens in August 2012 as the Managing Director of the Corporate Finance practice. Prior to RBS Citizens, Jim was the Head of Corporate Finance Americas at RBS Securities Inc. for 8 years, advising numerous RBS clients including Energy Transfer, UTC, Kraft, Jabil, Alltel and Getty Images. Before joining RBS, Jim was a partner of Crest Advisors, LLC, where he worked with companies on mergers, acquisitions, divestitures and capital raises. Before Crest, Jim spent 13 years at Chase Securities, Inc. where he was responsible for corporate finance and advisory transactions for many prominent companies in the Telecom, Media and Technology sectors.

John Potter is a Partner in the Transaction Services practice at PwC. He specializes in providing strategic, financial, economic and accounting advice impacting deals to both private equity and multi-national corporate clients. He also has extensive experience in the capital raising process, which provides an integral connection throughout the deal process. His experience includes both buy-side and sell-side transaction advisory work, with substantial experience in various sectors, including Retail & Consumer, Industrial Products, Education, and Technology, working across the value chain. John spent three years working in our London office, as well as Chicago, and is currently based in Minneapolis.